



CA INTERMEDIATE • PAPER 5 • AUDITING AND ETHICS

Scanner Notes 2.0

Topic by Topic • October 2026 Edition



11 Chapters • 11 Units • 132 Topics • 662 Classified Questions

Based on the ICAI Study Material and the Scanner, Auditing and Ethics 2026 October Edition (V2)

How this book works

For each topic, first read the Study Material paragraphs named in the “Read first” line. Then work down the skill bands — each band names the skill the examiner has actually used on that topic, and lists the exact Scanner questions to practise at it.

The section that follows the Contents — **How to Use These Notes** — explains the question lines, ICAI’s Manner of Assessment, and what the skill mix should change about your preparation. Read it once before you begin.

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BEFORE YOU START

How to Use These Notes

Every question in the Scanner has been read and classified — **662 of them in this paper** — against the skill framework ICAI itself publishes. These notes are built around that classification rather than around the syllabus order. Ten minutes spent on this page will change how you use the rest of the book.

1. How a topic is laid out

Read it like this	
Read first	The exact Study Material paragraphs the topic rests on. Open the Study Material and read them before the notes — the notes assume you have.
Notes	What the topic actually turns on, written for the examination rather than for coverage. Short, and meant to be re-read the night before.
Skill bands	One band for each skill the examiner has actually used on that topic, each with a few lines of guidance and the exact Scanner questions to practise. Work down the bands in the order printed: they run from the least demanding skill to the most.
Concept base	A topic the examiner has not yet reached. It is not optional — it has simply not been asked, and it is examinable.

2. Reading a question line

CSQ 4.2 • PYQ 2025-Sep [1] (b) {C} • 5M • Pg 231 **LEVEL II Application** **Easy**

Part of the line	What it tells you
CSQ 4.2	The Scanner's own question number. CSQ is a case-scenario question, TQ a theory question.
PYQ 2025-Sep [1] (b)	Where it was asked — PYQ past examination, MTP mock test paper, RTP revision test paper — then the sitting, and its number in that paper.
{C}	A case-scenario question.
5M	Marks, as printed in the Scanner. Blank where the source does not print them — RTPs do not.
Pg 347	The page of the Scanner where the question and its answer are printed.
LEVEL II Application	ICAI's skill level, and the sub-skill within it. Section 3 explains these.

Part of the line	What it tells you
Easy	How demanding the question is — judged on the marks it carries and the number of separate things it asks for.

3. The Manner of Assessment — what each skill asks of you

ICAI publishes a **Skill Assessment Specification Grid**. It states three skill levels, and in its **Manner of Assessment of Skills** column it describes each level as two distinct skills. Those six skills are the band headings that run through this book.

Skill	Rolls up to	What the examiner is asking you to do	Directive verbs to watch for
Remembering	Level I	Reproduce what you have learnt, as you learnt it.	Define · List · State · Name · Enumerate · Recognise
Understanding	Level I	Explain it, and place it in context — show you have grasped why the rule is what it is.	Describe · Explain · Distinguish · Identify · Illustrate · Outline
Application	Level II	Use or demonstrate the knowledge, concept or technique. Work the problem.	Apply · Calculate · Determine · Prepare · Reconcile · Record · Perform · Use · Conduct · Demonstrate
Analysis	Level II	Examine the interrelationships between distinct areas to identify root causes and find evidence that supports a judgement.	Analyse · Discuss · Compare and Contrast · Examine · Develop · Monitor · Prioritise · Produce · Align · Communicate
Evaluation	Level III	Assess the problem and use judgement to reach a conclusion.	Advise · Evaluate · Recommend · Review · Select · Assess
Synthesis	Level III	Integrate data and information, separating the relevant facts from the irrelevant.	ICAI lists no verb for synthesis.

ICAI prints the verbs for **Application** and **Analysis** as two separate lists, so that division is the Institute's own. For Level I and for Level III it prints one combined list each — so the line between **Remembering and Understanding**, and between **Evaluation and Synthesis**, follows ICAI's description of the manner of assessment rather than a published list of verbs.

CA Intermediate is assessed at **Levels I and II only** — Evaluation & Synthesis begins at Final. Where a question in this paper is worded as an evaluation, the skill is shown as the question reads and the level tag shows **Level II**, the level the paper is actually assessed at.

4. What the skill mix should change about your preparation

ICAI grades this paper **Level I 40–60%** and **Level II 40–60%** of marks, and CA Intermediate carries **no Level III at all** — Evaluation and Synthesis begin at Final. Measured on the classified Scanner questions in

this book, Level I comes to **55.1% of the marks** — inside ICAI's own band. Two things follow that are easy to miss.

- **Do not read "Analysis & Application" as an even split.** Inside Level II this paper puts about **79%** of the marks on Application and about **21%** on Analysis. Most of the work is taking a stated Standard to a stated set of facts and reaching a conclusion.
- **The paper's balance is not each chapter's balance.** Every chapter opens with its own **ICAI Skill Profile** panel, showing how that chapter's marks actually divide and what that means for preparing it. Some chapters are a third theory; others carry almost none. Read the panel before you start the chapter.

5. Two guides at the front of the book

	What it is for
Study Priority Guide	Every examined topic ranked by its share of the classified Scanner questions, and graded A, B or C on cumulative coverage. Category A carries the first 60% of all questions — secure those to full command first.
Importance grade	The A-D grade printed against each chapter in the Contents. This is ICAI's syllabus weightage signal, and it is separate from the question-frequency ranking. Where the two disagree, prepare the chapter to the higher of the two.

STUDY PRIORITY GUIDE

Topic Ranking — Exam Weightage

Read first: Every topic in this booklet that the examiner has actually asked is ranked below by its share of the 662 classified Scanner questions (2026 October Edition, V2), aggregated across all 11 Units — and graded A, B or C on cumulative coverage. **Category A (ranks 1–36)** covers the first 60% of all classified questions: with the passing standard at 50%, a student who prepares the A-topics to full command holds a clear margin above it. **Category B (ranks 37–54)** adds the next 15%, taking coverage to about 75% — work through these as time allows. **Category C (ranks 55–117)** is the remaining 25%: a long tail that is slower to mine for marks, much of which gets covered automatically while preparing A and B. The **Pg.** column cross-references the page on which that topic's study notes begin.

#	CAT.	CHAPTER	TOPIC	SHARE	CUM.	PG.
1	A	Audit Report	Reporting Under the Companies Auditor's Report Order, 2020 (CARO, 2020)	3.5%	3.5%	201
2	A	Risk Assessment and Internal Control	Audit Risk	3.2%	6.6%	51
3	A	Audit Evidence	Audit Sampling (SA 530)	3.0%	9.7%	98
4	A	Audit of Banks	Advances	2.9%	12.5%	244
5	A	Risk Assessment and Internal Control	Internal Control	2.6%	15.1%	60
6	A	Audit Evidence	Audit Evidence	2.6%	17.7%	82
7	A	Audit Evidence	Analytical Procedures (SA 520)	2.4%	20.1%	94
8	A	Audit Strategy, Audit Planning and Audit Programme	Audit Programme	2.3%	22.4%	46
9	A	Special Features of Audit of Different Types of Entities	Government Audit	2.3%	24.6%	206
10	A	Completion and Review	Written Representations (SA 580)	2.1%	26.7%	171
11	A	Audit of Items of Financial Statements	Balance Sheet Captions: Inventories	2.0%	28.7%	123
12	A	Completion and Review	Meaning of Going Concern and its Significance (SA 570)	2.0%	30.7%	167
13	A	Risk Assessment and Internal Control	What is an Automated Environment?	1.8%	32.5%	69
14	A	Audit Evidence	Audit Evidence-Specific Considerations for	1.8%	34.3%	86

#	CAT.	CHAPTER	TOPIC	SHARE	CUM.	PG.
Selected Items (SA 501)						
15	A	Special Features of Audit of Different Types of Entities	Audit of Co-Operative Societies	1.8%	36.1%	233
16	A	Audit Strategy, Audit Planning and Audit Programme	Planning Process - Elements of Planning	1.7%	37.8%	35
17	A	Completion and Review	Subsequent Events (SA 560)	1.5%	39.3%	164
18	A	Audit Report	Modifications to The Opinion in the Independent Auditor's Report (SA 705)	1.5%	40.8%	186
19	A	Ethics and Terms of Audit Engagements	SA 220- Quality Control for an Audit of Financial Statements	1.5%	42.3%	282
20	A	Audit of Items of Financial Statements	Balance Sheet Captions: PPE	1.4%	43.7%	126
21	A	Audit Report	Reporting Requirement Under the Companies Act, 2013	1.2%	44.9%	198
22	A	Ethics and Terms of Audit Engagements	Threats to Independence	1.2%	46.1%	266
23	A	Nature, Objective and Scope of Audit	Scope of Audit-What it Includes?	1.1%	47.1%	21
24	A	Nature, Objective and Scope of Audit	Inherent Limitations of Audit	1.1%	48.2%	23
25	A	Risk Assessment and Internal Control	Understanding the Entity and its Environment	1.1%	49.2%	57
26	A	Audit Evidence	External Confirmations (SA 505)	1.1%	50.3%	89
27	A	Audit Evidence	Related Parties (SA 550)	1.1%	51.4%	104
28	A	Audit Evidence	Using the Work of Internal Auditors (SA 610)	1.1%	52.4%	106
29	A	Audit of Items of Financial Statements	Balance Sheet Captions: Provisions and Contingent Liabilities	1.1%	53.5%	134
30	A	Audit of Items of Financial Statements	Statement of Profit and Loss Captions: Other Expenses Like Power and Fuel, Rent, Repair to Building, Plant and Machinery, Insurance, Travelling, Legal and Professional, Miscellaneous expenses.	1.1%	54.5%	147
31	A	Audit Report	Auditor's Report	1.1%	55.6%	182
32	A	Special Features of Audit of Different Types of Entities	Audit of Hire Purchase and Leasing	1.1%	56.6%	228
33	A	Ethics and Terms of Audit Engagements	Fundamental Principles of Professional Ethics	1.1%	57.7%	262
34	A	Ethics and Terms of Audit	SQC 1	1.1%	58.8%	277

#	CAT.	CHAPTER	TOPIC	SHARE	CUM.	PG.
		Engagements				
35	A	Nature, Objective and Scope of Audit	Qualities of Auditor	0.9%	59.7%	28
36	A	Audit Strategy, Audit Planning and Audit Programme	Auditor's Responsibility to Plan an Audit of Financial Statements	0.9%	60.6%	33
37	B	Risk Assessment and Internal Control	Materiality	0.9%	61.5%	55
38	B	Audit of Items of Financial Statements	Balance Sheet Captions: Share Capital	0.9%	62.4%	113
39	B	Completion and Review	Why Communication of Significant Deficiencies in Internal Control is Necessary? (SA 265)	0.9%	63.3%	176
40	B	Audit of Banks	Computation of Drawing Power	0.9%	64.2%	249
41	B	Audit of Banks	Audit of Advances	0.9%	65.1%	252
42	B	Audit of Banks	Audit of Revenue Items- Profit and Loss Account	0.9%	66.0%	254
43	B	Ethics and Terms of Audit Engagements	Agreeing the Terms of Audit Engagements	0.9%	66.9%	271
44	B	Audit Strategy, Audit Planning and Audit Programme	Overall Audit Strategy and Audit Plan - The Auditor's Responsibility	0.8%	67.7%	40
45	B	Risk Assessment and Internal Control	Internal Financial Controls as per Regulatory Requirements	0.8%	68.4%	75
46	B	Audit Evidence	Initial Audit Engagements-Opening Balances (SA 510)	0.8%	69.2%	92
47	B	Audit of Items of Financial Statements	Assertions Balance Sheet Captions Comprising Assets, Liabilities and Equity Balances	0.8%	69.9%	111
48	B	Audit of Items of Financial Statements	Balance Sheet Captions: Borrowings	0.8%	70.7%	116
49	B	Audit of Items of Financial Statements	Balance Sheet Captions: Trade Receivables	0.8%	71.5%	119
50	B	Audit of Items of Financial Statements	Balance Sheet Captions: Intangible Assets	0.8%	72.2%	128
51	B	Audit of Items of Financial Statements	Statement of Profit and Loss Captions: Sale of Products and Services	0.8%	73.0%	138
52	B	Audit Documentation	Form, Content and Extent of Audit Documentation	0.8%	73.7%	153
53	B	Audit Report	Communicating Key Audit Matters in the Independent Auditor's Report (SA 701)	0.8%	74.5%	191

#	CAT.	CHAPTER	TOPIC	SHARE	CUM.	PG.
54	B	Audit Report	Standard on Auditing 710, Comparative Information- "Corresponding Figures and Comparative Financial Statements"	0.8%	75.2%	193
55	C	Special Features of Audit of Different Types of Entities	Audit of Non Governmental Organisations (NGO's)	0.8%	76.0%	213
56	C	Special Features of Audit of Different Types of Entities	Audit of Firm	0.8%	76.7%	216
57	C	Special Features of Audit of Different Types of Entities	Audit of Hotels	0.8%	77.5%	230
58	C	Ethics and Terms of Audit Engagements	Acceptance of A Change in the Terms of the Audit Engagement	0.8%	78.2%	274
59	C	Nature, Objective and Scope of Audit	Objectives of Audit	0.6%	78.9%	19
60	C	Nature, Objective and Scope of Audit	Engagement and Quality Control Standards: An Overview	0.6%	79.5%	30
61	C	Risk Assessment and Internal Control	Risks that Require Special Audit Consideration	0.6%	80.1%	64
62	C	Audit of Items of Financial Statements	Balance Sheet Captions: Trade Payables and Other Current Liabilities	0.6%	80.7%	131
63	C	Audit of Items of Financial Statements	Statement of Profit and Loss Captions: Purchases	0.6%	81.3%	142
64	C	Audit of Items of Financial Statements	Statement of Profit And Loss Captions: Employee Benefit Expenses	0.6%	81.9%	143
65	C	Audit Documentation	Example of Audit Documentation	0.6%	82.5%	155
66	C	Audit Documentation	Assembly of Final Audit File	0.6%	83.1%	158
67	C	Audit Report	Forming an Opinion and Reporting on Financial Statements (SA 700)	0.6%	83.7%	180
68	C	Audit Report	Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report (SA 706)	0.6%	84.3%	189
69	C	Special Features of Audit of Different Types of Entities	Audit of Local Bodies	0.6%	84.9%	211
70	C	Special Features of Audit of Different Types of Entities	Audit of Educational Institutions (School, College or Universities)	0.6%	85.5%	220
71	C	Audit Strategy, Audit Planning and Audit Programme	Documentation	0.5%	86.0%	44
72	C	Risk Assessment and Internal Control	Evaluation of Internal Control System	0.5%	86.4%	66
73	C	Risk Assessment and Internal	Assess and Report Audit Findings	0.5%	86.9%	78

#	CAT.	CHAPTER	TOPIC	SHARE	CUM.	PG.
		Control				
74	C	Audit of Items of Financial Statements	Balance Sheet Captions: Cash and Cash Equivalents	0.5%	87.3%	121
75	C	Audit of Items of Financial Statements	Balance Sheet Captions: Loans and Advances and Other Current Assets	0.5%	87.8%	133
76	C	Audit Documentation	Documentation of Significant Matters and Related Significant Professional Judgements	0.5%	88.2%	160
77	C	Completion and Review	Evaluation of Misstatements Identified During the Audit (SA 450)	0.5%	88.7%	170
78	C	Completion and Review	Significance of Communication with those Charged with Governance (SA 260)	0.5%	89.1%	175
79	C	Audit Report	Audit of Branch Office Accounts	0.5%	89.6%	195
80	C	Audit Report	Joint Audit	0.5%	90.0%	196
81	C	Special Features of Audit of Different Types of Entities	Audit of Hospital	0.5%	90.5%	222
82	C	Ethics and Terms of Audit Engagements	Independence of Auditors	0.5%	90.9%	264
83	C	Ethics and Terms of Audit Engagements	Professional Skepticism	0.5%	91.4%	269
84	C	Ethics and Terms of Audit Engagements	Elements of System of Quality Control	0.5%	91.8%	280
85	C	Nature, Objective and Scope of Audit	Meaning And Nature of Auditing	0.3%	92.1%	17
86	C	Nature, Objective and Scope of Audit	Benefits of Audit- Why Audit is Needed	0.3%	92.4%	25
87	C	Audit Strategy, Audit Planning and Audit Programme	Relationship Between - Audit Strategy and Audit Plan	0.3%	92.7%	39
88	C	Audit Strategy, Audit Planning and Audit Programme	Planning Supervision and Review of Work of Engagement Team Members	0.3%	93.1%	43
89	C	Risk Assessment and Internal Control	Testing of Internal Control	0.3%	93.4%	67
90	C	Risk Assessment and Internal Control	Data Analytics for Audit	0.3%	93.7%	73
91	C	Risk Assessment and Internal Control	The Auditors Responses to Assessed Risks SA-330	0.3%	94.0%	79
92	C	Audit of Items of Financial Statements	Assertions Income Statement Captions Comprising Revenue and Expense Balances	0.3%	94.3%	110
93	C	Audit of Items of Financial	Balance Sheet Captions: Reserves And	0.3%	94.6%	115

#	CAT.	CHAPTER	TOPIC	SHARE	CUM.	PG.
		Statements	Surplus			
94	C	Audit of Items of Financial Statements	Statement of Profit and Loss Captions: Other Income Comprising Interest Income, Dividend Income, Gain/Loss on Sale of Investments etc.	0.3%	94.9%	140
95	C	Audit Documentation	Objective of the Auditor	0.3%	95.2%	150
96	C	Audit Documentation	Completion Memorandum or Audit Documentation Summary	0.3%	95.5%	161
97	C	Audit Documentation	Ownership of Audit Documentation	0.3%	95.8%	162
98	C	Special Features of Audit of Different Types of Entities	Audit of Charitable Institution	0.3%	96.1%	218
99	C	Special Features of Audit of Different Types of Entities	Audit of Club	0.3%	96.4%	224
100	C	Special Features of Audit of Different Types of Entities	Audit of Cinema	0.3%	96.7%	226
101	C	Audit of Banks	Introduction	0.3%	97.0%	239
102	C	Audit of Banks	Bank Audit Approach	0.3%	97.3%	240
103	C	Audit of Banks	Conducting an Audit	0.3%	97.6%	243
104	C	Ethics and Terms of Audit Engagements	Safeguards to Independence	0.3%	97.9%	268
105	C	Ethics and Terms of Audit Engagements	Terms of Engagement in Recurring Audits	0.3%	98.2%	276
106	C	Nature, Objective and Scope of Audit	Interdisciplinary Nature of Auditing Relationship with Diverse Subjects	0.2%	98.3%	18
107	C	Audit Strategy, Audit Planning and Audit Programme	Changes to Planning Decisions During the Course of Audit	0.2%	98.5%	42
108	C	Risk Assessment and Internal Control	Characteristics of Manual and Automated Elements of Internal Control Relevant to the Auditor's Risk Assessment	0.2%	98.6%	72
109	C	Risk Assessment and Internal Control	Digital Audit	0.2%	98.8%	74
110	C	Audit of Items of Financial Statements	Balance Sheet Captions: Miscellaneous	0.2%	98.9%	137
111	C	Audit of Items of Financial Statements	Statement of Profit And Loss Captions: Depreciation And Amortisation	0.2%	99.1%	146
112	C	Audit Documentation	Purpose of Audit Documentation	0.2%	99.2%	152
113	C	Audit Report	Form of Opinion	0.2%	99.4%	182

#	CAT.	CHAPTER	TOPIC	SHARE	CUM.	PG.
114	C	Audit Report	Auditor's Report Prescribed by Law or Regulation	0.2%	99.5%	185
115	C	Audit of Banks	Auditor's Report	0.2%	99.7%	242
116	C	Ethics and Terms of Audit Engagements	Principles Based Approach vs Rules Based Approach to Ethics (Ethical or Legal)	0.2%	99.8%	261
117	C	Ethics and Terms of Audit Engagements	What Happens if Preconditions for an Audit are not Present?	0.2%	100.0%	273

Share % is a question-frequency signal drawn from the Scanner — what has actually been asked. The **Importance** grade (A–D) printed against each Chapter and Unit heading is ICAI's own weightage signal, taken from the Chapter Priority Table, Front Matter — ICAI marks over the papers set under the 2023 scheme, including September 2026. The two measure different things, and where they diverge, prepare to the higher of the two standards. A further **15 topics** are declared in the Scanner's frequency tables but carry no question yet; they are badged **CONCEPT BASE** in the notes and are not ranked here.

CHAPTER 1

Nature, Objective and Scope of Audit

12 Topics · 33 Classified Questions · Importance: C

ICAI SKILL PROFILE ICAI band for this paper: Level I 40-60% · Level II 40-60% — this chapter reads **theory-heavy**

Level I — Comprehension & Knowledge

65.4%

87 of 133 marks

Level II — Analysis & Application

34.6%

46 of 133 marks

Above the paper's Level I ceiling: 65% of this chapter's marks are Comprehension and Knowledge, against ICAI's 40-60% for the paper. Reading carries more of the preparation here than it does elsewhere; do not prepare this chapter by working sums alone.

Topic 1: Origin of Auditing

L2P5-C1-T01

CONCEPT BASE — no exam question asked yet · essential for full preparation

Read first Read ICAI Study Material Chapter 1, Nature, Objective and Scope of Audit — the origin of auditing.

NOTES

This is a concept-base topic: the Scanner records no question ever set on it — no PYQ, no RTP, no MTP. Read it once for background and do not spend revision time on it. Everything the examiner actually wants from the opening of the chapter is carried by **Topic 2, the definition of audit**, and by **Topic 11, the qualities of an auditor**.

Where the historical material does surface, it surfaces as a quotation. The one line from the past that the answers use is Lord Justice Lindley in the **London and General Bank** case — 'an auditor must be honest, that is, he must not certify what he does not believe to be true and must take reasonable care and skill before he believes that what he certifies is true'. Learn that sentence under Topic 11, not here.

Do not manufacture dates or names in the exam. Nothing in the printed answers turns on when auditing began; every mark in this chapter is given for a definition, a list or an application of SA 200. If a question ever opened on origin, the safe answer is the one the chapter itself makes — that audit exists because owners are separate from those who prepare the accounts, which is the point the benefits topic states.

Topic 2: Meaning And Nature of Auditing

L2P5-C1-T02

Read first Read ICAI Study Material Chapter 1, Nature, Objective and Scope of Audit — the meaning and nature of auditing and the definition of audit.

NOTES

The definition, and reproduce it word for word: 'An audit is independent examination of financial information of **any entity**, whether **profit oriented or not**, and irrespective of its **size or legal form**, when such an examination is conducted with a view to **expressing an opinion thereon**.' The examiner asks you to 'discuss' it, which means quote it first and then take it apart.

The analysis of the definition runs in three limbs, and that is how the answer is marked. (1) Audit is an **independent examination of financial information**. (2) **Of any entity** — the entity may be profit oriented or not and it does not matter what its size or legal form is; the answers give **a listed company in business** as the profit-oriented example and **an NGO** as the not-for-profit example. (3) **The objective of the audit is to express an opinion on the financial statements**.

The six aspects the auditor satisfies himself of, so that the financial statements would not mislead anybody. This list has been set twice on its own and it is where the marks are: (i) the accounts have been drawn up with reference to entries in the books of account; (ii) the entries in the books of account are adequately supported by sufficient and appropriate audit evidence; (iii) **none of the entries in the books of account has been omitted** in the process of compilation; (iv) **the information conveyed by the statements is clear and unambiguous**; (v) the amounts are properly classified, described and disclosed in conformity with accounting standards; and (vi) **the statement of accounts presents a true and fair picture** of the operational results and of the assets and liabilities.

Notice what the six aspects are not. They are not a list of procedures. They are the things the auditor must be satisfied about, and the answers introduce them with the words 'this he can do honestly by satisfying himself that'. Keep that framing: the assurance the audit gives **lends credibility to the financial statements**, and it does so because each of these six has been tested.

The classic wrong answer is to give the definition and stop. Every printed question on this topic adds a second half — 'explain how the person conducting this task should take care to ensure that financial statements would not mislead anybody', or 'state some of the aspects examined'. Half the marks sit in the six-item list, so never leave it out.

Understanding explain it, and place it in context · 1 question

- Answer in two blocks — analysis of the definition in three limbs, then the six aspects, numbered. Marks follow the number of aspects named, so list all six even if you can expand only briefly.

Application use the Standard - apply it to the facts · 1 question

- The ask is the **aspects the auditor examines** to give the assurance, not what assurance means. Name them as a list first, then explain.
- Tie the list back to the opinion: each aspect is something the auditor must be satisfied about before an opinion can be expressed.

TQ 2.2 · PYQ 2025-Sep [2] (c) · 4M · Pg 4

LEVEL II
Application

Medium

Topic 3: Interdisciplinary Nature of Auditing Relationship with Diverse Subjects

L2P5-C1-T03

Read first Read ICAI Study Material Chapter 1, Nature, Objective and Scope of Audit — the interdisciplinary nature of auditing and its relationship with diverse subjects.

NOTES

The rule in one line: verification of accounting records alone is not enough to form an opinion, so the auditor is expected to have a **working knowledge of disciplines other than auditing**. The question is always set as a case scenario and always asks you to tie each discipline to a fact in the scenario.

Auditing and Statistics and Mathematics. Statistics is used mainly for **audit sampling**; mathematics for **checking calculations and the valuation of inventories**. Where the entity has a large volume of transactions, examining every one is impractical, so **statistical sampling** lets the auditor select an appropriate sample and reach a reliable conclusion about the whole.

Auditing and Financial Management. It gives the auditor the concepts of working capital management, ratio analysis, funds flow and capital budgeting. Where the entity follows an **aggressive working capital policy**, the auditor must evaluate whether that affects **liquidity**, increases **financial risk**, or produces **misstatements** in the financial statements.

Auditing and Data Processing. With the growth of **Electronic Data Processing (EDP)** the auditor must understand **computerised accounting systems and the related internal controls**. Where the entity relies heavily on automated processing, the auditor assesses whether the system processes financial information accurately, safeguards data and minimises the risk of error or manipulation.

Auditing and Behavioural Science. It explains **how human behaviour influences financial reporting**. Facts such as **pressure on managers to meet targets** or **frequent disputes with contractors** may encourage unethical practice or fraud; understanding behaviour lets the auditor evaluate management's attitude, identify suspicious behaviour and assess the likelihood of intentional misstatement.

The trap is answering in the abstract. The scenario plants one fact per discipline — the volume of transactions for statistics, aggressive working capital for financial management, automated processing for data processing, target pressure for behavioural science. An answer that explains the four disciplines generally, without naming the fact that calls each one in, loses the application marks.

Understanding explain it, and place it in context · 1 question

- Take the four disciplines as four headings in the order the question lists them. Under each, one line on what the discipline gives the auditor and one line on why an auditor needs it.

CSQ 3.1 · PYQ 2026-May [4] (c) · 4M · Pg 5

LEVEL I
Understanding

Medium

Topic 4: Objectives of Audit

L2P5-C1-T04

Read first Read ICAI Study Material Chapter 1, Nature, Objective and Scope of Audit — the objectives of audit under SA 200.

NOTES

The rule, and name the Standard: under SA 200, 'Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing', the overall objectives of the auditor in conducting an audit of financial statements are — (1) to obtain reasonable assurance about whether the financial statements 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 financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework; and (2) to report on the financial statements, and communicate as required by the SAs, in accordance with the auditor's findings. Both limbs carry marks; the second is the one students forget.

The four-point analysis the answers run after quoting the objectives. (1) The objective is **reasonable assurance, which is to be distinguished from absolute assurance** — absolute assurance is a **complete assurance or guarantee**; reasonable assurance is a **high level of assurance but not complete assurance**, arrived at because the audit is carried out with professional competence and skill in accordance with the SAs, audit procedures are applied, audit evidence is obtained and evaluated, conclusions are drawn and an opinion is formed. (2) Misstatements **can occur due to fraud or error or both**, and the auditor looks at their effect **on the financial statements as a whole, in totality**. (3) Obtaining that reasonable assurance is what **enables the auditor to express an opinion** on compliance with the applicable financial reporting framework. (4) The opinion is **reported and communicated through a written report** as required by the

Standards on Auditing.

Where the objective is not met, say so in the words of the Standard. An auditor who expresses an opinion **without having obtained reasonable assurance** that the financial statements as a whole are free from material misstatement has not complied with the objective of audit stated in SA 200. That is the whole conclusion, and the examiner wants it in one sentence.

The recurring fact pattern is a demand for a guarantee, and the answer is always no. Whether it is audit assistants who think an audit guarantees the statements are free from error or fraud, or a management that asks for a complete assurance because it suspects the accounts contain errors and frauds, the conclusion is the same: **the auditor does not give a guarantee; he obtains reasonable assurance.**

Why only reasonable assurance — the answers give a short reason and a long one. Short: the audit process **suffers from certain inbuilt limitations**, arising from the nature of financial reporting, the nature of audit procedures, the fact that audit is not in the nature of an investigation, timeliness of financial reporting and the decrease in relevance of information over time, and future events. Long: preparation of financial statements **involves many judgements by management**, which may be subjective or uncertain; and although one premise of an audit is that management acknowledges its responsibility for preparing the financial statements and for devising suitable internal controls, those controls may fail to produce reliable information because of their own limitations.

Collusion is the fact the examiner plants. Where two employees — say a purchasing manager and an accounts clerk — work together to bypass a control and pass fake invoices, that is collusion, a significant limitation of internal control, because it overrides the control designed to prevent the very fraud. Because such collusion can occur, the auditor **cannot provide absolute assurance.**

Understanding explain it, and place it in context • 2 questions

- Follow the quotation with the four-point analysis. Marks follow the number of points, so number them.

CSQ 4.2 • RTP 2025-Jan [9] • Pg 9

LEVEL I
Understanding

Medium

TQ 4.1 • PYQ 2022-May [2] (c) • 3M • Pg 6

LEVEL I
Understanding

Hard

Application use the Standard - apply it to the facts • 2 questions

- Set out SA 200 first, then the reasonable-versus-absolute distinction, then apply it to the facts, then state the conclusion in the Standard's own words. An answer that jumps to 'no guarantee can be given' without the Standard loses the application marks.

CSQ 4.1 • RTP 2024-May [1] • Pg 7

LEVEL II
Application

Medium

Topic 5: Scope of Audit-What it Includes?

L2P5-C1-T05

Read first Read ICAI Study Material Chapter 1, Nature, Objective and Scope of Audit — the scope of audit, what it includes and what falls outside it.

NOTES

What the scope of audit includes — three heads, and they are the marks. (1) **Coverage of all aspects of the entity** — the audit must be organised adequately to cover all aspects of the entity relevant to the financial statements being audited. (2) **Reliability and sufficiency of financial information** — the auditor should be reasonably satisfied that the information in the underlying accounting records and other source data (bills, vouchers, documents) is a reliable and sufficient basis for preparing the financial statements, and he judges this by a study and assessment of accounting systems and internal controls and by **appropriate tests, enquiries and procedures**. (3) **Proper disclosure of financial information** — the auditor decides whether relevant information is properly disclosed, keeping in mind **applicable statutory requirements**.

How the disclosure limb is applied, because it is the one examined. The auditor ensures the financial statements **properly summarise the transactions and events recorded in them** and considers **the judgements made by management** in preparing them — for example the **choice of accounting policies**, such as the method of charging depreciation or the method of valuing inventories. He then **evaluates the selection and the consistent application of those policies**: whether the selection is proper and whether the chosen policy has been applied **consistently from period to period**. A change of inventory valuation method, or a change from straight-line to written-down value depreciation without adequate disclosure, is squarely within the scope of audit.

What falls outside the scope of audit — four heads. (1) **Matters outside the auditor's technical competence** — he cannot certify the **physical condition or remaining useful life of sophisticated machinery**, or the structural suitability of buildings; those need engineers or other experts. (2) **Authentication of documents** — the auditor is neither trained as nor expected to be an expert in the authentication of documents, so he cannot guarantee that invoices or contracts are genuine. (3) **Conducting an official investigation** — an audit **is not an official investigation into alleged wrongdoing**, and the auditor has no specific legal powers, such as the power of search or of recording statements of witnesses on oath. (4) **Audit is distinct from investigation**.

Audit versus investigation — learn this as a two-line distinction. **Investigation is a critical examination of the accounts with a special purpose** — if fraud is suspected and the accountant is specifically called upon to check the accounts to establish whether fraud really exists, the examination **takes the character of investigation**. The objective of audit, by contrast, is to obtain

reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion. The scope of audit is general and broad; the scope of investigation is specific and narrow.

Two fact patterns recur, and both are answered by that distinction. (a) Management suspects employees of **making fraudulent payments to dummy workers** and wants a detailed examination of accounts — the objection to calling it an 'audit' is **correct**, because such an assignment is **in the nature of investigation**. (b) The appointment letter says 'the auditor shall be responsible for detecting the frauds that may happen during the year' — the auditor is right to object, because **such a clause is uncalled for and outside the scope of audit**.

The classic wrong answer is that a matter about the future is outside scope. The scope of an audit covers **the financial statements as a whole, including the disclosures**. Where a material claim is pending, the **obligating event has already occurred** and what is uncertain is only the outcome — and uncertainty about outcome is exactly what a contingent liability disclosure exists for. Meet management's 'it relates to a future outcome' argument directly.

Understanding explain it, and place it in context • 2 questions

- When asked to distinguish audit from investigation, give purpose first and scope second — general and broad against specific and narrow. Two sentences earn the mark.

TQ 5.1 • MTP 2024-Mar [4] (c) • 3M • Pg 12

LEVEL I
Understanding

Easy

CSQ 5.2 • PYQ 2024-Sep [1] (c) {C} • 3M • Pg 14

LEVEL I
Understanding

Easy

Application use the Standard - apply it to the facts • 3 questions

- Say which head of scope the facts fall under, then apply it, then conclude that the matter is or is not within scope. The conclusion sentence is a separate mark.

TQ 5.2 • RTP 2025-May [9] • Pg 12

LEVEL II
Application

Medium

CSQ 5.1 • MTP 2024-Jul [2] (c) • 4M • Pg 14

LEVEL II
Application

Medium

CSQ 5.3 • RTP 2025-Sep [9] • Pg 15

LEVEL II
Application

Medium

Analysis break it down and take the parts separately • 2 questions

- Where the scenario lists several demands, take them one at a time and say for each why it is inside or outside scope, naming the reason — technical competence, authentication, or legal powers.

CSQ 5.4 • MTP 2026-Mar S1 [1] (b) {C} • 5M • Pg 17

LEVEL II

Medium

Analysis

CSQ 5.5 · PYQ 2026-Sep [4] (c) · 4M · Pg 18

LEVEL II
Analysis

Medium

Topic 6: Inherent Limitations of Audit

L2P5-C1-T06

Read first Read ICAI Study Material Chapter 1, Nature, Objective and Scope of Audit — the inherent limitations of an audit.

NOTES

The rule in one line: the auditor is not expected to, and cannot, reduce audit risk to zero, and therefore cannot obtain **absolute assurance** that the financial statements are free from material misstatement due to fraud or error. This is because of the **inherent limitations of an audit**. Open every answer on this topic with that sentence.

The three heads as the Standard-based answers give them. (1) **The nature of financial reporting** — preparation of financial statements involves **judgement by management** in applying the framework; many items involve **subjective decisions or assessments or a degree of uncertainty**, and there may be **a range of acceptable interpretations or judgements**. (2) **The nature of audit procedures** — there are practical and legal limitations on the auditor's ability to obtain audit evidence. (3) **Timeliness of financial reporting and the balance between benefit and cost** — difficulty, time or cost is not in itself a valid basis for omitting an audit procedure for which there is no alternative, but the relevance and value of information **tends to diminish over time**, so a balance must be struck between reliability and cost.

Under the nature of audit procedures, three examples are printed, and they are asked for by name. (a) Management or others may not provide, intentionally or unintentionally, the complete information relevant to the financial statements or requested by the auditor. (b) Fraud may involve sophisticated and carefully organised schemes designed to conceal it, including **collusion to falsify documentation**, which may cause the auditor to believe evidence is valid when it is not — and the auditor is neither trained as nor expected to be an expert in the authentication of documents. (c) **An audit is not an official investigation into alleged wrongdoing**, so the auditor **is not given specific legal powers such as the power of search**.

Practical limitation versus legal limitation — one example each, and the examiner asks for exactly that. **Practical:** the auditor does not test all transactions and balances; he forms his opinion only by testing samples. **Legal:** management may not provide complete information as requested, and there is no way by which the auditor can force management to provide it — if he is not given it, he can only report.

The five-factor version of the list, which the Study Material answers use for the broader question. (1) **Nature of financial reporting** — many judgements by management, subjective or uncertain. (2) **Nature of audit procedures** — the practical and legal limitations above. (3) **Not in the nature of**

investigation — audit is not an official investigation. (4) Timeliness of financial reporting and decrease in relevance of information over time — the auditor cannot verify every matter and must balance reliability against cost. (5) **Future events** — future events or conditions may affect an entity adversely and may **seriously affect its ability to continue its business**, through changes in market conditions, emergence of new business models or products, or the onset of adverse events.

Other matters that affect the limitations of an audit — the four subject matters where the limitation on detecting misstatement is particularly significant. **Fraud, particularly fraud involving senior management or collusion; the existence and completeness of related party relationships and transactions; the occurrence of non-compliance with laws and regulations;** and future events or conditions that may cause an entity to cease to continue as a going concern. Name all four — marks follow the count.

The recurring trap: proper controls existed, so the auditor should have caught it. The answer is that management's own controls may fail to produce reliable information because of their own limitations, and **collusion between two persons overrides internal control**; the existence of proper controls does not eliminate the inherent limitations of an audit, nor guarantee detection of all frauds or errors. The second trap is the shutdown case — shareholders who say the auditor should have warned them the business would fail; that is met by the **future events** factor, not by an apology.

Remembering reproduce what you have learnt • 1 question

- List the heads before expanding any of them. Use the five-factor version when the question says 'list down the factors', and the three-head version when the question quotes the 'cannot reduce audit risk to zero' sentence.

TQ 6.5 • PYQ 2024-May [2] (c) • 3M • Pg 23

LEVEL I
Remembering

Easy

Understanding explain it, and place it in context • 6 questions

- Tie every limitation back to 'reasonable and not absolute assurance'. A list of limitations without that sentence has missed what they are limitations of.

TQ 6.4 • MTP 2024-Mar [2] (c) • 3M • Pg 22

LEVEL I
Understanding

Easy

TQ 6.1 • RTP 2018-Nov [2] (a) • Pg 19

LEVEL I
Understanding

Medium

TQ 6.2 • RTP 2020-May [3] (b) • Pg 21

LEVEL I
Understanding

Medium

TQ 6.3 • RTP 2022-Nov [2] (a) • Pg 21

LEVEL I
Understanding

Medium

TQ 6.6 • MTP 2025-Dec S2 [5] (a) • 5M • Pg 24

LEVEL I
Understanding

Medium

TQ 6.7 • RTP 2026-May [9] • Pg 25

LEVEL I
Understanding

Medium

Topic 7: Benefits of Audit- Why Audit is Needed

L2P5-C1-T07

Read first Read ICAI Study Material Chapter 1, Nature, Objective and Scope of Audit — the benefits of audit and why an audit is needed.

NOTES

The seven benefits, in the order the answers give them. (1) **Audited accounts provide high quality information** — it gives users confidence that what they rely on is qualitative and is the outcome of an exercise carried out **following Auditing Standards recognised globally**. (2) **Shareholders' interest is safeguarded** — in companies the shareholders may or may not be involved in daily affairs, the financial statements are prepared by management consisting of directors, and as owners the shareholders **need an independent mechanism** so that the financial information is qualitative and reliable. (3) **An audit acts as a moral check on employees** from committing frauds, for fear of being discovered. (4) Audited financial statements are helpful to government authorities for determining tax liabilities. (5) Lenders and bankers can rely on audited financial statements for credit decisions — whether to lend or not to lend. (6) **An audit may also detect fraud or error or both**. (7) An audit reviews the existence and operation of the various controls in the entity and is therefore **useful at pointing out deficiencies**.

The conclusion sentence the examiner wants. Audit is not merely a statutory requirement but an essential mechanism that enhances the credibility of financial statements, protects stakeholder interests and supports informed decision-making. Write it; the scenario usually has a director calling the audit a pure cost.

Note which benefit answers which stakeholder. The question is often framed as 'benefits to various stakeholders', so pair them off: **users generally** get high quality information; **shareholders** get the independent mechanism; **employees** are under a moral check; **government** gets a basis for tax; **lenders and bankers** get a basis for credit; **management** gets the control deficiencies pointed out. Do not re-order the list — just label it.

Do not overclaim. The benefit is stated as 'an audit **may also** detect fraud or error'. It is not a promise of detection, and a benefits answer that says an audit guarantees detection of fraud contradicts the objectives topic and the inherent limitations topic.

Understanding explain it, and place it in context • 2 questions

- Both questions set up a business that needs its accounts believed. **Answer the benefit, then name who gets it** — the lender, the shareholder, the tax authority. A benefit with no beneficiary reads as a slogan.

- Where the facts name a director who doubts the need for audit, answer the doubt directly before listing benefits.

TQ 7.1 • MTP 2024-Dec S2 [2] (c) • 4M • Pg 27

LEVEL I
Understanding

Medium

CSQ 7.1 • MTP 2026-Apr S2 [1] (b) {C} • 5M • Pg 28

LEVEL I
Understanding

Medium

Topic 8: Audit - Mandatory or Voluntary

L2P5-C1-T08

CONCEPT BASE — no exam question asked yet • essential for full preparation

Read first Read ICAI Study Material Chapter 1, Nature, Objective and Scope of Audit — whether audit is mandatory or voluntary.

NOTES

This is a concept-base topic and the Scanner records no question printed on it. Read it once; do not build revision time around it. It is examined, if at all, only through the topics next to it — the definition in Topic 2 and the benefits in Topic 7.

What the printed answers do establish, and it is the point of the topic: an audit is an independent examination of financial information of any entity, whether profit oriented or not, and irrespective of its size or legal form. The definition is deliberately indifferent to legal form, so **audit is not confined to entities that are required by statute to have one** — an NGO is given as an example of the audited entity alongside a listed company in business.

Where an audit is not compelled, the benefits topic supplies the reason it is still undertaken. Audit is not merely a statutory requirement but an essential mechanism that enhances the credibility of financial statements, protects stakeholder interests and supports informed decision-making. The concrete pulls are the ones listed there: **lenders and bankers rely on audited statements for credit decisions, government authorities use them for determining tax liabilities**, and the audit **acts as a moral check on employees and points out deficiencies in controls**.

Do not invent thresholds. Nothing in the printed answers for this chapter states a turnover limit, a capital limit or a section number under which an audit becomes compulsory. If a question ever reaches this topic, answer it from the definition and the benefits and leave figures alone.

Topic 9: Who Appoints An Auditor?

L2P5-C1-T09

CONCEPT BASE — no exam question asked yet • essential for full preparation

Read first Read ICAI Study Material Chapter 1, Nature, Objective and Scope of Audit — who appoints an auditor.

NOTES

This is a concept-base topic and the Scanner records no question printed on it. Read it once. The marks near it are in the benefits topic and in the qualities topic.

The reasoning the chapter gives, and it is what an answer here would have to rest on: in companies **the shareholders may or may not be involved in the daily affairs**, and **the financial statements are prepared by management consisting of directors**. Because **the shareholders are the owners**, they need **an independent mechanism** to be sure the financial information is qualitative and reliable — and that is why **their interest is safeguarded by an audit**. The appointment therefore belongs to the owners, not to the preparers of the accounts.

The quality that follows from who appoints him. The auditor **must have the highest degree of integrity backed by adequate independence**, and the Code of ethics names **integrity, objectivity and independence** among the fundamental principles of professional ethics. That is the link between this topic and Topic 11 — the appointment mechanism exists to protect the independence.

Do not state section numbers or procedures here. The printed answers in this chapter give no section of the Companies Act on appointment, no tenure and no rotation rule. Appointment machinery belongs to a different chapter; answer this one from the ownership-and-independence argument only.

Topic 10: To Whom Report is Submitted by An Auditor?

L2P5-C1-T10

CONCEPT BASE — no exam question asked yet • essential for full preparation

Read first Read ICAI Study Material Chapter 1, Nature, Objective and Scope of Audit — to whom the auditor submits his report.

NOTES

This is a concept-base topic and the Scanner records no question printed on it. Read it once and move on; the reporting content that is examined sits under SA 200 in Topic 4.

The reporting obligation itself comes from SA 200 and is worth carrying here. The second overall objective of the auditor is to report on the financial statements, and communicate as required by the SAs, in accordance with the auditor's findings, and **the opinion is reported and communicated through a written report** as required by the Standards on Auditing. The audit output is a written

report containing an opinion — not a certificate and not a guarantee.

Who the report is for follows from why the audit exists. The shareholders are the owners and they need an independent mechanism because the statements are prepared by directors; the report is what gives them that mechanism. Beyond them, the answers name the users who rely on the audited statements — **lenders and bankers for credit decisions** and **government authorities for determining tax liabilities** — which is what is meant by saying the assurance **lends credibility to the financial statements**.

Do not state a section, a time limit or a form of report here. None is printed in this chapter's answers. Keep the answer to the SA 200 reporting objective and the ownership argument.

Topic 11: Qualities of Auditor

L2P5-C1-T11

Read first Read ICAI Study Material Chapter 1, Nature, Objective and Scope of Audit — the qualities of an auditor, and assurance engagements including prospective financial information.

NOTES

The personal qualities, and the list is attributed. According to **Dicksee** the qualities required are tact, caution, firmness, good temper, integrity, discretion, industry, judgement, patience, clear headedness and reliability — in short, all those personal qualities that make a good businessman contribute to the making of a good auditor. To these the answer adds **the shine of culture**, and **the highest degree of integrity backed by adequate independence**; the **Code of ethics mentions integrity, objectivity and independence** as fundamental principles of professional ethics.

The quotation the question is usually built around. Lord Justice Lindley, in the judgment in the famous **London and General Bank** case, summed up what an auditor should be: 'an auditor must be honest, that is, he must not certify what he does not believe to be true and must take reasonable care and skill before he believes that what he certifies is true'. Reproduce it in inverted commas.

The knowledge the auditor must have, in four blocks. (a) **A thorough knowledge of the general principles of law** governing the matters he deals with — the **Companies Act** needs special mention, **mercantile law and especially the law of contracts** is no less important, the **special statute** where an undertaking is governed by one, and **a sound knowledge of the law and practice of taxation**. (b) **An intensive programme of theoretical education** in financial and management accounting, general management, business and corporate laws, computers and information systems, taxation and economics. (c) **Both practical training and theoretical education**, which are equally necessary for professional competence. (d) Knowledge of the way business is generally conducted and of the special features peculiar to the particular business under audit. Over all of it: an exhaustive knowledge of accounting in all its branches is the sine qua non of the practice of

auditing.

Why behavioural knowledge is essential — this is set on its own. Auditing involves review of assertions, both financial and non-financial, to prove their veracity and express an opinion, so the auditor must know the fields he reviews. The financial auditor deals basically with figures but **has to interact with a great many people in the organisation**; the internal auditor or management auditor deals with human beings rather than financial figures. And **personnel is one of the basic elements in designing an internal control system** — however sound the structure, it cannot work unless the people working in the organisation are competent and honest.

Reasonable assurance engagement versus limited assurance engagement — learn the four bases. **Level of assurance:** reasonable assurance gives a **high level**; limited assurance gives a **lower level than a reasonable assurance engagement**. **Procedures:** reasonable assurance involves elaborate and extensive procedures to obtain sufficient appropriate evidence; limited assurance involves **fewer procedures**. **Conclusion:** reasonable assurance draws reasonable conclusions on the basis of sufficient appropriate evidence; limited assurance **obtains sufficient appropriate evidence to draw limited conclusions**. **Example:** an audit engagement, the audit of financial statements, against a review engagement, the review of financial statements.

Audit is an assurance engagement, but it is not the only one. Assurance engagements are not restricted to auditing alone — there are also **review engagements**, engagements providing assurance involving prospective financial information and engagements providing assurance on internal controls in an entity; the last two relate to matters other than historical financial information. All of them provide assurance to users; **the difference is one of degree**.

Historical against prospective financial information, and the level of assurance that follows. **Historical financial information** relates to information expressed in financial terms about **economic events, conditions or circumstances occurring in past periods**; **prospective financial information** is based on assumptions about the occurrence of future events and possible actions by an entity. In an assurance engagement on prospective financial information the practitioner obtains sufficient appropriate evidence that **management's assumptions are not unreasonable**, that the information is **properly prepared on the basis of those assumptions**, that it is **properly presented**, and that **all material assumptions are adequately disclosed**. Because the evidence is **oriented towards the future**, the practitioner **cannot express an opinion on whether the results shown will be achieved** and instead reports that nothing has come to his attention to suggest the assumptions do not provide a reasonable basis — so the engagement provides only a '**moderate**' level of assurance, and the applicable Standards are the **Standards on Assurance Engagements**.

Understanding explain it, and place it in context · 5 questions

- Answer the reasonable-versus-limited question in a four-row table: level of assurance, procedures performed, conclusion drawn, example. The examiner has printed it as a table twice.

	Understanding	
TQ 11.2 • RTP 2021-Nov [2] (a) • Pg 30	LEVEL I Understanding	Medium
CSQ 11.1 • RTP 2024-Sep [9] • Pg 32	LEVEL I Understanding	Medium
CSQ 11.2 • MTP 2024-Nov [2] (c) • 4M • Pg 33	LEVEL I Understanding	Medium
CSQ 11.3 • PYQ 2025-Jan [2] (a) • 5M • Pg 34	LEVEL I Understanding	Medium

Analysis break it down and take the parts separately • 1 question

- A distinguish question between **reasonable assurance** and **limited assurance**. Set them side by side on the same points: the level of assurance, the work done, and the form the conclusion takes.
- The conclusion wording is the mark most often lost — a reasonable assurance engagement gives a **positive** opinion, a limited assurance engagement a **negative** conclusion.

TQ 11.3 • MTP 2025-Mar S1 [5] (c) • 4M • Pg 31	LEVEL II Analysis	Medium
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Topic 12: Engagement and Quality Control Standards: An Overview

L2P5-C1-T12

Read first Read ICAI Study Material Chapter 1, Nature, Objective and Scope of Audit — Engagement and Quality Control Standards, an overview.

NOTES

The four Engagement Standards, issued under the authority of the ICAI Council, and what each applies to. (1) **Standards on Auditing (SAs)** — apply to **audits of historical financial information**. (2) **Standards on Review Engagements (SREs)** — apply to **reviews of historical financial information**. (3) **Standards on Assurance Engagements (SAEs)** — apply to assurance engagements other than audits and reviews of historical financial information. (4) **Standards on Related Services (SRSs)** — apply to agreed-upon procedures for information, compilation engagements and other related service engagements. The purpose of issuing these Standards is to establish high-quality benchmarks and guidance in the areas of financial statement audits and other types of assurance services.

The distinction the examiner tests: audit against review. SAs apply in the **audit** of historical financial information, which is a **reasonable assurance engagement** whose objective is reduction in assurance engagement risk to an acceptably low level in the circumstances of the engagement. SREs apply in the **review** of historical financial information, which is a **limited assurance engagement** whose objective is a reduction in assurance engagement risk to a level that is acceptable in the circumstances of the engagement. **Historical financial information** means

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

The named Standards to quote as examples — give the number and the title together. Standards on Auditing: SA 200 Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing; **SA 230 Audit Documentation**; SA 315 Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment; **SA 500 Audit Evidence**; **Revised SA 700 Forming an Opinion and Reporting on Financial Statements**. Standards on Review Engagements: **SRE 2400 (Revised) Engagements to Review Historical Financial Statements** and SRE 2410 Review of Interim Financial Information Performed by the Independent Auditor of the Entity. SAs have been issued across the spectrum — overall objectives, audit documentation, planning, identifying and assessing the risks of material misstatement, audit evidence, audit sampling, going concern, and forming an opinion and reporting.

Two matching questions come up as one-liners, so fix the pairing. An assignment to assist management with the preparation and presentation of historical financial information without obtaining assurance on it is governed by the **Standards on Related Services**, and the applicable standard is **SRS 4410 (Revised)**. An assignment to **examine prospective financial information** is governed by the **Standards on Assurance Engagements**, and the applicable standard is **SAE 3400**.

Departure from a Standard — the three obligations, and the sentence that closes the answer. It is the duty of chartered accountants to see that the Standards are followed, and **ordinarily they are to be followed**. But where a specific procedure required by the Standards would be ineffective in a particular engagement, the member must (a) document how the alternative procedure performed achieves the purpose of the required procedure; (b) **document the reason for the departure, unless it is clear**; and (c) **draw attention to the departure in his report**. A mere disclosure in the report does not absolve a chartered accountant from complying with the applicable Standards. The classic wrong answer stops at the disclosure in the report and omits the two documentation duties.

Remembering reproduce what you have learnt · 1 question

- When asked for 'any three' Engagement Standards, still name the abbreviation, the expansion and the class of engagement each applies to, and add the purpose sentence — the purpose is a separate mark.

TQ 12.2 · PYQ 2025-May [2] (a) · 5M · Pg 36

LEVEL I
Remembering

Medium

Understanding explain it, and place it in context · 1 question

- Keep 'audit' and 'review' apart by the level of assurance and by the objective each has in terms of assurance engagement risk. Give one named Standard as an example on each side.

TQ 12.3 · MTP 2025-Nov S1 [5] (c) · 4M · Pg 37

LEVEL I
Understanding**Medium****Application** use the Standard - apply it to the facts · 1 question

- For a 'which standard applies' question, answer in two steps for each limb: name the family of Standards first, then the specific standard number. A bare number without the family loses half the limb.

TQ 12.1 · RTP 2022-May [2] (b) · Pg 35

LEVEL II
Application**Medium****Analysis** break it down and take the parts separately · 1 question

- The question gives assignments and asks which Standard applies to each. **Answer assignment by assignment**, naming the Standard and its number, and say in one clause why.
- The decision turns on whether assurance is given and on what information: historical or prospective, audit or review, or no assurance at all. State that test once, then apply it.

TQ 12.4 · PYQ 2026-Jan [1] (b) {C} · 5M · Pg 38

LEVEL II
Analysis**Medium**

CHAPTER 2

Audit Strategy, Audit Planning and Audit Programme

8 Topics • 45 Classified Questions • Importance: B

ICAI SKILL PROFILE ICAI band for this paper: Level I 40-60% • Level II 40-60% — this chapter reads **on profile**

Level I — Comprehension & Knowledge **54.7%** 104 of 190 marks

Level II — Analysis & Application **45.3%** 86 of 190 marks

This chapter sits inside ICAI's own band for the paper — 55% Level I against 40-60%. Prepare it in those proportions: know the method, then drill it.

Topic 1: Auditor's Responsibility to Plan an Audit of Financial Statements

L2P5-C2-T01

Read first Read ICAI Study Material Chapter 2, Audit Strategy, Audit Planning and Audit Programme — the auditor's responsibility to plan an audit of financial statements under SA 300.

NOTES

The rule in one line, and name the Standard: under SA 300, 'Planning an Audit of Financial Statements', planning is not a discrete phase of an audit, but rather a continual and iterative process that often begins shortly after (or in connection with) the completion of the previous audit and continues until the completion of the current audit engagement. Learn that sentence verbatim — it is set on its own and it opens most answers in this chapter. The auditor shall establish an overall audit strategy that sets the scope, timing and direction of the audit, and that guides the development of the audit plan.

What the plan should cover, in the classic four points: (1) acquiring knowledge of the client's accounting systems, policies and internal control procedures; (2) **establishing the expected degree of reliance to be placed on internal control**; (3) determining and programming the nature, timing and extent of the audit procedures to be performed; and (4) **coordinating the work to be performed**. And plans should be further developed and revised as necessary during the course of the audit. The framing sentence is that the auditor should plan his work to enable him to conduct an effective audit in an efficient and timely manner, and plans should be based on knowledge of the client's business.

The six benefits of adequate planning — these are the marks when the question says 'an adequate planning benefits the audit'. It helps the auditor (1) **devote appropriate attention to important areas of the audit**; (2) **identify and resolve potential problems on a timely basis**; (3) properly organise and manage the audit engagement so that it is performed in an effective and efficient

manner; (4) select engagement team members with appropriate levels of capabilities and competence to respond to anticipated risks, and assign work to them properly; (5) facilitate the direction and supervision of engagement team members and the review of their work; and (6) assist, where applicable, in coordinating the work done by auditors of components and experts. Note the opening definition: planning an audit involves establishing the overall audit strategy for the engagement and developing an audit plan — two things, not one.

The five matters to be considered before the auditor identifies and assesses the risks of material misstatement. (1) **The analytical procedures to be applied as risk assessment procedures**; (2) obtaining a general understanding of the legal and regulatory framework applicable to the entity and how the entity is complying with that framework; (3) **the determination of materiality**; (4) **the involvement of experts**; and (5) **the performance of other risk assessment procedures**. This list answers two different questions — the 'continual and iterative' question and the 'does consideration of experts fall within planning' question, where the conclusion is yes, the involvement of an expert must be evaluated at the planning stage in accordance with SA 300, taking into account the complexity of the business.

Preliminary engagement activities — three, and the examiner asks for them by name. (a) **Performing procedures regarding the continuance of the client relationship** — appropriate acceptance and continuance procedures must have been followed and the conclusions reached must be appropriate; the firm should obtain the necessary information before accepting an engagement with a new client, when deciding whether to continue an existing engagement, and when considering a new engagement with an existing client, considering matters such as **the integrity of principal owners and key management, the competence of the engagement team** and the implications of matters that have arisen during current and previous audit engagements; in **initial engagements, communication with the predecessor auditor** should be made where there has been a change of auditors. (b) **Evaluating compliance with ethical requirements, including independence** — 'independence' means that the judgement of a person is not subordinate to the wishes or direction of another person who might have engaged him, and throughout the audit engagement the engagement partner shall remain alert, through observation and inquiry, for evidence of non-compliance with relevant ethical requirements by members of the engagement team. (c) **Establishing an understanding of the terms of engagement** — it is in the interests of both entity and auditor that **an audit engagement letter is sent before the commencement of the audit** to avoid misunderstandings.

Why the preliminary activities are performed — the closing sentence carries a mark. Performing them assists the auditor in identifying and evaluating events or circumstances that may adversely affect the auditor's ability to plan and perform the audit engagement.

The recurring case pattern: a regulatory requirement noticed at planning. Two questions are asked and they are answered from two different limbs. Whether the matter belongs in the **overall audit strategy** is answered from the strategy limb — the strategy sets the scope, timing and direction of the audit and guides the development of the audit plan, and identifying **the characteristics of the engagement that define its scope** and **the factors significant in directing the**

engagement team's efforts brings a regulatory obligation with heavy penalties into the strategy. Whether an **inquiry of the IT head** is in line with SA 300 is answered from the planning-matters limb — it goes to obtaining a general understanding of the legal and regulatory framework and how the entity complies with it.

Remembering reproduce what you have learnt • 1 question

- Give SA 300's full title once — 'Planning an Audit of Financial Statements' — and reproduce the 'continual and iterative process' sentence word for word. It is the highest-frequency sentence in the chapter.

TQ 1.5 • RTP 2026-Jan [10] • Pg 46

LEVEL I
Remembering

Medium

Understanding explain it, and place it in context • 4 questions

- Keep the two products of planning separate from the first line: planning involves establishing the overall audit strategy and developing the audit plan. Answers that treat planning as one document lose marks throughout this chapter.

TQ 1.1 • MTP 2018-Mar [2] (b) • 5M • Pg 43

LEVEL I
Understanding

Medium

TQ 1.2 • PYQ 2018-Nov [2] (b) • 5M • Pg 44

LEVEL I
Understanding

Medium

TQ 1.3 • PYQ 2018-Nov [4] (a) • 5M • Pg 44

LEVEL I
Understanding

Medium

TQ 1.4 • MTP 2025-Aug S2 [2] (c) • 4M • Pg 45

LEVEL I
Understanding

Medium

Application use the Standard - apply it to the facts • 1 question

- For 'does this fall within planning', quote the five matters to be considered prior to identifying and assessing the risks of material misstatement, then point at the one the facts engage, then conclude. The conclusion sentence is a separate mark.

CSQ 1.1 • PYQ 2025-Jan [1] (a) {C} • 5M • Pg 48

LEVEL II
Application

Medium

Topic 2: Planning Process - Elements of Planning

L2P5-C2-T02

Read first Read ICAI Study Material Chapter 2, Audit Strategy, Audit Planning and Audit Programme — the planning process, the elements of the overall audit strategy and the contents of the audit plan.

NOTES

The five moves in establishing the overall audit strategy. This is the spine of the chapter — memorise it in order. The auditor shall (1) **identify the characteristics of the engagement that define its scope**; (2) ascertain the reporting objectives of the engagement to plan the timing of the audit and the nature of the communications required; (3) consider the factors that, in the auditor's professional judgement, are significant in directing the engagement team's efforts; (4) consider the results of preliminary engagement activities and, where applicable, whether knowledge gained on other engagements performed by the engagement partner for the entity is relevant; and (5) ascertain the nature, timing and extent of resources necessary to perform the engagement. Almost every question in Topics 2, 3 and 4 is one of these five expanded.

Move 1 — characteristics that define the scope, with the examples the answers use. **The applicable financial reporting framework** (a listed company preparing under Ind AS must be planned for accordingly); **industry-specific reporting requirements imposed by industry regulators** (a bank must comply with RBI prudential norms and reporting formats); the nature of the business segments to be audited, including the need for specialised knowledge (a defence manufacturer may require technical experts on the team); **the expected audit coverage — the number and locations of components** (subsidiaries across five states must all be planned for, deciding which components are significant); and **the expected use of audit evidence obtained in previous audits** (controls over sales tested and found effective last year may guide this year's planning and reduce re-testing). Only a well identified scope can lead to the establishment of a sound audit strategy.

Move 2 — reporting objectives, five instances, and they are asked for as 'any four'. **The entity's timetable for reporting, such as at interim and final stages**; the organisation of meetings with management and those charged with governance to discuss the nature, timing and extent of the audit work; discussion with management and those charged with governance regarding the expected type and timing of reports to be issued and other communications, written and oral, including the auditor's report, management letters and communications to those charged with governance; discussion with management regarding the expected communications on the status of audit work throughout the engagement; and the expected nature and timing of communications among engagement team members, including the timing of team meetings and the timing of the review of work performed. A working paper setting out a timetable of planning, field work, manager review, partner review, EQCR review and issuance is exactly this limb in practice.

Move 5 — resources, the four matters the strategy determines, 'subject to completion of the auditor's risk assessment procedures'. (1) **The resources to deploy for specific audit areas — appropriately experienced team members for high risk areas, the involvement of experts on complex matters**. (2) The amount of resources to allocate to specific audit areas — the number of team members assigned to observe the inventory count at material locations, the extent of review of other auditors' work in group audits, **the audit budget in hours to allocate to high risk areas**. (3) **When these resources are to be deployed — whether at an interim audit stage or at key cut-off**

dates. (4) **How such resources are managed, directed and supervised** — when team briefing and debriefing meetings are expected to be held, how engagement partner and manager reviews are expected to take place, and **whether to complete engagement quality control reviews**. The examiner words this as 'marshalling his human resources'; the four-point answer is the same.

The audit plan, and what makes it different from the strategy. This is the distinction the examiner returns to again and again. The audit plan is more detailed than the overall audit strategy and describes how the strategy is to be implemented. The auditor shall develop an audit plan that includes a description of: (1) the nature, timing and extent of planned risk assessment procedures, as determined under SA 315, 'Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment'; (2) the nature, timing and extent of planned further audit procedures at the assertion level, as determined under SA 330, 'The Auditor's Responses to Assessed Risks'; and (3) other planned audit procedures that are required to be carried out so that the engagement complies with the SAs. Within limb (2), **nature** is what type of procedure (inspection, observation, confirmation, inquiry), **timing** is when it is performed (interim stage or year-end), and **extent** is how much work is done, considering sample size and coverage. **Planning is not sequential, and the example is printed.** Planning of the auditor's risk assessment procedures occurs early in the audit process, but planning the nature, timing and extent of specific further audit procedures depends on the outcome of those risk assessment procedures. The auditor may even begin the execution of further audit procedures for some classes of transactions, account balances and disclosures before planning all remaining further audit procedures. So the audit plan develops **over the course of the audit**; it is not written once and frozen.

Factors in developing the overall audit plan — the sixteen-point list, where the question asks for it in that form. **Terms of engagement and any statutory responsibilities; nature and timing of reports or other communication; applicable legal or statutory requirements;** accounting policies adopted by the client and changes in those policies; **effect of new accounting or auditing pronouncements; identification of significant audit areas; setting of materiality levels;** conditions requiring special attention, such as the possibility of material error or fraud and the involvement of parties in whom directors or substantial owners are interested; degree of reliance to be placed on the accounting system and internal control; **possible rotation of emphasis on specific audit areas; nature and extent of audit evidence to be obtained;** work of internal auditors and the extent of their involvement; involvement of other auditors in the audit of subsidiaries or branches; **involvement of experts;** allocation of work between joint auditors, where applicable; and **establishing and coordinating staffing requirements.**

Two discussion questions come as a pair, and the answers pull in opposite directions. Discussion **with the engagement team** is required: the engagement partner and other key members of the engagement team shall be involved in planning the audit, including planning and participating in the discussion among engagement team members, because their experience and insight enhance the effectiveness and efficiency of the planning process. Discussion **with management** is permitted but guarded: the auditor may decide to discuss elements of planning with the entity's

management to facilitate the conduct and management of the audit engagement, but when discussing matters included in the overall audit strategy or audit plan, care is required in order not to compromise the effectiveness of the audit — that is, not to destroy the **unpredictability** of the procedures.

Remembering reproduce what you have learnt • 1 question

- Learn the five moves of the overall audit strategy as a list before you learn any one of them in detail. Nearly every question in this chapter is one move expanded, and the list itself is often the whole answer.

TQ 2.1 • PYQ 2018-May [4] (a) • 5M • Pg 50

LEVEL I
Remembering

Medium

Understanding explain it, and place it in context • 7 questions

- When the question names 'overall audit strategy', answer only from the five moves; when it names 'audit plan', answer only from the three descriptions and cite SA 315 and SA 330. Mixing the two is the single most costly error in this chapter.

TQ 2.2 • PYQ 2019-May [2] (d) • 4M • Pg 51

LEVEL I
Understanding

Medium

TQ 2.4 • RTP 2022-May [4] (a) • Pg 52

LEVEL I
Understanding

Medium

TQ 2.5 • RTP 2023-May [5] • Pg 53

LEVEL I
Understanding

Medium

TQ 2.7 • RTP 2023-Nov [4] (b) • Pg 55

LEVEL I
Understanding

Medium

TQ 2.8 • PYQ 2025-May [6] (c) • 4M • Pg 56

LEVEL I
Understanding

Medium

CSQ 2.2 • PYQ 2024-Sep [4] (a) • 4M • Pg 59

LEVEL I
Understanding

Medium

CSQ 2.3 • PYQ 2026-Jan [5] (c) • 4M • Pg 60

LEVEL I
Understanding

Medium

Application use the Standard - apply it to the facts • 3 questions

- For a working-paper or timetable scenario, identify which move of the strategy the paper evidences — usually reporting objectives or resources — then expand that move's list, then say how it helped the auditor.

TQ 2.6 • RTP 2023-Nov [4] (a) • 3M • Pg 55

LEVEL II
Application

Easy

TQ 2.3 • PYQ 2019-Nov [2] (b) • 4M • Pg 51

LEVEL II
Application

Medium

Topic 3: Relationship Between - Audit Strategy and Audit Plan

L2P5-C2-T03

Read first Read ICAI Study Material Chapter 2, Audit Strategy, Audit Planning and Audit Programme — the relationship between the audit strategy and the audit plan.

NOTES

The six points on the relationship, and they are the whole answer. (1) The audit strategy and the audit plan are interrelated and complement each other. (2) The audit strategy sets the broad direction of the audit, while the audit plan translates that strategy into detailed actionable steps. (3) The audit strategy provides the overall direction, whereas the audit plan contains the detailed steps required to execute that strategy. (4) The audit plan is essentially an extension of the audit strategy — once the strategy is formulated, it guides the development of the audit plan. (5) The strategy informs decisions on resource allocation, timing of audit work, the audit team's approach to risk assessment, and the selection of areas to focus on. (6) The engagement partner ensures that the team understands this relationship so that the audit can be executed effectively and efficiently, while being responsive to changes in risks and circumstances during the engagement.

Hold the two definitions side by side, because the examiner tests the difference and not the similarity. The overall audit strategy sets the scope, timing and direction of the audit and guides the development of the audit plan. The audit plan is more detailed than the overall audit strategy and describes how the strategy is to be implemented, covering the nature, timing and extent of audit procedures to be performed by engagement team members. Strategy is direction; plan is execution.

Scope is where the relationship starts, so the scope characteristics are asked under this topic too. It is important for the auditor to identify the scope of the engagement — only a well identified scope can lead to the establishment of a sound audit strategy. The characteristics are **the applicable financial reporting framework**, the nature of the business segments to be audited including the need for specialised knowledge, **industry-specific reporting requirements required by industry regulators**, and **the expected use of audit evidence obtained in previous audits**. A company in multiple segments including financial services, subject to a financial regulator's reporting requirements, engages the second and third of those directly.

The classic wrong answer is to say the strategy comes first and the plan comes second, and stop there. The order is right but it is only point four of six. The relationship is two-way and continuing: the strategy guides the plan, and **both are updated and changed as necessary during the audit** as risks and circumstances change. An answer that describes a one-off handover from strategy to plan misses the responsiveness point the engagement partner is being asked to explain.

Understanding explain it, and place it in context · 2 questions

- Open with the one-line definition of each — strategy sets scope, timing and direction; plan is more detailed and says how the strategy is implemented — and then give the relationship points. The definitions frame the answer and earn their own marks.

TQ 3.1 · PYQ 2024-Sep [2] (d) · 3M · Pg 61

LEVEL I
Understanding

Easy

TQ 3.2 · MTP 2025-Dec S2 [1] (c) · DESC · 4M · Pg 62

LEVEL I
Understanding

Medium

Topic 4: Overall Audit Strategy and Audit Plan - The Auditor's Responsibility

L2P5-C2-T04

Read first Read ICAI Study Material Chapter 2, Audit Strategy, Audit Planning and Audit Programme — the overall audit strategy and audit plan and the auditor's responsibility for them.

NOTES

The concept, in the Standard's own words: under SA 300, 'Planning an Audit of Financial Statements', the auditor shall establish an overall audit strategy that sets the scope, timing and direction of the audit and that guides the development of the audit plan. Start every answer on this topic with that sentence, then take the limb the question asks for.

The factors to be taken into consideration in establishing the audit strategy — the four moves, given here with their own examples. **Identify the characteristics of the engagement that define its scope** — the financial reporting framework, industry-specific reporting requirements, the locations of components, and the availability of the work of internal auditors. Ascertain the reporting objectives of the engagement to plan the timing of the audit and the nature of the communications required — deadlines for interim and final reporting, and the timing of discussions with management and those charged with governance. Consider the factors that, in the auditor's professional judgement, are significant in directing the engagement team's efforts — the determination of materiality, preliminary identification of areas of higher risk of material misstatement, and preliminary identification of material components and account balances. **Consider the results of preliminary engagement activities**, and where applicable whether knowledge from other engagements for the entity is relevant; **and ascertain the nature, timing and extent of the resources necessary**.

Factors significant in directing the engagement team's efforts — four examples, and this is the most-set limb of this topic. (a) **Volume of transactions**, which may determine whether it is more efficient for the auditor to **rely on internal control** rather than test every transaction individually. (b) **Significant industry developments**, such as **changes in industry regulations and new reporting requirements**. (c) **Significant changes in the financial reporting framework**, such as **changes in accounting standards**. (d) **Other significant relevant developments**, such as **changes in the legal**

environment affecting the entity. The framing sentence is that the auditor needs to direct the efforts of the engagement team towards matters that in his professional judgement are significant, and that preliminary identification of material classes of transactions, account balances and disclosures helps in establishing the overall audit strategy.

The four resource matters the strategy determines, 'subject to completion of the auditor's risk assessment procedures'. (i) **The resources to deploy for specific audit areas** — experienced team members for high-risk areas, experts for complex matters such as valuation of specialised inventory or long-term contract accounting. (ii) **The amount of resources to allocate** — the number of team members to observe inventory counts at major warehouses, the extent of review of other auditors' work where there are multiple locations, the **audit budget in hours** for high-risk areas. (iii) **When these resources are to be deployed** — at the **interim audit stage** or at the **year-end and key cut-off dates**. (iv) **How such resources are managed, directed and supervised** — team briefing and debriefing meetings, how engagement partner and manager reviews will take place, on-site or off-site, and whether an engagement quality control review is required.

Reporting objectives, restated for this topic because it is set here too. The entity's timetable for reporting; organisation of meetings to discuss the nature, timing and extent of audit work with management; discussion with management regarding the expected type and timing of reports to be issued, including the auditor's report; discussion with management regarding expected communications on the status of audit work throughout the engagement; and the expected nature and timing of communications among engagement team members, including team meetings and the review of work performed.

The trap in this topic is answering a strategy question with the audit plan. Where the scenario speaks of multiple locations, technically complex areas, deployment of resources, timing at various locations and supervision and review, it is asking about the **overall audit strategy** and the four resource matters — not about risk assessment procedures under SA 315 or further audit procedures under SA 330, which belong to the audit plan. Close the answer by saying the strategy ensures that appropriate personnel, in appropriate numbers, are deployed at the appropriate time and are properly directed and supervised, particularly in areas of higher audit risk.

Remembering reproduce what you have learnt · 1 question

- Open with the SA 300 sentence defining the overall audit strategy. Then give the limb asked for as a numbered list; the lists here are short and marks follow the count.

TQ 4.2 · PYQ 2026-Sep [6] (c) · 4M · Pg 64

LEVEL I
Remembering

Medium

Understanding explain it, and place it in context · 1 question

- When the question says 'directing the engagement team's efforts', give the four examples — volume of transactions, industry developments, changes in the financial reporting framework, other developments such as legal changes. Do not substitute the resources list.

TQ 4.1 • PYQ 2026-May [6] (Or) (c) • 4M • Pg 63

LEVEL I
Understanding

Medium

Application use the Standard - apply it to the facts • 3 questions

- Name the fact in the scenario that engages each factor — diversification into a new product line, multiple manufacturing units, a strict reporting schedule — before you expand the factor. Then close with what the strategy therefore enables the auditor to do.

CSQ 4.1 • PYQ 2024-May [2] (d) • 3M • Pg 65

LEVEL II
Application

Easy

CSQ 4.2 • MTP 2026-Mar S1 [4] (a) • 5M • Pg 65

LEVEL II
Application

Medium

CSQ 4.3 • MTP 2026-Apr S2 [4] (a) • 5M • Pg 67

LEVEL II
Application

Medium

Topic 5: Changes to Planning Decisions During the Course of Audit

L2P5-C2-T05

Read first Read ICAI Study Material Chapter 2, Audit Strategy, Audit Planning and Audit Programme — changes to planning decisions during the course of the audit.

NOTES

When planning starts and when it ends. Planning is not a discrete phase of an audit, but rather a continual and iterative process that begins shortly after the completion of the previous audit and continues until the completion of the current audit engagement. Applied: if last year's audit report was issued in June, planning for the current year's audit **commenced right after the completion of the preceding audit in June** and **continues until the current year's audit is completed**. Give the general rule first, then the dates from the scenario.

The rule on changes: the auditor shall update and change the overall audit strategy and the audit plan as necessary during the audit. Note that both documents change — not the plan alone.

The three causes of change, named as such. Unexpected events, changes in conditions, or the audit evidence obtained from the results of audit procedures. As a result the auditor may need to modify the overall audit strategy and audit plan and thereby the resulting planned nature, timing and extent of further audit procedures, based on the revised consideration of assessed risks.

When this happens, stated as a test: it is the case when information comes to the auditor's attention that differs significantly from the information available when the auditor planned the audit procedures. The printed example is that audit evidence obtained through detailed checking may contradict the audit evidence obtained through testing internal controls — learn it, because the examiner asks for an example.

The classic wrong answer is that the plan is fixed once approved. It is not; but nor does the auditor change it silently. Significant changes to the strategy or the plan, **and the reasons for them**, must be **documented** under the documentation topic. Tie the two topics together: change is permitted, change must be justified by revised assessed risks, and change must be recorded.

Application use the Standard - apply it to the facts · 1 question

- Say yes, the auditor can change planning decisions, then give the three causes, then the test of significantly different information, then the detailed-checking-contradicts-controls-testing example. Four steps, four marks.

TQ 5.1 · MTP 2025-Jul S1 [1] (b) · 5M · Pg 68

LEVEL II
Application

Medium

Topic 6: Planning Supervision and Review of Work of Engagement Team Members

L2P5-C2-T06

Read first Read ICAI Study Material Chapter 2, Audit Strategy, Audit Planning and Audit Programme — planning the direction, supervision and review of the work of engagement team members.

NOTES

The rule in one line: the auditor shall plan the nature, timing and extent of direction and supervision of engagement team members and the review of their work. It is planned **before commencing the audit and throughout its course**, not settled at the end.

The four factors it varies with, and they are the marks. (1) **The size and complexity of the entity.** (2) **The area of the audit.** (3) The assessed risks of material misstatement. (4) The capabilities and competence of the individual team members performing the audit work. Name all four before expanding any.

The printed rider on factor three, which carries a mark of its own: an increase in the assessed risk of material misstatement for a given area of the audit ordinarily requires a corresponding increase in the extent and timeliness of direction and supervision of engagement team members, and a more detailed review of their work.

How factor four works in practice — the inventory obsolescence example. Where a problem in the production process raises concerns about **inventory obsolescence** in a significant class of transactions and the team concludes that **additional tests of details** are required, the senior will take part in the discussions with management about the provision for obsolescence and examine the supporting documentation, rather than just reading the memo on file, and these procedures should be completed as the work is being performed rather than as an after-the-fact review. The extent of the senior's involvement requires judgement, taking into account the complexity of the

area and the experience of the team.

This topic is usually set together with the change-of-plan topic, so carry both. The second half of the question asks what the auditor must do on finding information significantly different from what was available when the procedures were planned: she must **revise and modify the overall audit strategy and the audit plan as necessary**, and thereby the planned nature, timing and extent of further audit procedures, based on the revised assessment of risks.

Understanding explain it, and place it in context · 1 question

- The ask is the **factors that make direction, supervision and review vary** — so every point must be a factor, not a description of supervision.
- Cover the size and complexity of the entity, the area of the audit, the assessed risks, and the capability of the individual team members.

TQ 6.1 · MTP 2020-May [2] (c) · 4M · Pg 69

LEVEL I
Understanding

Medium

Analysis break it down and take the parts separately · 1 question

- The facts give a team told to reuse last year's plan on a business that has changed. **Say what has changed first**, then why the plan must change with it.
- Bring in the review and supervision requirement expressly — the manager's instruction is a supervision failure as much as a planning one.

CSQ 6.1 · PYQ 2025-Sep [5] (a) · 5M · Pg 70

LEVEL II
Analysis

Medium

Topic 7: Documentation

L2P5-C2-T07

Read first Read ICAI Study Material Chapter 2, Audit Strategy, Audit Planning and Audit Programme — documentation of the audit strategy, the audit plan and changes to them.

NOTES

The rule in one line — the auditor shall document three things: (a) **the overall audit strategy**; (b) **the audit plan**; and (c) any significant changes made during the audit engagement to the overall audit strategy or the audit plan, and the reasons for such changes. Any answer that gives fewer than three has lost marks at the first sentence.

What the documentation of the overall audit strategy is, and why. It is a record of the key decisions considered necessary to properly plan the audit and to communicate significant matters to the engagement team. The form is given as an example: the auditor may summarise the overall

audit strategy in the form of a memorandum containing the key decisions regarding the overall scope, timing and conduct of the audit.

What the documentation of the audit plan is, and the two purposes it serves. It is a record of the planned nature, timing and extent of risk assessment procedures and further audit procedures at the assertion level in response to the assessed risks. It also serves as a record of the proper planning of the audit procedures that can be reviewed and approved prior to their performance — that second purpose is often the point of the question. The **tools** are also printed: the auditor may use standard audit programmes and/or audit completion checklists, tailored as needed to reflect the particular engagement circumstances.

What the record of significant changes must do — three things. It explains why the significant changes were made; it records the overall strategy and audit plan finally adopted for the audit; and it reflects the appropriate response to the significant changes occurring during the audit, including the **resulting changes to the planned nature, timing and extent of audit procedures**. Where a scenario gives a material misstatement discovered in inventory valuation and an unexpected acquisition that widens the scope, those are exactly the changes that must be recorded with reasons.

The activities in the planning phase that form part of the auditor's documentation — the printed list. (1) **A summary of discussions with the entity's key decision makers**; (2) **documentation of audit committee pre-approval of services, where required**; (3) **audit documentation access letters**; (4) other communications or agreements with management or those charged with governance regarding the scope, or changes in scope, of our services; (5) **the auditor's report on the entity's financial statements**; and (6) other reports as specified in the engagement agreement, for example a debt covenant compliance letter.

The trap is answering 'documentation' with a definition of working papers. The question in this chapter is narrow: it asks what is documented **in relation to audit planning**. Answer with the three items, then the content and purpose of each, then the reasons requirement for changes. Do not drift into SA 230 generally — nothing beyond the above is printed here.

Understanding explain it, and place it in context · 2 questions

- For each of the three, give what it records and what purpose it serves. The 'reviewed and approved prior to their performance' purpose of the audit plan documentation is a separate mark.

TQ 7.2 · RTP 2022-Nov [4] (b) · Pg 73

LEVEL I
Understanding

Medium

CSQ 7.1 · PYQ 2025-Jan [5] (a) · 5M · Pg 74

LEVEL I
Understanding

Medium

Application use the Standard - apply it to the facts · 1 question

- Where the scenario says the auditor failed to document, say plainly what should have been documented, item by item, and why the change record matters — it explains why the change was made and shows the response was appropriate.

TQ 7.1 · PYQ 2021-Jul [2] (a) · 4M · Pg 72

LEVEL II
Application

Medium

Topic 8: Audit Programme

L2P5-C2-T08

Read first Read ICAI Study Material Chapter 2, Audit Strategy, Audit Planning and Audit Programme — the audit programme, its construction, advantages, disadvantages and periodic review.

NOTES

What an audit programme is: a detailed plan of verification procedures applied to financial statements to obtain sufficient appropriate audit evidence. The extent and nature of the audit programme is substantially influenced by the internal control system in operation, which is why the auditor can formulate his entire audit programme only after he has had a satisfactory understanding of the internal control systems and their actual operation. Why the understanding of internal control must come first — three reasons, then the effect on procedures. Reasons: it **avoids an unwieldy programme**, in which the audit objective is lost in a mass of entries and vouchers; it distinguishes **the system from its actual operation**, because after installation management often fails to ensure compliance and the system may operate only partially, and failure to detect this **can seriously mislead the auditor**; and **an early review enables better planning**, letting the auditor frame a more objective programme and bring weaknesses to management's attention. Effect: **weak controls lead to extended procedures** — for example, where controls over wages are weak and dummy workers are a risk, the programme may include **observation of wage distribution to identify workers who do not collect wages**; **strong controls allow reduced procedures** — where controls over trade receivables are strong, **balance confirmations can be obtained at any time near the year-end**, whereas if they are weak, **confirmations must be obtained exactly at year-end with wider coverage**.

The seven points of programme construction. This is the most frequently set list in the chapter — learn it in order. (1) **Stay within the scope and limitation of the assignment**, so that no time is wasted on matters not pertinent. (2) Prepare a written audit programme setting forth all the procedures needed to implement the audit plan. (3) Determine the evidence reasonably available and identify the best evidence for deriving the necessary satisfaction — what is best evidence is a matter of **professional judgement and experience**. (4) Apply only those steps and procedures which are useful in accomplishing the verification purpose in the specific situation. (5) Include the audit objectives for each area and sufficient details to serve as a set of instructions for the assistants, helping in controlling the proper execution of the work. (6) **Consider all possibilities of**

error — whether from fraud, mistake or omission. (7) **Co-ordinate the procedures to be applied to related items**, so the interrelationship of one audit step with another is established and no area is overlooked.

One programme cannot serve every business — this is the conclusion the case scenarios want. Businesses vary in nature, size and composition; work which is suitable to one business may not be suitable to others; the efficiency and operation of internal controls and the exact nature of the service to be rendered by the auditor are other factors that vary from assignment to assignment. On account of such variations, evolving one audit programme applicable to all businesses under all circumstances is not practicable. So where one engagement partner offers his programme to another for a different client, the answer is that the second partner is **correct to insist on a different audit programme**. The auditor should first frame a **minimum essential work programme, which may be termed a standard programme**, and then as experience is gained, alter it to take care of situations left out originally, and drop any work that proves beyond doubt to be unnecessary or irrelevant; and the assistant should be encouraged to keep an open mind beyond the programme given to him and **to note and report significant matters to his seniors or the partners**.

The eight advantages of an audit programme. (a) It provides the assistant carrying out the audit with a total and clear set of instructions of the work generally to be done. (b) It is essential, particularly for major audits, to provide a total perspective of the work to be performed. (c) Selection of assistants for the jobs on the basis of capability becomes easier when the work is rationally planned, defined and segregated. (d) Without a written and pre-determined programme, work is carried out on the basis of a '**mental**' plan, with the **danger of ignoring or overlooking certain books and records**; under a properly framed programme that danger is significantly less. (e) The assistants, by putting their signature on the programme, accept responsibility for the work carried out by them individually, and the work can be traced back to the assistant. (f) The principal can control the progress of the various audits in hand by examining the audit programmes initiated by the assistants. (g) **It serves as a guide for audits to be carried out in the succeeding year.** (h) A properly drawn up audit programme serves as evidence in the event of any charge of negligence being brought against the auditor, and may be of considerable value in establishing that **he exercised reasonable skill and care**.

The four disadvantages and how each is removed. (1) **The work may become mechanical** — particular parts may be carried out **without any understanding of the object of such parts in the whole audit scheme**. (2) **The programme tends to become rigid and inflexible**, following set grooves: the business may change in its operation or conduct but the old programme is still carried on, and changes in staff or internal control may make precautions necessary at different points. (3) **Inefficient assistants may take shelter behind the programme**, defending deficiencies on the ground that no instruction in the matter was contained in it. (4) A hard and fast programme may kill the initiative of efficient and enterprising assistants. The removal: **imaginative supervision of the work carried on by the assistants; the auditor must have a receptive attitude as regards the assistants**; and the assistants should be encouraged to observe matters objectively and bring

significant matters to the notice of the supervisor or principal.

Periodic review — the highest-frequency case scenario in this topic, and the conclusion is always the same. There should be periodic review of the audit programme to assess whether it continues to be adequate for obtaining the requisite knowledge and evidence about the transactions. The utility of the audit programme can be retained and enhanced only by keeping the programme, and also the client's operations and internal control, under periodic review so that inadequacies or redundancies may be removed. Unless this is done, any change in the business policy of the client may not be adequately known, and consequently audit work may be carried on on the basis of an obsolete programme — and for this negligence the whole audit may be held as negligently conducted and the auditor may have to face legal consequences. On rigidity: so long as the programme is not officially changed by the principal, every assistant deputed on the job should unflinching carry out the detailed work according to the instructions governing the work; the charge of rigidity **is not true provided the periodic review is undertaken** and assistants are encouraged to observe the salient features of the client's accounting functions. The responsibility to update and revise the programme lies with the auditor, not with the assistants.

Evidence, because the programme exists to obtain it. Audit evidence forms the foundation for forming an opinion, and identifying the best evidence for testing an assertion depends largely on the auditor's professional knowledge and experience — a primary responsibility of the auditor before finalising the audit programme. The broad categories are: **documentary examination; physical examination; statements and explanations from management, officials and employees; statements and explanations from third parties; arithmetical calculations performed by the auditor; evaluation of internal controls and internal checks; analysis of the inter-relationship among different accounting data; subsidiary and memorandum records; minutes; and subsequent actions taken by the client and by others.** Two one-line answers are printed: the most appropriate evidence for **cash in hand is physical count**, and for **investments pledged with a bank is the banker's certificate**. The format of a drafted programme, where the question asks you to draft one. Head it with name of concern, financial year, prepared by, reviewed by and approved by (each with a date), and rule columns for serial number, nature of procedure, extent of check, basis of sample and done by. For purchases the printed procedures are: **vouch a few purchase invoices from the purchase records; trace these invoices into the account books; verify a few purchase invoices on the GST portal; and trace a few purchase invoices into the stock records to ensure the goods have been added to the stock of raw material.**

Understanding explain it, and place it in context · 5 questions

- When asked about rigidity, give both halves — the assistant must follow the approved programme unflinching, and the charge of rigidity fails only because the principal reviews the programme periodically.

TQ 8.4 · RTP 2022-Nov [5] · Pg 79	LEVEL I Understanding	Medium
TQ 8.6 · MTP 2025-Mar S1 [2] (c) · 4M · Pg 80	LEVEL I Understanding	Medium
CSQ 8.8 · PYQ 2026-May [2] (b) · 5M · Pg 92	LEVEL I Understanding	Medium
TQ 8.5 · MTP 2024-Jul [6] (c) · 4M · Pg 80	LEVEL I Understanding	Hard

Application use the Standard - apply it to the facts · 8 questions

- For the reused-programme scenario, run the test in order: businesses vary and one programme cannot serve all; there must be periodic review; the client's changes are listed and matched to the audit areas they affect; the old programme is therefore obsolete; and continuing with it may amount to negligence with legal consequences.

TQ 8.7 · MTP 2025-Aug S2 [1] (b) · 5M · Pg 81	LEVEL II Application	Medium
CSQ 8.1 · PYQ 2024-May [1] (a) {C} · 4M · Pg 83	LEVEL II Application	Medium
CSQ 8.2 · RTP 2024-May [4] · Pg 84	LEVEL II Application	Medium
CSQ 8.3 · PYQ 2024-Sep [5] (a) · 4M · Pg 85	LEVEL II Application	Medium
CSQ 8.4 · PYQ 2025-Sep [1] (a) {C} · 5M · Pg 86	LEVEL II Application	Medium
CSQ 8.5 · MTP 2026-Mar S1 [2] (c) · 4M · Pg 87	LEVEL II Application	Medium
CSQ 8.6 · MTP 2026-Apr S2 [2] (c) · 4M · Pg 89	LEVEL II Application	Medium
TQ 8.3 · PYQ 2021-Dec [2] (b) · 4M · Pg 78	LEVEL II Application	Hard

Analysis break it down and take the parts separately · 1 question

- Where the scenario lists lettered problems — assistants unsure of procedures, no perspective on a multi-unit audit, no sign-offs, a mental plan last year — answer letter by letter, pairing each problem with the advantage of a written programme that cures it.

CSQ 8.7 · RTP 2026-May [10] · Pg 90	LEVEL II Analysis	Medium
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Synthesis integrate the material and construct · 1 question

- The statement to analyse is that the programme can only be framed **after** the internal control system is understood. Take the two halves in order: what the understanding gives the auditor, then what the programme does with it.

- Make the dependence concrete — the extent of the tests, and whether the auditor can rely on controls at all, both follow from that understanding.

TQ 8.1 · RTP 2018-Nov [9] (a) · Pg 75

LEVEL II
Synthesis

Hard

CHAPTER 3

Risk Assessment and Internal Control

15 Topics · 86 Classified Questions · Importance: A

ICAI SKILL PROFILE ICAI band for this paper: Level I 40-60% · Level II 40-60% — this chapter reads **on profile**

Level I — Comprehension & Knowledge **56.4%** 195 of 346 marks

Level II — Analysis & Application **43.6%** 151 of 346 marks

This chapter sits inside ICAI's own band for the paper — 56% Level I against 40-60%. Prepare it in those proportions: know the method, then drill it.

Topic 1: Audit Risk

L2P5-C3-T01

Read first Read ICAI Study Material Chapter 3, Risk Assessment and Internal Control — audit risk, its components, risks of material misstatement and misstatement.

NOTES

The definition, and it carries the mark on its own: audit risk is 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 and detection risk. Two things are **not** in it: (i) the risk that the auditor says the statements are materially misstated when they are not — **this risk is ordinarily insignificant**; and (ii) the auditor's **business risks** such as loss from litigation, adverse publicity or other events arising in connection with the audit. The assessment of risks is based on audit procedures to obtain the information necessary for that purpose and evidence obtained throughout the audit, and it is **a matter of professional judgement, not a matter capable of precise measurement** — the judgement expected is that of an auditor whose **training, knowledge and experience** have developed the competencies to reach reasonable judgements.

Three components; only one belongs to you. Inherent risk, control risk and detection risk. Inherent risk and control risk belong to the entity and are influenced by the entity; **the auditor can only influence detection risk**. Inherent risk is the susceptibility of an assertion about a class of transactions, account balance or disclosure to a misstatement that could be material, individually or when aggregated, before consideration of any related controls (SA 200) — higher, for example, for **complex calculations**, for a new or complex accounting standard management may not understand, and where there are **large numbers of business failures in the industry** or **technological developments that might make a product obsolete**. **Detection risk** is 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 and that could be material, either individually or when aggregated with other misstatements; it is reduced by increasing the area of checking, testing larger samples, and including competent and experienced persons in the engagement team. **The**

inverse relationship is the trap the pack sets twice: where the **risk of material misstatement has been assessed as high** — for instance a gross profit ratio jumping from 14% to 24%, pointing to overvaluation of inventories, overstatement of revenues or understatement of direct expenses — **detection risk must be kept low**, not high. The classic wrong answer says the opposite.

Detection risk comprises sampling risk and non-sampling risk. **Sampling risk** is the risk that the auditor's conclusion based on a sample may be different from the conclusion if the entire population were subjected to the same audit procedure; it produces two erroneous conclusions — (i) that controls are **more** effective than they are, or that a material misstatement does **not** exist when it does, which **affects audit effectiveness** and is the one the auditor is primarily concerned with because it is more likely to lead to an inappropriate opinion; and (ii) that controls are **less** effective than they are, or that a misstatement exists when it does not, which **affects audit efficiency** only. **Non-sampling risk** is the risk that the auditor reaches an erroneous conclusion for any reason not related to sampling risk — inappropriate audit procedures, misinterpretation of audit evidence, human mistakes, failure to recognise a misstatement or deviation, reliance on erroneous information.

Risks of material misstatement exist at two levels. The **overall financial statement level** — risks that relate pervasively to the financial statements as a whole and potentially affect many assertions; and the **assertion level** for classes of transactions, account balances and disclosures — assessed **in order to determine the nature, timing and extent of further audit procedures** needed to obtain sufficient appropriate audit evidence. Under SA 315, "Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment", the objective is to identify and assess those risks **whether arising from fraud or error**, at both levels, by obtaining an understanding of the entity and its environment including its internal control.

Misstatement, and the examples that are asked for by number. A misstatement is the difference between the amount, classification, presentation or disclosure of a reported financial statement item and the amount, classification, presentation or disclosure required for that item to be in accordance with the applicable financial reporting framework. **Misstatements can arise from error or fraud.** Examples: **charging an item of capital expenditure to revenue or vice versa**; difference in disclosure against the framework's requirement; **selection or application of inappropriate accounting policies**; difference in an accounting estimate against its appropriateness under the framework; **intentional booking of fake expenses**; **overstating receivables by not writing off irrecoverable debts**; **overstating or understating inventories**.

Risk assessment procedures — and their ceiling. **Analytical procedures performed as risk assessment procedures** may identify aspects of the entity of which the auditor was unaware; they may use **both financial and non-financial information** (the relationship between sales and square footage of selling space, or volume of goods sold) and help identify **unusual transactions or events, and amounts, ratios and trends**, especially **risks of material misstatement due to fraud**. But data aggregated at a high level gives **only a broad initial indication**, and risk assessment procedures by themselves do not provide sufficient appropriate audit evidence on which to base the audit opinion. **Inquiries** go beyond management: **internal audit personnel** (internal audit

procedures performed on the design and effectiveness of internal control and whether management responded to the findings), **in-house legal counsel** (litigation, compliance with laws, knowledge of fraud, warranties, post-sales obligations, arrangements with business partners, the meaning of contract terms), **marketing or sales personnel** (marketing strategies, sales trends, contractual arrangements with customers) and **information systems personnel** (system changes, system or control failures, other information system-related risks). **SA 300, "Planning an Audit of Financial Statements"** adds what must be considered **before** identifying and assessing the risks: the analytical procedures to be applied as risk assessment procedures, a general understanding of the legal and regulatory framework and the entity's compliance with it, **the determination of materiality**, the involvement of experts, and the performance of other risk assessment procedures.

Two fact patterns the pack keeps repeating. Fraud risk factors: a **strained relationship between management and the current or predecessor auditor** shows itself in frequent disputes on accounting, auditing or reporting matters; unreasonable demands such as unrealistic time constraints; restrictions that inappropriately limit access to people or information or the ability to communicate with those charged with governance; and domineering management behaviour, especially attempts to influence the scope of the work or the selection of personnel. **Discrepancies in the accounting records** indicating possible fraud include **unsupported or unauthorised balances or transactions**, **last-minute adjustments that significantly affect financial results**, evidence of employees' access to systems and records inconsistent with their authorised duties, and **tips or complaints to the auditor about alleged fraud**. **Litigation and claims:** where the auditor assesses a risk of material misstatement regarding identified litigation or claims, he shall seek direct communication with the entity's external legal counsel through a letter of inquiry; if law, regulation or the professional body **prohibits** the counsel from communicating directly, the auditor **shall perform alternative audit procedures**; and where a response to a **general** inquiry is unlikely, he may send a **letter of specific inquiry** containing (a) a list of litigation and claims, (b) management's assessment of the outcome of each and its estimate of the financial implications including costs, and (c) a request that counsel confirm the reasonableness of those assessments and supply further information if the list is incomplete or incorrect.

Remembering reproduce what you have learnt · 1 question

- Learn the definition of audit risk, inherent risk and detection risk word for word. Each is a one-line answer that carries a full mark, and the examiner sets them as stand-alone parts.

TQ 1.6 · PYQ 2023-Nov [2] (b) · 4M · Pg 103

LEVEL I
Remembering

Medium

Understanding explain it, and place it in context · 14 questions

- Always finish the components question by saying which component the auditor can influence and which two he cannot. An answer that lists the three without that sentence loses the point of the question.

- When asked what audit risk does not include, give both exclusions — the insignificant reverse risk and the auditor's business risks.

TQ 1.1 · RTP 2020-Nov [9] (a) · Pg 99	LEVEL I Understanding	Medium
TQ 1.2 · RTP 2020-Nov [10] (b) · Pg 100	LEVEL I Understanding	Medium
TQ 1.3 · RTP 2022-May [9] (b) · Pg 100	LEVEL I Understanding	Medium
TQ 1.5 · PYQ 2023-May [2] (b) · 4M · Pg 102	LEVEL I Understanding	Medium
TQ 1.8 · RTP 2024-May [5] · Pg 104	LEVEL I Understanding	Medium
TQ 1.9 · MTP 2025-Jul S1 [2] (c) · 4M · Pg 105	LEVEL I Understanding	Medium
TQ 1.10 · MTP 2025-Aug S2 [4] (c) · 4M · Pg 106	LEVEL I Understanding	Medium
TQ 1.11 · MTP 2025-Dec S2 [1] (a) · 5M · Pg 106	LEVEL I Understanding	Medium
TQ 1.12 · RTP 2026-Jan [11] · Pg 108	LEVEL I Understanding	Medium
CSQ 1.4 · MTP 2024-Dec S2 [5] (b) · 5M · Pg 111	LEVEL I Understanding	Medium
CSQ 1.5 · PYQ 2025-Sep [1] (b) {C} · 5M · Pg 113	LEVEL I Understanding	Medium
CSQ 1.6 · MTP 2025-Nov S1 [1] (a) · 5M · Pg 114	LEVEL I Understanding	Medium
CSQ 1.8 · MTP 2026-Mar S1 [1] (a) {C} · 5M · Pg 116	LEVEL I Understanding	Medium
CSQ 1.9 · PYQ 2026-Sep [4] (a) · 5M · Pg 118	LEVEL I Understanding	Medium

Application use the Standard - apply it to the facts · 4 questions

- Name the risk first, define it in the Standard's words, then anchor it in the facts, then conclude. In the small-sample and the high-gross-profit scenarios the conclusion is the mark: detection risk must be kept low.
- Where a scenario gives you an example of a misstatement (capital expenditure charged to revenue), say it is a misstatement, say why, then give the definition and the further examples asked for.

TQ 1.4 · PYQ 2023-May [2] (a) · 4M · Pg 101	LEVEL II Application	Medium
CSQ 1.2 · MTP 2024-Jul [1] (b) {C} · 5M · Pg 109	LEVEL II Application	Medium

CSQ 1.3 • MTP 2024-Nov [1] (c) {C} • 4M • Pg 110

LEVEL II
Application

Medium

CSQ 1.7 • PYQ 2026-Jan [4] (a) • 5M • Pg 115

LEVEL II
Application

Medium

Analysis break it down and take the parts separately • 2 questions

- Where two risks could fit, name the one that does not apply and say why not. Distinguishing sampling risk from non-sampling risk is what separates the marks.

TQ 1.7 • PYQ 2023-Nov [4] (c) • 3M • Pg 103

LEVEL II
Analysis

Medium

CSQ 1.1 • PYQ 2024-May [2] (a) • 4M • Pg 108

LEVEL II
Analysis

Medium

Topic 2: Materiality

L2P5-C3-T02

Read first Read ICAI Study Material Chapter 3, Risk Assessment and Internal Control — materiality in planning and performing an audit under SA 320.

NOTES

The Standard: SA 320, “Materiality in Planning and Performing an Audit”, requires the auditor to consider **materiality and its relationship with audit risk** while conducting the audit. Financial reporting frameworks generally explain materiality in three propositions: (1) misstatements, including omissions, are material if they, individually or in the aggregate, could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements; (2) judgements about materiality are made in the light of surrounding circumstances and are affected by the size or nature of a misstatement, or a combination of both; and (3) judgements are based on **the common financial information needs of users as a group** — the possible effect on specific individual users, whose needs may vary widely, is not considered.

Materiality cannot be fixed for all situations. What is material in one situation may not be material in another: ₹5,000 may be material for a small entity, but even ₹1,00,000 may not be material for a large entity. At the **planning** stage the auditor considers materiality **for the financial statements as a whole** and carries out a preliminary identification of significant components and material classes of transactions, account balances and disclosures he plans to examine; this preliminary assessment helps him decide **what items to examine and whether to use sampling and analytical procedures**. Note the point examiners like: the assessment of materiality and audit risk may be different at the time of initially planning the audit from what it is at the time of evaluating the results of audit procedures.

The four assumptions about users — these are a stand-alone four-mark answer. It is reasonable for the auditor to assume that users: (1) have reasonable knowledge of business and economic

activities and accounting, and a willingness to study the information in the financial statements with reasonable diligence; (2) understand that financial statements are prepared, presented and audited to levels of materiality; (3) recognise the uncertainties inherent in the measurement of amounts based on the use of estimates, judgement and the consideration of future events; and (4) make reasonable economic decisions on the basis of the information in the financial statements.

Benchmarks. Determining materiality involves the exercise of professional judgement, and a percentage is often applied to a chosen benchmark as a starting point in determining materiality for the financial statements as a whole. **Factors affecting the identification of an appropriate benchmark:** (a) **the elements of the financial statements** — assets, liabilities, equity, revenue, expenses; (b) whether there are items on which the attention of the users of that entity's financial statements tends to be focused — for evaluating financial performance users may focus on profit, revenue or net assets; (c) the nature of the entity, where it is in its life cycle, and the industry and economic environment in which it operates; (d) **the entity's ownership structure and the way it is financed** — an entity financed solely by debt rather than equity leads users to emphasise assets and claims on them rather than earnings; and (e) **the relative volatility of the benchmark.**

Which benchmark, on the facts. Examples of benchmarks include categories of reported income such as profit before tax, total revenue, gross profit and total expenses, total equity or net asset value. Profit before tax from continuing operations is often used for profit-oriented entities. The examined twist: when profit before tax from continuing operations is volatile, other benchmarks may be more appropriate, such as gross profit or total revenues. So in a scenario where profit swings but revenue and gross profit are stable, say so and switch the benchmark — that is where the application marks sit.

Concluding on materiality at the end of the audit. To conclude whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, the engagement partner considers: (1) the auditor's conclusion, in accordance with SA 330, whether sufficient appropriate audit evidence has been obtained; (2) the auditor's conclusion, in accordance with SA 450, whether uncorrected misstatements are material, individually or in the aggregate; and (3) the evaluation of whether the financial statements are prepared in accordance with the requirements of the applicable financial reporting framework, including consideration of the qualitative aspects of the entity's accounting practices and indicators of possible bias in management's judgements.

Understanding explain it, and place it in context · 1 question

- Tie materiality to audit risk every time; SA 320 is about the relationship, not about materiality in isolation.
- Say that materiality is a matter of professional judgement before you give the mechanics; the printed answers open with it.

Application use the Standard - apply it to the facts · 5 questions

- Where the scenario gives volatile profit but stable revenue, run the benchmark factors first, then name the appropriate benchmark and say why profit before tax is unsuitable here. The conclusion on the benchmark is the marked step.

TQ 2.1 · RTP 2021-May [5] (b) · Pg 119	LEVEL II Application	Medium
TQ 2.3 · RTP 2022-May [5] · Pg 121	LEVEL II Application	Medium
TQ 2.4 · PYQ 2023-Nov [4] (a) · 4M · Pg 122	LEVEL II Application	Medium
CSQ 2.1 · PYQ 2021-Dec [5] (a) · 4M · Pg 122	LEVEL II Application	Medium
CSQ 2.2 · MTP 2026-Apr S2 [1] (a) {C} · 5M · Pg 123	LEVEL II Application	Medium

Topic 3: Understanding the Entity and its Environment

L2P5-C3-T03

Read first Read ICAI Study Material Chapter 3, Risk Assessment and Internal Control — understanding the entity and its environment under SA 315.

NOTES

The five heads of understanding under SA 315, “Identifying and Assessing the Risk of Material Misstatement through Understanding the Entity and Its Environment” — learn them as a list, because the question is usually “guide the auditor” and marks follow the heads named: (a) relevant industry, regulatory and other external factors including the applicable financial reporting framework; (b) **the nature of the entity** — its operations, its ownership and governance structures, the types of investments it is making and plans to make including investments in special-purpose entities, and the way it is structured and how it is financed — so as to understand the classes of transactions, account balances and disclosures to be expected in the financial statements; (c) the entity's selection and application of accounting policies, including the reasons for changes, which the auditor must evaluate for appropriateness to the business and consistency with the framework and with the industry; (d) the entity's objectives and strategies, and those related business risks that may result in risks of material misstatement; and (e) **the measurement and review of the entity's financial performance**.

Why it matters beyond the audit plan: without adequate knowledge of the client's business, a proper audit is not possible. Such knowledge also helps the auditor identify areas of special audit consideration, evaluate the reasonableness of accounting estimates and management representations, and make judgements about the appropriateness of accounting policies and disclosures. Examples under head (a): the competitive environment, including demand, capacity,

product and price competition as well as cyclical or seasonal activity; **supplier and customer relationships**, such as types of suppliers and customers (related parties, unified buying groups) and the related contracts; **technological developments** relating to products, energy supply and cost; and **the effect of regulation on entity operations**.

The understanding is continuous, not a one-off at planning. Obtaining an understanding of the entity and its environment, including internal control, is a continuous, dynamic process of gathering, updating and analysing information throughout the audit. It establishes a frame of reference within which the auditor plans the audit and exercises professional judgement — when **assessing risks of material misstatement, determining materiality in accordance with SA 320**, considering the selection and application of accounting policies, **identifying areas where special audit consideration may be necessary** (related party transactions, the appropriateness of management's use of the going concern assumption, the business purpose of transactions), developing expectations for analytical procedures, and evaluating **the sufficiency and appropriateness of audit evidence obtained**.

Objectives, strategies and business risks. If management's objective is to grow the business, it may adopt steady but regular growth through specific marketing campaigns and development of new markets, or a **more aggressive, complex strategy of acquiring competitors** — each gives rise to differing business risks and potentially differing risks of material misstatement. Examples of potential business risks: **failure to keep up to date with new products, technologies or services**; excessive reliance on a key supplier, product or individual, such as the owner; **lack of personnel with expertise to react to changes in the industry**; insufficient or excessive production capacity caused by inaccurate estimation of demand; and **loss of financing due to the entity's inability to meet financial covenants**.

Circumstances in which risks can arise or change — the nine, and the examiner wants the reason attached to each: **changes in operating environment** (regulatory or operating changes alter competitive pressures and bring significantly different risks); **new personnel** (a different focus on or understanding of internal control); **new or revamped information systems** (significant and rapid change alters the risk relating to internal control); **rapid growth** (rapid expansion strains controls and increases the risk of a breakdown); **new technology** (new technologies in production or information systems change the risk associated with internal control); **new business models, products or activities** (little experience introduces new risks); **corporate restructurings** (staff reductions and changes in supervision and segregation of duties); **expanded foreign operations** (new and often unique risks, for example from foreign currency transactions); and **new accounting pronouncements** (adopting or changing accounting principles affects risks in preparing financial statements).

Inquiries of others within the entity — not only management. Much of the information comes from management and those responsible for financial reporting, but a **different perspective** comes from employees at different levels of authority: **those charged with governance** help the auditor understand the environment in which the financial statements are prepared; **internal audit personnel** on internal audit procedures performed during the year on the design and effectiveness

of internal control and management's response to the findings; employees involved in initiating, processing or recording complex or unusual transactions, to evaluate the selection and application of accounting policies; **in-house legal counsel** on litigation, compliance with laws and regulations, knowledge of fraud or suspected fraud, warranties, post-sales obligations, arrangements with business partners and the meaning of contract terms; **marketing or sales personnel** on marketing strategies, sales trends and contractual arrangements with customers; **the risk management function** on operational and regulatory risks affecting financial reporting; and **information systems personnel** on system changes, system or control failures and other information system-related risks.

The four steps of identification and assessment, which follow the understanding and are frequently set on their own: (1) identify risks throughout the process of obtaining an understanding of the entity and its environment, including relevant controls that relate to the risks, and by considering the classes of transactions, account balances and disclosures in the financial statements; (2) assess the identified risks and evaluate whether they relate more pervasively to the financial statements as a whole and potentially affect many assertions; (3) relate the identified risks to what can go wrong at the assertion level, taking account of relevant controls that the auditor intends to test; and (4) consider the likelihood of misstatement, including the possibility of multiple misstatements, and whether the potential misstatement is of a magnitude that could result in a material misstatement.

Understanding explain it, and place it in context • 4 questions

- Open with 'without adequate knowledge of the client's business, a proper audit is not possible' and name SA 315 with its full title. The printed answers do both.
- When asked why the understanding is continuous, give the uses of the frame of reference — materiality, accounting policies, analytical expectations, evaluating evidence.

TQ 3.2 • RTP 2020-May [5] (a) • Pg 126	LEVEL I Understanding	Medium
TQ 3.4 • RTP 2020-Nov [9] (b) • Pg 127	LEVEL I Understanding	Medium
TQ 3.5 • RTP 2020-Nov [10] (a) • Pg 128	LEVEL I Understanding	Medium
TQ 3.6 • RTP 2022-May [4] (b) • Pg 129	LEVEL I Understanding	Medium

Application use the Standard - apply it to the facts • 2 questions

- Where the question asks you to guide a named auditor, set out the SA 315 heads and attach the scenario's facts to the head each one falls under, rather than writing the list in the abstract.

TQ 3.1 • PYQ 2019-Nov [2] (a) • 5M • Pg 125	LEVEL II Application	Medium
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CSQ 3.1 · PYQ 2023-May [4] (a) · 4M · Pg 130

LEVEL II
Application

Medium

Analysis break it down and take the parts separately · 1 question

- The statement calls the understanding a **continuous, dynamic process**. Answer that adjective: say what makes it continuous, and give the examples the question asks for.
- Cover gathering, updating and analysing as three activities running through the audit, not a stage completed at the start.

TQ 3.3 · RTP 2020-May [9] (b) · Pg 127

LEVEL II
Analysis

Medium

Topic 4: Internal Control

L2P5-C3-T04

Read first Read ICAI Study Material Chapter 3, Risk Assessment and Internal Control — internal control and its five components.

NOTES

The five components, in the order the answers print them: (1) the control environment; (2) the entity's risk assessment process; (3) monitoring of controls; (4) control activities; and (5) the information system, including the related business processes, relevant to financial reporting, and communication. The division of internal control into five components provides a useful framework for the auditor to consider how different aspects of an entity's internal control may affect the audit. **Benefits of understanding internal control:** it assists the auditor in **identifying types of potential misstatements, identifying factors that affect the risks of material misstatement, and designing the nature, timing and extent of further audit procedures. But not every control has to be assessed — and that is a set question.** Although most controls relevant to the audit are likely to relate to financial reporting, not all controls that relate to financial reporting are relevant to the audit; it is a matter of the auditor's professional judgement whether a control, individually or in combination with others, is relevant. Where a company has controls addressing financial reporting, operational efficiency and compliance, the correct conclusion is that only those controls relevant to mitigating the risk of material misstatement need be assessed. **The factors bearing on that judgement: materiality; the significance of the related risk; the size of the entity;** the nature of the entity's business, including its organisation and ownership characteristics; **the diversity and complexity of the entity's operations; applicable legal and regulatory requirements; the circumstances and the applicable component of internal control;** the nature and complexity of the systems that are part of internal control, including the use of service organisations; and whether, and how, a specific control, individually or in combination with others, prevents, or detects and corrects, material misstatement.

Control environment. It is the set of standards, processes and structures that provide the basis for

carrying out internal control across the organisation. **The seven elements: communication and enforcement of integrity and ethical values; commitment to competence** (management's consideration of the competence levels for particular jobs and how those translate into requisite skills and knowledge); **participation by those charged with governance** (their independence from management, experience and stature, the extent of their involvement and scrutiny, and the information they receive); **management's philosophy and operating style** (its approach to taking and managing business risks and its attitudes to financial reporting, information processing and accounting functions and personnel); **organisational structure** (the framework within which activities are planned, executed, controlled and reviewed); **assignment of authority and responsibility** (how authority and responsibility for operating activities are assigned and how reporting relationships and authorisation hierarchies are established); and **human resources policies and practices** (recruitment, training, appraisal, promotion). The control environment includes the governance and management functions and the attitude, awareness and actions of those charged with governance and management, and it sets the tone of an organisation, influencing the control consciousness of its people. In **evaluating** it the auditor evaluates whether **management has created and maintained a culture of honesty and ethical behaviour** and whether the strengths in the control environment elements collectively provide an appropriate foundation for the other components of internal control.

The control environment is not an absolute deterrent to fraud — say this in as many words. **A satisfactory control environment does not guarantee protection against fraud; it is a positive factor when the auditor assesses the risks of material misstatement** but it **cannot fully eliminate** fraud. A control environment alone does not prevent, detect or correct a material misstatement; it influences the auditor's evaluation of **the effectiveness of other controls**, for example how the monitoring of controls and specific control activities contribute to the assessment of risks. Conversely, **weaknesses in the control environment undermine the other controls** — if management fails to allocate sufficient resources to address IT security risks, unauthorised changes to programs or data and processing of unauthorised transactions become possible. Any claim in a scenario that “fraud cannot happen” is wrong on the printed answer.

The two components students swap: control activities and monitoring. Control activities are the policies and procedures that help ensure that management directives are carried out; they exist **within IT or manual systems**, have various objectives and apply at various organisational and functional levels — segregation of duties, so that the person recording a transaction is different from the person authorising it, is a control activity. The auditor needs an understanding of only those control activities related to significant classes of transactions, account balances and disclosures and the assertions he finds relevant; relevant control activities are those relating to significant risks and those relating to risks for which substantive procedures alone do not provide sufficient appropriate audit evidence, or those the auditor judges relevant. Monitoring of controls is a process to assess the effectiveness of internal control performance over time — it asks whether controls are operating as intended and are modified as appropriate for changes in conditions, and involves **assessing effectiveness on a timely basis and taking necessary remedial actions**. Management accomplishes it through **ongoing monitoring activities** (built into normal

recurring activities, including regular management and supervisory activities), **separate evaluations** (performed periodically, for example through internal audit), **information from external parties** (customer complaints, regulator comments indicating problems or areas needing improvement), and **in small entities, the owner-manager's close involvement in operations**, which identifies significant variances from expectations and inaccuracies in financial data.

The entity's risk assessment process, and the information system. For the **risk assessment process** the auditor obtains an understanding of whether the entity has a process for **identifying business risks relevant to financial reporting objectives, estimating the significance of the risks, assessing the likelihood of their occurrence and deciding about actions to address those risks**; if that process is appropriate it assists the auditor in identifying risks of material misstatement, and **whether it is appropriate to the circumstances is a matter of judgement**. For the information system, including the related business processes, relevant to financial reporting, the auditor obtains an understanding of: the classes of transactions in the entity's operations that are significant to the financial statements; the procedures by which those transactions are initiated, recorded, processed, corrected as necessary, transferred to the general ledger and reported in the financial statements; the related accounting records, supporting information and specific accounts used to initiate, record, process and report transactions; how the information system captures events and conditions that are significant to the financial statements; **the financial reporting process used to prepare the financial statements**; and **controls surrounding journal entries**.

Inherent limitations of internal control — the answer to every “why did the controls fail even though they existed” scenario: (1) internal control, no matter how effective, can provide only reasonable assurance about achieving the entity's financial reporting objectives; (2) human judgement in decision-making can be faulty and breakdowns can occur because of human error; (3) **lack of understanding of the purpose** — an exception report is not effectively used because the person reviewing it does not understand its purpose or fails to act; (4) **collusion of two or more people, or inappropriate management override** — side agreements with customers altering standard sales terms leading to improper revenue recognition, or edit checks on credit limits being overridden or disabled; and (5) **judgements by management** on the nature and extent of the controls it chooses to implement and the risks it chooses to assume.

Where inadequate control shows up in the exam. Inadequate internal control over assets may increase the susceptibility of misappropriation of those assets: inadequate **segregation of duties or independent checks**; inadequate **oversight of senior management expenditures** such as travel and other reimbursements; inadequate **management oversight of employees responsible for assets**, for example poor supervision of remote locations; inadequate **job applicant screening** of employees with access to assets; inadequate **record keeping**; inadequate **system of authorisation and approval of transactions**; inadequate physical safeguards over cash, investments, inventory or fixed assets; **lack of complete and timely reconciliations**; **lack of timely and appropriate documentation of transactions**, for example credits for merchandise returns; and lack of mandatory vacations for employees performing key control functions. Where deficiencies are identified, the auditor determines the significant financial statement assertions affected by the

ineffective controls: if the deficiency relates to **the only control identified for an assertion**, he revises the assessment to **'not rely on controls'**; if it relates to one **'what can go wrong' out of several**, he may still **'rely on controls' but performs additional substantive procedures** to address the risk.

Remembering reproduce what you have learnt • 4 questions

- Name all five components before explaining any one of them, and all seven elements of the control environment before expanding them. Marks follow the number of items named.

TQ 4.1 • PYQ 2019-Nov [5] (d) • 4M • Pg 132	LEVEL I Remembering	Medium
TQ 4.4 • MTP 2020-Oct [3] (b) • 4M • Pg 134	LEVEL I Remembering	Medium
CSQ 4.4 • MTP 2025-Aug S2 [1] (a) • 5M • Pg 146	LEVEL I Remembering	Medium
CSQ 4.5 • PYQ 2026-May [2] (a) • 5M • Pg 147	LEVEL I Remembering	Medium

Understanding explain it, and place it in context • 6 questions

- When asked about a single component, define it, say how management operates it, and then say what the auditor obtains an understanding of. The printed answers follow that order.
- Say expressly that internal control gives only reasonable assurance whenever limitations are in issue.

TQ 4.3 • PYQ 2020-Nov [3] (a) • 4M • Pg 133	LEVEL I Understanding	Medium
TQ 4.7 • RTP 2021-May [10] (a) • Pg 137	LEVEL I Understanding	Medium
TQ 4.8 • RTP 2021-May [10] (b) • Pg 138	LEVEL I Understanding	Medium
TQ 4.11 • MTP 2024-Jul [5] (b) • 5M • Pg 141	LEVEL I Understanding	Medium
TQ 4.12 • PYQ 2026-Sep [6] (b) • 5M • Pg 141	LEVEL I Understanding	Medium
TQ 4.5 • RTP 2021-May [9] (a) • Pg 135	LEVEL I Understanding	

Application use the Standard - apply it to the facts • 4 questions

- Where the scenario describes a lapse, name the component or the limitation first, then map the facts to it. Duplicate payments and collusion are limitations; segregation of duties is a control activity; 'are controls modified for changed conditions' is monitoring.
- If a scenario claims a good control environment makes fraud impossible, contradict it in the first line and then give the reasons.

CSQ 4.1 • PYQ 2022-Nov [4] (a) • 4M • Pg 142	LEVEL II Application	Medium
CSQ 4.3 • PYQ 2025-Jan [1] (c) {C} • 4M • Pg 145	LEVEL II Application	Medium
TQ 4.2 • RTP 2020-May [9] (a) • Pg 133	LEVEL II Application	Hard
TQ 4.6 • RTP 2021-May [9] (b) • Pg 136	LEVEL II Application	Hard

Analysis break it down and take the parts separately • 3 questions

- Where two situations are given and you must identify the component in each, take them one at a time, name the component, define it, and only then explain why the facts fall under it.

TQ 4.9 • RTP 2022-May [10] • Pg 139	LEVEL II Analysis	Medium
CSQ 4.2 • PYQ 2024-Sep [3] (a) • 4M • Pg 143	LEVEL II Analysis	Medium
TQ 4.10 • RTP 2022-Nov [9] (a) • Pg 140	LEVEL II Analysis	

Topic 5: Risks that Require Special Audit Consideration

L2P5-C3-T05

Read first Read ICAI Study Material Chapter 3, Risk Assessment and Internal Control — significant risks and risks that require special audit consideration.

NOTES

The rule: under SA 315, in exercising judgement as to which risks are significant risks, **the auditor shall consider at least the following — the complexity of transactions; whether the risk is a risk of fraud; whether the risk involves significant transactions with related parties;** whether the risk is related to recent significant economic, accounting or other developments such as changes in the regulatory environment, and therefore requires specific attention; whether the risk involves significant transactions that are outside the normal course of business for the entity, or that otherwise appear to be unusual; and the degree of subjectivity in the measurement of financial information related to the risk, especially measurements involving a wide range of measurement uncertainty. The phrase **“at least”** matters — the list is a minimum, not a ceiling.

Significant risks often relate to significant non-routine transactions or judgemental matters. Non-routine transactions are transactions that are unusual, due to either size or nature, and that therefore occur infrequently. Risk of material misstatement is **greater for significant non-routine transactions** because of: **greater management intervention to specify the accounting treatment;**

greater manual intervention for data collection and processing; complex calculations or accounting principles; and the nature of non-routine transactions, which may make it difficult for the entity to implement effective controls over the risks.

The second limb, and it is the one candidates drop. Risk of material misstatement is greater for significant judgemental matters that require the development of accounting estimates because accounting principles for accounting estimates or revenue recognition may be subject to differing interpretation, and because the required judgement may be subjective or complex, or require assumptions about the effects of future events, for example judgement about fair value. A question that quotes only the non-routine limb still expects you to know which limb you are in; a question that quotes both expects both lists.

Internal control, defined by SA 315, is set under this head too. Internal control is the process designed, implemented and maintained by those charged with governance, management and other personnel to provide reasonable assurance about the achievement of an entity's objectives with regard to the reliability of financial reporting, effectiveness and efficiency of operations, safeguarding of assets, and compliance with applicable laws and regulations. **Benefits of understanding internal control: identifying types of potential misstatements; identifying factors that affect the risks of material misstatement; and designing the nature, timing and extent of further audit procedures.** Quote the definition whole — the four objectives at its end are separately marked.

Understanding explain it, and place it in context · 1 question

- Define a non-routine transaction before listing why its risk is greater. The definition — unusual by size or nature, occurring infrequently — is a mark on its own.

TQ 5.3 · PYQ 2022-Nov [4] (c) · 3M · Pg 152

LEVEL I
Understanding

Easy

Application use the Standard - apply it to the facts · 3 questions

- Where the scenario states one reason and asks for 'the other matters', agree with the view in one line, then give the complete list including the reason already stated, and close by confirming the auditor's view is correct.

TQ 5.2 · RTP 2021-Nov [9] (b) · Pg 151

LEVEL II
Application

Medium

CSQ 5.1 · MTP 2026-Mar S1 [6] (c) · 4M · Pg 153

LEVEL II
Application

Medium

TQ 5.1 · PYQ 2018-Nov [6] (a) · 4M · Pg 150

LEVEL II
Application

Hard

Topic 6: Evaluation of Internal Control System

L2P5-C3-T06

Read first Read ICAI Study Material Chapter 3, Risk Assessment and Internal Control — evaluation of the internal control system and the methods of evaluation.

NOTES

The rule in one line: so far as the auditor is concerned, the examination and evaluation of the internal control system is an indispensable part of the overall audit programme. The auditor needs reasonable assurance that the accounting system is adequate and that all the accounting information which should be recorded has in fact been recorded, and internal control normally contributes to that assurance. He should gain an understanding of the accounting system and related internal controls and should study and evaluate the operation of those internal controls upon which he wishes to rely in determining the nature, timing and extent of other audit procedures.

The benefits of evaluation — a long list, and the marks are per item. The review of internal controls enables the auditor to know: whether errors and frauds are likely to be located in the ordinary course of operations of the business; whether an adequate internal control system is in use and operating as planned by the management; **whether an effective internal auditing department is operating; whether any administrative control has a bearing on his work** — if control over worker recruitment and enrolment is weak, dummy names may be included in the wages sheet, and that is relevant to the auditor; **whether the controls adequately safeguard the assets**; how far and how adequately management is discharging its function so far as correct recording of transactions is concerned; **how reliable the reports, records and certificates to the management can be**; the extent and depth of the examination needed in the different areas of accounting; what would be the appropriate audit technique and audit procedure in the given circumstances; **what are the areas where control is weak and where it is excessive**; and **whether some worthwhile suggestions can be given to improve the control system**.

The administrative-control limb is the one the case scenario turns on. Where the facts say the auditor looked not only at accounting controls but also at administrative controls, the wages-sheet example above is the answer the examiner wants: an administrative control can bear on the auditor's work even though it is not an accounting control.

Methods of evaluation — the internal control questionnaire. Where the auditor prepares a set of questions to be circulated among the executives and employees for their response, in order to collect information about the existence, operation and efficiency of internal controls, the method is the **internal control questionnaire**. A creditors questionnaire runs: **are suppliers' invoices routed direct to the Accounts Department**; are they entered in a bill register before submission to other departments for check or approval; are **advance and partial payments entered on the invoices** before submission; does the system ensure that **all invoices are duly processed**; for raw materials and supplies, are reconciliations made of quantities and values received as shown by

purchase invoices with receipts into stock records; does the Accounts Department **match invoices with Goods Received Notes and purchase orders**; do all invoices **bear evidence of being checked for prices, freight, terms**; are **advance payments duly authorised by competent persons**; are duplicate invoices marked immediately on receipt to avoid payment against them; are **suppliers' statements compared with ledger accounts**, with **follow-up action to investigate differences**; and is a **list of unpaid creditors prepared and reconciled periodically**.

Evaluating operating effectiveness, and what to do on a deviation. The auditor shall evaluate whether misstatements detected by substantive procedures indicate that controls are not operating effectively; but the absence of misstatements detected by substantive procedures does not provide audit evidence that the controls related to the assertion being tested are effective. When deviations from controls upon which the auditor intends to rely are detected, he shall make specific inquiries to understand these matters and their potential consequences, and shall determine whether (a) the tests of controls performed provide an appropriate basis for reliance on the controls; (b) additional tests of controls are necessary; or (c) the potential risks of misstatement need to be addressed using substantive procedures. Note the closing line, which is regularly a mark: a material misstatement detected by the auditor's procedures is a strong indicator of the existence of a significant deficiency in internal control.

Application use the Standard - apply it to the facts · 2 questions

- When a scenario describes the auditor circulating questions, name the method first — internal control questionnaire — then produce the questions for the area given. Half the marks are in the questions themselves.

TQ 6.2 · MTP 2025-Jul S1 [1] (a) · 5M · Pg 155

LEVEL II
Application

Medium

CSQ 6.1 · PYQ 2018-May [5] (c) · 5M · Pg 156

LEVEL II
Application

Medium

Analysis break it down and take the parts separately · 1 question

- The ask is **why evaluation of internal control is indispensable to the audit programme**. Answer the 'why' before the 'how'.
- Link it to the assurance the auditor needs: that the accounting system is adequate, and that what should be recorded has been recorded.

TQ 6.1 · RTP 2019-May [10] (b) · Pg 153

LEVEL II
Analysis

Hard

Topic 7: Testing of Internal Control

L2P5-C3-T07

Read first Read ICAI Study Material Chapter 3, Risk Assessment and Internal Control — testing of

internal control, procedural tests and examination in depth.

NOTES

The rule: the actual operation of the internal control should be tested by the application of procedural tests and examination in depth. Procedural tests simply mean testing of compliance with the procedures laid down by the management in respect of initiation, authorisation, recording and documentation of a transaction at each stage through which it flows. The four words — **initiation, authorisation, recording and documentation** — are the frame for any “explain procedural tests” answer.

The worked example the answers use is sales. The procedure for sales requires: before acceptance of any order the position of inventory of the relevant article should be known, to ascertain whether the order can be executed in time; an advice under the authorisation of the sales manager should be sent to the party placing the order, giving the internal reference number and the acceptance of the order, prepared on a **standardised form**, with a **copy forwarded to the inventory section** so it can prepare for execution in time; the credit period allowed should be the normal credit period, and any special credit period needs a special authorisation of the sales manager; the rate at which the order has been accepted and the other terms about transport, insurance and so on should be clearly specified; and before deciding the credit period a reference should be made to the credit section to know the creditworthiness of the party, and particularly whether it has honoured its commitments in the past.

The four procedures used for tests of controls, with what each looks like. **Reperformance** — the auditor **independently reperforms the control**; reviewing the company's bank reconciliations and verifying their accuracy is a reperformance test. **Inquiry** — asking company personnel how controls are designed and whether they are followed, for example asking the finance team about the process for reconciling bank accounts. **Observation** — observing the actual application of a control procedure, for example watching accounting personnel perform bank reconciliations. **Inspection of documents** — examining documents, records or reports evidencing the performance of controls, such as bank reconciliation statements, approval sign-offs or internal control checklists. Add testing of internal control operating on specific computerised applications or over the overall information technology function, for example access or program change controls.

The identification step is where the mark is. Where a scenario describes the auditor independently redoing a reconciliation, name the test — **reperformance** — before you list the others. The examiner asks “what kind of test of control” first and “what other procedures” second; answering only the second half loses the first.

Understanding explain it, and place it in context · 1 question

- Define procedural tests using the four stages of the transaction flow before giving any example.

TQ 7.1 · RTP 2020-May [10] (b) · Pg 157

LEVEL I
Understanding

Medium

Application use the Standard - apply it to the facts · 1 question

- The sales example is expected in the sequence given — inventory position, authorised advice, credit period, terms, credit section reference. Keep the order.
- Name the test performed in the facts, then list the other procedures with one line each tied back to the same facts.

CSQ 7.1 · PYQ 2024-Sep [2] (a) · 4M · Pg 158

LEVEL II
Application

Medium

Topic 8: What is an Automated Environment?

L2P5-C3-T08

Read first Read ICAI Study Material Chapter 3, Risk Assessment and Internal Control — auditing in an automated environment, IT risks, types of IT controls and testing methods.

NOTES

Understanding the automated environment is compulsory, not optional. Understanding the entity and its automated environment involves understanding how the IT department is organised, IT activities, IT dependencies, and relevant risks and controls, so the suggestion that gaining knowledge of the company's IT systems depends on the auditor's judgement is **not valid**. **The points to consider: the information systems being used** (one or more application systems and what they are); **their purpose** (financial and non-financial); **location of IT systems — local versus global**; **architecture** (desktop based, client-server, web application, cloud based); **version**, because functions and risks could vary across versions of the same application; **interfaces within systems** where multiple systems exist; **in-house versus packaged**; **outsourced activities** (IT maintenance and support); and **key persons** (CIO, CISO, administrators). In a scenario where a company has moved to a fully automated ERP, add **documenting business processes using flowcharts or narratives, preparing Risk and Control Matrices (RCM), evaluating the design of controls through walkthroughs of end-to-end processes**, and process-wide considerations including entity-level controls, segregation of duties, and IT general and application controls — and say that **the understanding obtained should be appropriately documented**.

What an automated environment actually does, and the risks it brings. In a more automated environment: computations and calculations are carried out automatically (bank interest computation, inventory valuation); **accounting entries are posted automatically** (sub-ledger to general ledger postings); business policies and procedures, including internal controls, are applied automatically (delegation of authority for journal approvals, customer credit limit checks); **reports used in the business are produced from systems** and management and other stakeholders rely on them (debtors ageing report); and user access and security are controlled by assigning system

roles to users, so segregation of duties can be enforced effectively. **Risks arising from the use of IT systems:** inaccurate processing of data, processing inaccurate data, or both; **unauthorised access to data;** **direct data changes (back-end changes);** **excessive access or privileged access (super users);** **lack of adequate segregation of duties;** **unauthorised changes to systems or programs;** **failure to make necessary changes to systems or programs;** and **loss of data.**

The impact of unmitigated IT risk on the audit runs under three heads. Impact on substantive checking — inability to address the risks leads to **non-reliance on data obtained from systems**, so all information, data and reports have to be tested thoroughly for **completeness and accuracy**, which means increased substantive checking, more detailed checking, and additional time and resources. **Impact on controls** — non-reliance on automated controls, system calculations and accounting procedures built into applications, so the auditor must perform **additional audit work to compensate.** **Impact on reporting** — because of the regulatory requirements on **internal financial controls** for companies under the **Companies Act, 2013**, unmitigated IT risks may lead to **modification of the auditor's report**, since the auditor has to report on the **adequacy and operating effectiveness of internal financial controls.**

Types of controls in an automated environment: general IT controls, application controls and IT-dependent controls. **General IT controls** are policies and procedures that relate to many applications and support the effective functioning of application controls; they maintain **the integrity of information and security of data** and cover **data centre and network operations, program change, access security, and application systems acquisition, development and maintenance.** Access security: the objective is to ensure that access to programs and data is authenticated and authorised to meet financial reporting objectives, and its activities are security organisation and management; security policies and procedures; application security; data security; operating system security; network security — internal network and perimeter network; physical security — access controls and environment controls; and system administration and privileged accounts — sysadmins, DBAs, super users.

The classification table is set again and again, so learn which side each item falls on. **Application controls** — **reasonableness checks, sequence number checks, mandatory data fields.** **General IT controls** — **access security, controls over data centre and network operations, program change controls,** controls over application system acquisition, development and maintenance. The rule of thumb the answers bear out: a check built into the processing of a transaction is an **application control**; anything that governs the environment in which the applications run is a **general IT control.**

The four audit tests, and the ranking that carries the marks. Inquiry, observation, inspection and reperformance. Inquiry is the most efficient audit test but provides the least audit evidence, and inquiry alone is not sufficient — it must always be used in combination with another method. Reperformance is the most effective audit test and gives the best audit evidence, but it can be very time-consuming and is the least efficient most of the time. Generally, applying inquiry in combination with inspection gives the most effective and efficient audit evidence. Which test to use, when and in what combination is a matter of professional judgement, varying with the risk

assessment, the control environment, the desired level of evidence required, the history of errors or misstatements, the complexity of the business and the assertions being addressed; and the auditor should document the nature of the test or combination of tests applied, along with the judgements exercised, in the audit file.

How the testing is actually done, and what to do when the general IT controls fail. Common methods: **walkthrough** — obtain an understanding of how an automated transaction is processed by walking through one end-to-end transaction using a combination of inquiry, observation and inspection; **observation** of how a user processes transactions under different scenarios; **inspection of the configuration defined in an application**; **inspection of system logs** to determine changes made since the last audit testing; **inspection of technical or user manuals** of systems and applications; **negative testing** — carry out a test check and observe the error message displayed by the application; and **reperformance using CAATs** — using raw source data and independently applying formulae, business rules or validations with Computer Assisted Audit Techniques. Where general IT controls do not exist or are ineffective, the auditor should assess the impact of IT risks and the complexity of the automated environment and plan alternative audit procedures in order to rely on system-based information, which may include performing additional substantive procedures and reducing reliance on automated controls.

Remembering reproduce what you have learnt · 2 questions

- The nine points for understanding the automated environment, and the eight IT risks, are pure list marks. Learn them in the printed order.
- Learn the three impact heads — substantive checking, controls, reporting — as headings, then a sentence each.

TQ 8.5 · PYQ 2021-Dec [2] (d) · 3M · Pg 163

LEVEL I
Remembering

Easy

TQ 8.1 · PYQ 2018-May [2] (d) · 5M · Pg 159

LEVEL I
Remembering

Medium

Understanding explain it, and place it in context · 5 questions

- When you rank the four tests, give both dimensions for each: inquiry is most efficient but weakest evidence; reperformance is most effective but least efficient. An answer that gives only one dimension halves the mark.
- Always close a testing question with the sentence that the choice is a matter of professional judgement and must be documented in the audit file.

TQ 8.8 · MTP 2024-Mar [6] (d) · 3M · Pg 165

LEVEL I
Understanding

Easy

TQ 8.2 · PYQ 2018-May [6] (e) · 5M · Pg 160

LEVEL I
Understanding

Medium

TQ 8.9 · PYQ 2025-May [1] (b) {C} · 5M · Pg 166	LEVEL I Understanding	Medium
CSQ 8.3 · PYQ 2026-May [4] (a) · 5M · Pg 169	LEVEL I Understanding	Medium
TQ 8.6 · PYQ 2022-May [6] (c) · 3M · Pg 164	LEVEL I Understanding	Hard

Application use the Standard - apply it to the facts · 4 questions

- In a fill-the-table question, write the table out with both columns; do not answer in prose. Each row is a mark.
- Where the facts say general IT controls are missing or ineffective, the concluding step is alternative procedures — more substantive work and less reliance on automated controls. State it explicitly.

TQ 8.7 · PYQ 2022-Nov [2] (d) · 3M · Pg 164	LEVEL II Application	Easy
TQ 8.4 · PYQ 2021-Jan [4] (b) · 4M · Pg 161	LEVEL II Application	Medium
CSQ 8.1 · PYQ 2026-Jan [3] (c) · 4M · Pg 167	LEVEL II Application	Medium
CSQ 8.2 · MTP 2026-Apr S2 [6] (c) · 4M · Pg 168	LEVEL II Application	Medium

Analysis break it down and take the parts separately · 1 question

- The ask is the **impact on the audit** of unmitigated IT risk, not a list of IT risks. Each point must end in a consequence for the audit.
- Cover the three heads the answers use — the reliability of the data, the effect on the audit approach, and the extra procedures the auditor must then perform.

TQ 8.3 · PYQ 2020-Nov [3] (d) · 3M · Pg 161	LEVEL II Analysis	Medium
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Topic 9: Characteristics of Manual and Automated Elements of Internal Control Relevant to the Auditor's Risk Assessment

L2P5-C3-T09

Read first Read ICAI Study Material Chapter 3, Risk Assessment and Internal Control — the characteristics of manual and automated elements of internal control relevant to the auditor's risk assessment.

NOTES

The rule in one line: manual elements in internal control may be more suitable where judgement

and discretion are required. That sentence must open the answer, because the four circumstances that follow are all instances of it.

The four circumstances: (1) large, unusual or non-recurring transactions; (2) circumstances where errors are difficult to define, anticipate or predict; (3) changing circumstances that require a control response outside the scope of an existing automated control; and **(4) monitoring the effectiveness of automated controls.**

The fourth limb is the one that is dropped, and it is the interesting one: even in a heavily automated entity whose controls work effectively, **the monitoring of those automated controls is itself a manual element.** So an answer that treats automation and manual control as alternatives has missed the point — the manual element sits on top of the automated one.

How it is set: as a short list question of about three marks, usually inside a scenario that stresses how strong and how automated the entity's controls are. Do not be drawn into describing the automated controls; the question asks only when manual elements are **more suitable**.

Remembering reproduce what you have learnt · 1 question

- Four circumstances, four marks-worth. Open with the judgement-and-discretion line, then number them.

TQ 9.1 · PYQ 2024-May [3] (c) · 3M · Pg 171

LEVEL I
Remembering

Easy

Topic 10: Data Analytics for Audit

L2P5-C3-T10

Read first Read ICAI Study Material Chapter 3, Risk Assessment and Internal Control — data analytics for audit and Computer Assisted Audit Techniques.

NOTES

The definition, and it is the first mark: the combination of processes, tools and techniques that are used to tap vast amounts of electronic data to obtain meaningful information is called data analytics. Companies benefit from it through increased profitability, better customer service, competitive advantage and more efficient operations, and auditors can make use of similar tools and techniques in the audit process and obtain good results. The tools and techniques that auditors use in applying the principles of data analytics are known as Computer Assisted Audit Techniques, or CAATs.

Where it is used: data analytics can be used in the testing of electronic records and data residing in IT systems using spreadsheets and specialised audit tools, namely IDEA and ACL. Name the two tools — they are printed in the answer.

The uses, and marks follow the number named: check the completeness of data and of the population used in either tests of controls or substantive audit tests; **selection of audit samples — random sampling, systematic sampling**; re-computation of balances — reconstruction of the trial balance from transaction data; reperformance of mathematical calculations — depreciation, bank interest calculation; **analysis of journal entries as required by SA 240**; **fraud investigation**; and **evaluating the impact of control deficiencies**.

The context sentence the answers open with is worth a line: in a digital age where companies rely more and more on IT systems and networks to operate the business, **the amount of data and information existing in these systems is enormous** — which is why the auditor needs tools that can test a whole population rather than a sample.

Understanding explain it, and place it in context · 1 question

- Define data analytics first and then equate the auditor's version of it with CAATs. An answer that never uses the word CAAT has missed the term the examiner is testing.

TQ 10.1 · RTP 2018-Nov [13] · Pg 172

LEVEL I
Understanding

Medium

Analysis break it down and take the parts separately · 1 question

- The ask is the **functions the auditor can perform** with data analytics, so answer with audit tasks — testing whole populations, matching, recomputing, identifying exceptions — not with the benefits to the company.
- Name the tools or techniques where the answers name them, and say what each is used to test.

TQ 10.2 · PYQ 2020-Nov [3] (b) · 4M · Pg 173

LEVEL II
Analysis

Medium

Topic 11: Digital Audit

L2P5-C3-T11

Read first Read ICAI Study Material Chapter 3, Risk Assessment and Internal Control — digital audit and the use of digital technology in the conduct of an audit.

NOTES

The setting: entities are embracing digitisation as part of their operations to keep pace with changing times; new technologies are helping companies revamp their operations and rethink the way business is conducted, and **companies are restructuring their business models driven by technology. Automation is key to digitisation.** Open with this, because the question is always set on facts about a company digitising its operations.

The rule in one line: in such a business environment, use of digital technology is being made by auditors right from planning to the expression of the final opinion — that is, across the whole engagement, not at one stage of it.

What the auditor uses and what he gets: auditors are making use of artificial intelligence, data analytics and other latest technologies to help understand business processes in a better way; by using such tools auditors can conduct audits in a better way and devote more attention to areas requiring greater focus; and digital audit is helping auditors to better identify risk making use of technology. The three benefits — **better understanding of business processes, more attention to the areas that need it, better identification of risk** — are the marks.

Understanding explain it, and place it in context · 1 question

- This is a short descriptive question. Give the setting, then the 'planning to final opinion' sentence, then the three benefits — do not stray into data analytics uses, which belong to a separate topic.

CSQ 11.1 · PYQ 2024-Sep [5] (c) · 3M · Pg 174

LEVEL I
Understanding

Easy

Topic 12: Internal Financial Controls as per Regulatory Requirements

L2P5-C3-T12

Read first Read ICAI Study Material Chapter 3, Risk Assessment and Internal Control — internal financial controls as per the regulatory requirements of the Companies Act, 2013.

NOTES

The definition, from the Act, and it is quoted verbatim in every answer. The Explanation to clause (e) of sub-section (5) of Section 134 explains internal financial controls as “the policies and procedures adopted by the company for ensuring the orderly and efficient conduct of its business, including adherence to company's policies, the safeguarding of its assets, the prevention and detection of frauds and errors, the accuracy and completeness of the accounting records, and the timely preparation of reliable financial information.” Break it into its **five limbs** when the question says “explain the meaning”: (1) orderly and efficient conduct of business including adherence to company's policies; (2) safeguarding of assets; (3) prevention and detection of frauds and errors; (4) accuracy and completeness of the accounting records; and (5) timely preparation of reliable financial information.

The reporting requirement: clause (i) of sub-section (3) of Section 143 requires the auditor's report to state whether the company has an adequate internal financial controls system in place with reference to financial statements and the operating effectiveness of such controls. Two limits follow. First, the auditor's reporting on internal financial controls is a requirement specified in the Act, so it applies only to reporting on financial statements prepared under the Act and reported

under Section 143 — accordingly it does not apply to interim financial statements such as quarterly or half-yearly statements, unless required by some other law or regulation. Second, the auditor's objective in an audit of internal financial controls over financial reporting is to express an opinion on the effectiveness of the company's internal financial controls over financial reporting, carried out **along with the audit of the financial statements**; reporting under **Section 143(3)(i)** depends on the underlying criteria for internal financial controls over financial reporting adopted by the management, **any system of internal controls provides only a reasonable assurance** on achievement of its objectives, and the auditor shall use the concept of materiality in determining the extent of testing such controls.

The exemption, and the figures are the answer. The reporting requirement on the adequacy of internal financial controls with reference to financial statements **shall not apply to a private company which is:** (a) a One Person Company; or (b) a small company; or (c) a company having turnover less than ₹50 crore as per the latest audited financial statement and having aggregate borrowings from banks or financial institutions or any body corporate at any point of time during the financial year less than ₹25 crore. Get both figures and the words **“at any point of time during the financial year”** right; the borrowings test is not a year-end test.

Do not confuse this exemption with the CARO exemption — they are set together in the same question. The Companies (Auditor's Report) Order, 2020 does not apply to a private limited company which is not a subsidiary or holding company of a public company, provided it satisfies all of the following: (a) paid-up capital and reserves and surplus not exceeding ₹1 crore as on the balance sheet date; (b) total borrowings not exceeding ₹1 crore from any bank or financial institution at any point of time during the financial year; and (c) total revenue as disclosed in Schedule III to the Companies Act, including revenue from discontinuing operations, not exceeding ₹10 crore during the financial year as per the financial statements. The CARO conditions are **cumulative** — all three must be satisfied.

Internal financial control against internal control over financial reporting. **Internal financial control** is the **Section 134(5)(e)** concept set out above — the whole set of policies and procedures covering the conduct of business, assets, frauds and errors, accounting records and reliable financial information. **Internal control over financial reporting** is the narrower field in which the auditor is required to express an opinion on the effectiveness of an entity's internal controls over financial reporting, and that opinion is in addition to and distinct from the opinion expressed by the auditor on the financial statements. Say “in addition to and distinct from” — that phrase is the distinction.

Who is responsible, by section. **Section 134(5)(e):** in the case of **listed companies**, the **directors' responsibility statement** shall state that the directors had laid down internal financial controls to be followed by the company and that such internal financial controls are adequate and were operating effectively. **Section 149(8):** the company and independent directors shall abide by the provisions specified in **Schedule IV**, which lays down the **code for independent directors**; under that code the role and functions of independent directors include that they shall satisfy themselves on the integrity of financial information and that financial controls and the systems of risk

management are robust and defensible. **Section 177(4)(vii):** every **audit committee** shall act in accordance with the terms of reference specified in writing by the Board, which shall inter alia include **evaluation of internal financial controls and risk management systems**. Add **Rule 8(5)(viii) of the Companies (Accounts) Rules, 2014**, which requires the board report of all companies to state the details in respect of adequacy of internal financial controls with reference to the financial statements — and note that this is **in addition to** the directors' statement that they took proper and sufficient care for the maintenance of adequate accounting records for safeguarding the assets and for preventing and detecting fraud and other irregularities.

Understanding explain it, and place it in context • 2 questions

- Say expressly that reporting on internal financial controls arises from the Act, and therefore does not extend to interim financial statements unless some other law requires it.

TQ 12.2 • PYQ 2021-Jan [3] (b) • 4M • Pg 176

LEVEL I
Understanding

Medium

TQ 12.3 • RTP 2022-May [14] • Pg 177

LEVEL I
Understanding

Medium

Application use the Standard - apply it to the facts • 3 questions

- When asked about a private company, give the exemption conditions and then apply them to the figures in the question. If the question also asks about CARO, keep the two sets of thresholds under separate headings — mixing ₹50 crore/₹25 crore with ₹1 crore/₹1 crore/₹10 crore loses both answers.

CSQ 12.1 • PYQ 2024-May [1] (c) {C} • 3M • Pg 178

LEVEL II
Application

Easy

TQ 12.1 • RTP 2018-Nov [9] (b) • Pg 175

LEVEL II
Application

Medium

CSQ 12.2 • PYQ 2025-Sep [3] (a) • 5M • Pg 179

LEVEL II
Application

Hard

Topic 13: Documenting the Risks

L2P5-C3-T13

CONCEPT BASE — no exam question asked yet • essential for full preparation

Read first Read ICAI Study Material Chapter 3, Risk Assessment and Internal Control — documenting the risks identified and the understanding obtained.

NOTES

No question has been printed on this topic in the Scanner, but it is examinable and it is the step that closes the risk assessment. The understanding the auditor obtains of **the entity, its environment and each component of internal control** is **required to be documented in accordance with the Standards on Auditing**; the documentation is not optional and is not a substitute for the assessment itself.

What the answers elsewhere in this chapter treat as documentation of risk: documenting business processes using flowcharts or narratives; preparing Risk and Control Matrices (RCM) to identify risks and controls; evaluating the design of controls through walkthroughs of end-to-end processes; and recording process-wide considerations, including entity-level controls, segregation of duties, and IT general and application controls. In an automated environment the rule is stated flatly: the understanding of a company's IT environment that is obtained should be appropriately documented.

Documentation of the testing, not just of the risk. The auditor should document the nature of the test — or the combination of tests — applied, along with the judgements exercised, in the audit file. Because which audit test to use, when and in what combination is a matter of professional judgement, the judgement itself has to be on the file; an undocumented judgement cannot be defended later.

The link back to the rest of the chapter: what is documented is the identification and assessment of the risks of material misstatement at the financial statement level and at the assertion level, the **controls related to those risks**, and the **responses** designed against them. Read this topic together with the four-step identification and assessment process under SA 315 and with the assessment and reporting of audit findings, which is where the documented deficiencies are communicated onwards.

Topic 14: Assess and Report Audit Findings

L2P5-C3-T14

Read first Read ICAI Study Material Chapter 3, Risk Assessment and Internal Control — assessing and reporting audit findings in an IT environment and IT controls.

NOTES

The rule in one line: at the conclusion of each audit it is possible that there will be certain findings or exceptions in the IT environment and IT controls of the company that need to be assessed and reported to the relevant stakeholders, including management and those charged with governance, namely the Board of Directors and the Audit Committee. Name both sets of recipients — management **and** those charged with governance.

The four points of consideration — this is the whole answer, and it is asked in the same words every time: (1) Are there any weaknesses in IT controls? (2) What is the impact of these

weaknesses on the overall audit? (3) Report deficiencies to management — Internal Controls Memo or Management Letter. (4) Communicate in writing any significant deficiencies to those charged with governance. Keep the two reporting channels distinct: ordinary deficiencies go to management by internal controls memo or management letter; significant deficiencies must be communicated in writing to those charged with governance.

The step that turns a finding into a report: the auditor needs to assess each finding or exception to determine its impact on the audit and to evaluate whether the exception results in a deficiency in internal control. A finding is not reported merely because it is a finding; it is assessed first, for audit impact and for whether it amounts to a control deficiency.

Where management asks for the exceptions, the answer is not “no”. On facts where management requests the auditor's observations on exceptions in the IT environment, the printed answer is that **the auditor should report such exceptions to the relevant stakeholders** using the four points above. Do not write about confidentiality; the reporting obligation is the point being tested.

Remembering reproduce what you have learnt • 1 question

- Four points, three or four marks. Write them as four numbered questions and statements, in the printed order.

CSQ 14.1 • PYQ 2021-Jul [3] (d) • 3M • Pg 181

LEVEL I
Remembering

Easy

Understanding explain it, and place it in context • 2 questions

- Both questions ask what the auditor **considers in assessing and reporting** findings in the IT environment. Answer as points the auditor weighs, each with a consequence for the report.
- Say expressly which findings go to management, which to those charged with governance, and which affect the audit opinion.

TQ 14.1 • PYQ 2022-May [3] (d) • 3M • Pg 180

LEVEL I
Understanding

Easy

TQ 14.2 • PYQ 2025-Sep [6] (c) • 4M • Pg 181

LEVEL I
Understanding

Medium

Topic 15: The Auditors Responses to Assessed Risks SA-330

L2P5-C3-T15

Read first Read ICAI Study Material Chapter 3, Risk Assessment and Internal Control — the auditor's responses to assessed risks under SA 330.

NOTES

When tests of controls must be designed and performed. Under SA 330, the auditor shall design and perform tests of controls to obtain sufficient appropriate audit evidence as to the operating effectiveness of relevant controls when: (1) the auditor's assessment of risks of material misstatement at the assertion level includes an expectation that the controls are operating effectively — that is, the auditor intends to rely on the operating effectiveness of controls in determining the nature, timing and extent of substantive procedures; or (2) substantive procedures alone cannot provide sufficient appropriate audit evidence at the assertion level. The two limbs are alternatives, not cumulative — the word is “**or**”.

The reliance-evidence relationship: in designing and performing tests of controls, the auditor shall obtain more persuasive audit evidence, the greater the reliance the auditor places on the effectiveness of a control. And a higher level of assurance may be sought about the operating effectiveness of controls when the approach adopted consists primarily of tests of controls, in particular where it is not possible or practicable to obtain sufficient appropriate audit evidence only from substantive procedures. Both sentences are marked; the second is the answer to “why a higher level of assurance”.

How this plays out on facts. In a highly automated entity — a bank running a centralised core banking system for deposits, withdrawals, interest calculations and loan repayments — the auditor tests controls because **he intends to rely on their operating effectiveness and** because substantive procedures alone cannot provide sufficient evidence given the high volume and automated nature of transactions. The more persuasive evidence then takes the form of examining system logs, testing automated interest calculations, reviewing exception reports and observing authorisation controls in operation.

Using audit evidence about operating effectiveness obtained in previous audits. In deciding whether that is appropriate and, if so, **the length of the time period that may elapse before retesting a control**, the auditor considers: (1) the effectiveness of other elements of internal control, including the control environment, the entity's monitoring of controls and the entity's risk assessment process; (2) the risks arising from the characteristics of the control, including whether it is manual or automated; **(3) the effectiveness of general IT controls**; (4) the effectiveness of the control and its application by the entity, including the nature and extent of deviations in the application of the control noted in previous audits, and whether there have been personnel changes that significantly affect its application; (5) whether the lack of a change in a particular control poses a risk due to changing circumstances; and **(6) the risks of material misstatement and the extent of reliance on the control.**

Understanding explain it, and place it in context · 1 question

- State the two circumstances for tests of controls as alternatives and say so. Treating them as cumulative conditions is the common error.
- Link persuasiveness to reliance in one sentence — greater reliance, more persuasive evidence — before you give examples.

TQ 15.2 · MTP 2024-Nov [4] (b) · 5M · Pg 183

LEVEL I
Understanding**Hard****Application** use the Standard - apply it to the facts · 1 question

- In an automated scenario, say which of the two limbs is satisfied, and if both are, say both. Then give the form the evidence takes in that system — logs, recomputed calculations, exception reports, observed authorisations.

TQ 15.1 · PYQ 2019-Nov [3] (a) · 4M · Pg 182

LEVEL II
Application**Hard**

CHAPTER 4

Audit Evidence

8 Topics · 91 Classified Questions · Importance: A

ICAI SKILL PROFILE ICAI band for this paper: Level I 40-60% · Level II 40-60% — this chapter reads **on profile**

 Level I — Comprehension & Knowledge **53.3%** 195 of 366 marks

 Level II — Analysis & Application **46.7%** 171 of 366 marks

This chapter sits inside ICAI's own band for the paper — 53% Level I against 40-60%. Prepare it in those proportions: know the method, then drill it.

Topic 1: Audit Evidence

L2P5-C4-T01

Read first Read ICAI Study Material Chapter 4, Audit Evidence — SA 500 'Audit Evidence': the meaning of audit evidence, sufficiency and appropriateness, relevance and reliability, the audit procedures for obtaining evidence, the assertions, selection of items for testing and the work of a management's expert.

NOTES

The definition, and it opens every answer on this topic: audit evidence is the information used by the auditor in arriving at the conclusions on which the auditor's opinion is based. It includes both information contained in the accounting records underlying the financial statements and other information. **Accounting records** means the records of initial accounting entries and supporting records — cheques and records of electronic fund transfers, invoices, contracts, the general and subsidiary ledgers, journal entries and other adjustments to the financial statements that are not reflected in journal entries, and records such as worksheets and spreadsheets supporting cost allocations, computations, reconciliations and disclosures. **Other information** means, for example, minutes of the meetings, written confirmations from trade receivables and trade payables, and manuals containing details of internal control. Close with the Study Material's own sentence: a combination of tests of accounting records and other information is generally used by the auditor to support his opinion.

How the evidence is obtained. Audit evidence to draw reasonable conclusions on which to base the opinion is obtained by performing **(I) risk assessment procedures** and **(II) further audit procedures**, which comprise (i) tests of controls, when required by the SAs or when the auditor has chosen to do so, and (ii) substantive procedures, including tests of details and substantive analytical procedures. The **seven types of audit procedure** then follow, and the marks follow the count: **1. Inspection** — examining records or documents, whether internal or external, in paper form, electronic form or other media, or physical examination of an asset; **2. Observation** — witnessing a process or procedure being performed by others, useful for a control that leaves no

audit trail; **3. External confirmation** — a direct written response to the auditor from a third party, in paper, electronic or other medium; **4. Computation or recalculation** — checking the arithmetical accuracy of documents and records, or performing independent calculations, for example depreciation or managerial remuneration; **5. Re-performance** — the auditor's independent execution of procedures or controls originally performed as part of the entity's internal control; **6. Analytical procedures** — evaluations of financial information made by a study of plausible relationships among both financial and non-financial data; **7. Inquiry** — seeking information of knowledgeable persons, financial and non-financial, within or outside the entity, ranging from formal written to informal oral inquiries.

Sufficiency is quantity; appropriateness is quality. The quantity needed is affected by the auditor's assessment of the risks of misstatement — **the higher the assessed risks, the more audit evidence is likely to be required** — and by the quality of the evidence — **the higher the quality, the less may be required. Obtaining more audit evidence, however, may not compensate for its poor quality.** The auditor's judgement as to sufficiency is affected by (1) materiality, (2) risk of material misstatement, and (3) size and characteristics of the population. Less evidence is required where assertions are less material, where the risk of material misstatement is lower, and where the population is smaller and more homogeneous; more is required in the opposite cases. Risk of material misstatement has two components at the assertion level — **inherent risk**, the susceptibility of an assertion to a misstatement that could be material before consideration of any related controls, and **control risk**, the risk that such a misstatement will not be prevented, or detected and corrected on a timely basis, by the entity's internal control.

Relevance and reliability are the two limbs of appropriateness, and the examiner asks for both.

Relevance deals with the logical connection between the audit procedure and the assertion under consideration — so **the direction of testing matters**: testing the recorded accounts payable balances is relevant to **overstatement**, but not to **understatement**, for which subsequent disbursements, unpaid invoices, suppliers' statements and unmatched receiving reports are the relevant procedures. **Reliability** is influenced by the **source and nature** of the information and the circumstances under which it is obtained, including the controls over its preparation and maintenance. The **five generalisations**, subject to exceptions: **(1) evidence from independent sources outside the entity is more reliable**; (2) internally generated evidence is more reliable when the related controls are effective; (3) evidence obtained directly by the auditor is more reliable than evidence obtained indirectly or by inference; (4) documentary evidence — paper, electronic or other medium — is more reliable than oral evidence; (5) original documents are more reliable than photocopies, facsimiles or documents filmed, digitised or otherwise transformed. The exceptions are examinable too: an independent external source may not be reliable **if the source is not knowledgeable**, and a management's expert **may lack objectivity**.

The assertion-identification question is set almost every attempt, and it is pure mapping. Read the procedure, name the assertion, then give the standard one-line explanation. **Occurrence** — the transactions recognised in the financial statements have occurred and relate to the entity (employee benefit expense excludes unauthorised personnel). **Completeness** — all assets,

liabilities and equity balances that were supposed to be recorded have been recognised (inventory held by a third party on the entity's behalf is included). **Cut-off** — all income and expenses are reported in the correct accounting period (year-end despatches are included in sales; inventory of the year is included regardless of location). **Rights and obligations** — the entity has ownership and legal title to its assets and the liabilities represent all its obligations to repay at a given date (purchase invoices in the client's name; inventory held for another entity is not recognised).

Measurement or accuracy — transactions are recorded at correct amounts, with no error in preparing documents or posting to the ledger (sales recorded per invoices, discounts properly adjusted). **Valuation** — assets, liabilities and equity are valued appropriately, with no overstatement or understatement (inventory at the lower of cost and net realisable value under AS 2).

Where the entity has used a management's expert — a valuer of long-term assets, a technical estimator of environmental provisions — the auditor may rely on that work provided he is satisfied that sufficient appropriate audit evidence is obtained. The requirement has **three limbs and the marks are one each**: (a) **evaluate the competence, capabilities and objectivity of that expert**; (b) **obtain an understanding of the work of that expert**; and (c) evaluate the appropriateness of that expert's work as audit evidence for the relevant assertion. Close with the sentence the answers close with: reliance on the work of a management's expert does not reduce the auditor's responsibility.

Four traps recur across the answers in this chapter. First, **audit evidence includes information that contradicts management's assertions**, not only information that supports them — a purchase bill of another concern entered in the client's books is audit evidence on occurrence. Second, **the absence of information is itself audit evidence** — management's refusal to provide a requested written representation is used by the auditor and therefore constitutes audit evidence. Third, **'available' does not mean 'all that exists'**: the auditor must know what evidence **ought** to be available for a transaction, so accepting the client's ledger invoices, debit notes and credit notes merely because they were offered is wrong. Fourth, where evidence from one source is inconsistent with that from another, or the auditor has doubts over the reliability of information to be used as evidence, he shall determine what modifications or additions to audit procedures are necessary to resolve the matter, and shall consider the effect of the matter, if any, on other aspects of the audit. Separately, when **selecting specific items** from a population the relevant factors are the auditor's understanding of the entity, the assessed risks of material misstatement, and the characteristics of the population, and the items selected may be high value or key items, all items over a certain amount, or items to obtain information.

Remembering reproduce what you have learnt · 3 questions

- List the seven audit procedures by name before you explain any of them. Marks follow the number of procedures named.
- The five generalisations about reliability are a list question in their own right. Give each one with the one-line example the answers give — bank confirmation, effective controls, own observation, written record, original invoice.

TQ 1.7 · RTP 2022-May [6] · Pg 196	LEVEL I Remembering	Medium
CSQ 1.3 · PYQ 2024-May [4] (a) · 4M · Pg 203	LEVEL I Remembering	Medium
TQ 1.1 · PYQ 2015-May [7] (b) · 4M · Pg 186	LEVEL I Remembering	Hard

Understanding explain it, and place it in context · 8 questions

- Quote the definition of audit evidence in full, then split it into accounting records and other information and give two examples of each. A definition without the split loses the examples' marks.
- Sufficiency and appropriateness must be named as quantity and quality respectively, and you must add the sentence that more evidence does not compensate for poor quality.

TQ 1.5 · PYQ 2021-Dec [5] (c) · 3M · Pg 194	LEVEL I Understanding	Easy
CSQ 1.5 · PYQ 2026-Sep [2] (b) (i) · 2M · Pg 206	LEVEL I Understanding	Easy
TQ 1.2 · RTP 2018-May [7] (b) · 4M · Pg 189	LEVEL I Understanding	Medium
TQ 1.3 · RTP 2018-May [8] (a) · Pg 191	LEVEL I Understanding	Medium
TQ 1.4 · RTP 2019-Nov [6] (a) · Pg 193	LEVEL I Understanding	Medium
TQ 1.8 · RTP 2022-Nov [7] (b) · Pg 197	LEVEL I Understanding	Medium
TQ 1.9 · PYQ 2025-Jan [4] (b) · 5M · Pg 197	LEVEL I Understanding	Medium
TQ 1.10 · MTP 2025-Aug S2 [2] (a) · 5M · Pg 198	LEVEL I Understanding	Medium

Application use the Standard - apply it to the facts · 4 questions

- Identify the procedure or the assertion first, then give the Standard's definition, then tie it to the facts in the question. An answer that only names 'inspection' without defining it gets half the mark.
- Where the facts show a refusal, a contradiction or an inconsistency, say which of the four traps is engaged and state the consequence the Standard prescribes.

TQ 1.6 · RTP 2021-May [7] (a) · Pg 195	LEVEL II Application	Medium
TQ 1.12 · RTP 2026-May [12] · Pg 200	LEVEL II Application	Medium
CSQ 1.2 · MTP 2024-Mar [3] (a) · 4M · Pg 202	LEVEL II Application	Medium

TQ 1.11 · MTP 2025-Nov S1 [1] (c) · 4M · Pg 199

LEVEL II
Application

Hard

Analysis break it down and take the parts separately · 2 questions

- The assertion questions give five short procedures; take them one at a time, name the assertion, then explain it. Do not merge two procedures into one paragraph — the marks are allotted item by item.

CSQ 1.1 · PYQ 2023-Nov [5] (a) · 4M · Pg 201

LEVEL II
Analysis

Medium

CSQ 1.4 · PYQ 2025-May [1] (a) {C} · 5M · Pg 204

LEVEL II
Analysis

Medium

Topic 2: Audit Evidence-Specific Considerations for Selected Items (SA 501)

L2P5-C4-T02

Read first Read ICAI Study Material Chapter 4, Audit Evidence — SA 501 'Audit Evidence—Specific Considerations for Selected Items': inventory, litigation and claims, and segment information.

NOTES

The Standard covers three selected items and nothing else: inventory, litigation and claims, and segment information. Name it in full — SA 501 'Audit Evidence—Specific Considerations for Selected Items' — because a question that says 'with reference to the relevant Standard' is testing whether you can place the item under SA 501 rather than SA 500.

Inventory. When inventory is material to the financial statements, the auditor shall obtain sufficient appropriate audit evidence regarding its existence and condition by: **1. attendance at physical inventory counting, unless impracticable**, to (a) evaluate management's instructions and procedures for recording and controlling the results of the entity's physical inventory counting, (b) observe the performance of management's count procedures, (c) inspect the inventory, and (d) perform test counts; and **2. performing audit procedures over the entity's final inventory records** to determine whether they accurately reflect actual inventory count results. In **planning attendance** the relevant matters include the nature of the inventories, the materiality of inventories at each location, the stage of completion of work-in-progress, whether a perpetual inventory system is maintained, the materiality of inventories lying with third parties and the timing of the count — and, the two candidates most often omit, whether adequate procedures are expected to be established and proper instructions issued for physical inventory counting and **the nature of internal control related to inventories at the different locations.**

The two variations the examiner sets on inventory attendance. (i) **Attendance impracticable:** impracticability turns on **the nature and location of the inventory**, for example where it is held where its location may pose threats to the safety of the auditor. **General inconvenience to the auditor is not sufficient**, and as SA 200 explains, difficulty, time or cost is not in itself a valid basis to omit a procedure for which there is no alternative. Alternative procedures — for example

inspection of documentation of the subsequent sale of specific inventory items acquired or purchased prior to the physical inventory counting — may give sufficient appropriate evidence; where they cannot, SA 705 requires the auditor to modify the opinion as a result of the scope limitation. (ii) **Count at a date other than the date of the financial statements:** the auditor shall perform additional audit procedures to obtain evidence about whether changes in inventory between the count date and the date of the financial statements are properly recorded — attend the later count, verify the movements in the intervening period (purchases, despatches, returns, transfers and adjustments), check that perpetual records have been properly adjusted, assess the reliability of those perpetual records, investigate significant differences between the count and the records, and perform cut-off procedures on documents around the year end.

Inventory under the custody and control of a third party. Where it is material, the auditor shall obtain evidence about existence and condition by performing **one or both** of: 1. requesting confirmation from the third party as to the quantities and condition of inventory held on behalf of the entity, and 2. performing inspection or other audit procedures appropriate in the circumstances. Other procedures include **inspecting documentation regarding inventory held by third parties**, requesting confirmation from other parties when inventory has been pledged as collateral, attending, or arranging for another auditor to attend, the third party's physical counting of inventory, if practicable, and obtaining another auditor's report, or a service auditor's report, on the adequacy of the third party's internal control for ensuring that inventory is properly counted and adequately safeguarded. For goods lying with a job worker or sub-contractor for a long period, the answers add: obtain confirmation of the amount, inquire into the necessity of the retention, give **special attention to provisioning** for goods held very long, review the records and slips regulating movement in and out, value the inventory on the appropriate formula including proportionate processing charges for work-in-process, evaluate the condition of the goods, check whether they were subsequently sold or received back, and ensure they have been included in closing inventory though lying with the third party.

Litigation and claims. The auditor shall design and perform audit procedures to identify litigation and claims involving the entity which may give rise to a risk of material misstatement, including: 1. inquiry of management and, where applicable, others within the entity, including in-house legal counsel; 2. reviewing minutes of meetings of those charged with governance and correspondence between the entity and its external legal counsel; and 3. reviewing legal expense accounts. If a risk of material misstatement is assessed, or procedures indicate other material litigation or claims may exist, the auditor **shall seek direct communication with the entity's external legal counsel**. A **letter of specific inquiry** — used where a letter of general inquiry is unlikely to be answered appropriately — ordinarily includes (1) a list of litigation and claims; (2) where available, management's assessment of the outcome of each identified litigation and claim and its estimate of the financial implications, including costs involved; and (3) a request that the external legal counsel confirm the reasonableness of management's assessments and provide further information if the list is considered incomplete or incorrect. A **meeting** with the external legal counsel may be necessary where **the auditor determines that the matter is a significant risk, the matter is complex, or there is disagreement between management and the entity's external**

legal counsel — and such meetings ordinarily require **management's permission** and are held with a representative of management in attendance. If management refuses permission to communicate or meet and alternative procedures do not yield sufficient appropriate evidence, the auditor shall modify the opinion in accordance with SA 705.

Segment information. The auditor shall obtain sufficient appropriate audit evidence regarding its presentation and disclosure in accordance with the applicable financial reporting framework by 1. obtaining an understanding of the methods used by management in determining segment information, and (a) evaluating whether such methods are likely to result in disclosure in accordance with the applicable financial reporting framework and (b) where appropriate, testing the application of such methods; and 2. performing analytical procedures or other audit procedures appropriate in the circumstances. The **examples of matters** relevant to understanding those methods are a four-item list: sales, transfers and charges between segments, and elimination of inter-segment amounts; comparisons with budgets and other expected results, for example operating profits as a percentage of sales; **the allocation of assets and costs among segments**; and consistency with prior periods, and the adequacy of the disclosures with respect to inconsistencies. **The line that carries a mark on its own:** the auditor's responsibility here relates to the financial statements taken as a whole, so he is not required to perform procedures that would be necessary to express an opinion on the segment information presented separately.

Remembering reproduce what you have learnt · 2 questions

- The four sub-limbs of attendance and the four examples of matters on segment information are pure list marks. Write them as a numbered list, not as prose.

CSQ 2.4 · PYQ 2022-May [4] (c) · 3M · Pg 216

LEVEL I
Remembering

Easy

CSQ 2.1 · PYQ 2020-Nov [1] (a) {C} · 5M · Pg 211

LEVEL I
Remembering

Medium

Understanding explain it, and place it in context · 4 questions

- State which of the three selected items the question is about in the first line, and name SA 501 in full. That sentence alone fixes the frame of the answer.

TQ 2.1 · MTP 2021-Mar [5] (a) · 4M · Pg 207

LEVEL I
Understanding

Medium

CSQ 2.5 · MTP 2024-Mar [4] (b) · 4M · Pg 216

LEVEL I
Understanding

Medium

CSQ 2.8 · PYQ 2026-Jan [1] (c) {C} · 4M · Pg 219

LEVEL I
Understanding

Medium

TQ 2.2 · RTP 2022-May [7] (b) · Pg 208

LEVEL I
Understanding

Application use the Standard - apply it to the facts • 5 questions

- For every inventory scenario, first say whether attendance was impracticable or the count was at another date — the two branches have different procedures, and an answer that runs them together loses marks.
- End a refusal or scope-limitation scenario with the consequence: alternative procedures first, and modification of the opinion under SA 705 only if those fail.

CSQ 2.2 • MTP 2021-Oct [4] (a) • 4M • Pg 213	LEVEL II Application	Medium
CSQ 2.3 • PYQ 2021-Jan [1] (b) {C} • 5M • Pg 214	LEVEL II Application	Medium
CSQ 2.6 • RTP 2024-Sep [12] • Pg 217	LEVEL II Application	Medium
CSQ 2.7 • PYQ 2025-Jan [1] (b) {C} • 5M • Pg 218	LEVEL II Application	Medium
TQ 2.4 • RTP 2025-Sep [13] • Pg 210	LEVEL II Application	Hard

Analysis break it down and take the parts separately • 1 question

- Where a question gives a list and asks what is missing from it, tick off each item in the Standard against the list given and name only the omissions. Do not reproduce the whole list.

TQ 2.3 • RTP 2025-Sep [12] • Pg 208	LEVEL II Analysis	Hard
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Topic 3: External Confirmations (SA 505)

L2P5-C4-T03

Read first Read ICAI Study Material Chapter 4, Audit Evidence — SA 505 'External Confirmations': confirmation procedures, positive and negative requests, management's refusal, and evaluating the results.

NOTES

What an external confirmation is and where it is used. It is audit evidence obtained by the auditor as a direct written response to the auditor from a third party (the confirming party), in paper form, or by electronic or other medium. External confirmation procedures are frequently relevant when addressing assertions associated with account balances and their elements, but need not be restricted to these items — the auditor may confirm the terms of agreements, contracts or transactions between an entity and other parties, and may confirm **the absence of certain conditions**, for example that **no 'side agreement' exists** relevant to a revenue cut-off assertion. The situations the answers list: **bank balances and other information relevant to banking**

relationships; accounts receivable balances and terms; inventories held by third parties at bonded warehouses for processing or on consignment; property title deeds held by lawyers or financiers for safe custody or as security; investments held for safekeeping by third parties, or purchased from stockbrokers but not delivered at the balance sheet date; and amounts due to lenders, including relevant terms of repayment and restrictive covenants.

The auditor shall maintain control over external confirmation requests, and the four limbs are the answer: **1. determining the information to be confirmed or requested; 2. selecting the appropriate confirming party;** 3. designing the confirmation requests, including determining that requests are properly addressed and contain return information for responses to be sent directly to the auditor; and 4. sending the requests, including follow-up requests when applicable, to the confirming party.

Why design matters, and the seven factors. The design of a confirmation request may directly affect the confirmation response rate, and the reliability and the nature of the audit evidence obtained from responses. The factors are (a) the assertions being addressed; (b) specific identified risks of material misstatement, including fraud risks; (c) the layout and presentation of the confirmation request; (d) prior experience on the audit or similar engagements; (e) the method of communication, for example in paper form or by electronic or other medium; (f) management's authorisation or encouragement to the confirming parties to respond to the auditor — confirming parties may only be willing to respond to a request containing management's authorisation; and (g) the ability of the intended confirming party to confirm or provide the requested information, for example individual invoice amount versus total balance.

Positive and negative requests, and the four conditions that are the examiner's favourite. A **positive confirmation request** asks the confirming party to respond directly to the auditor indicating whether the confirming party agrees or disagrees with the information in the request, or providing the requested information. A **negative confirmation request** asks the confirming party to respond directly to the auditor only if the confirming party disagrees with the information provided in the request. The auditor shall not use negative confirmation requests as the sole substantive procedure to address an assessed risk of material misstatement at the assertion level unless all of the following are present: (a) the auditor has assessed the risk of material misstatement as low and has obtained sufficient appropriate audit evidence regarding the operating effectiveness of controls relevant to the assertion; (b) the population of items subject to negative confirmation procedures consists of a large number of small, homogeneous account balances, transactions or conditions; **(c) a very low exception rate is expected;** and (d) the auditor is not aware of any circumstances or conditions that would cause recipients of negative confirmation requests to disregard such requests. The classic wrong answer is that a negative confirmation is as persuasive as a positive one. It is not: a non-response to a negative request does not explicitly indicate receipt by the intended confirming party, or verification of the accuracy of the information contained in the request, and therefore **provides significantly less persuasive audit evidence.**

Evaluating the results — the four categories, which is how the scenario questions are marked. The

auditor shall evaluate whether the results of the external confirmation procedures provide relevant and reliable audit evidence or whether performing further audit procedures is necessary, categorising each result as (a) a positive confirmation request; (b) a negative confirmation request; (c) a non-response; or (d) a response indicating an exception. A **non-response** is a failure of the confirming party to respond, or fully respond, to a positive confirmation request, or a confirmation request returned undelivered; it **does not provide audit evidence**, so alternative audit procedures may be required. A **response indicating an exception** is a response that indicates a difference between information requested to be confirmed, or contained in the entity's records, and information provided by the confirming party; exceptions **require investigation to determine whether they represent misstatements**. Work an exception in this order: **obtain management's explanation for the difference; review supporting documentation** — the receivables ledger, sales invoices, delivery receipts, credit notes, payment records, and subsequent receipts after the year end; **reconcile the difference**, identifying timing differences or unrecorded transactions; and assess whether the unexplained difference is material to the financial statements. The evaluation of the results, taken with the other procedures performed, shall assist in concluding whether sufficient appropriate audit evidence has been obtained, as required by SA 330.

Management's refusal to allow a confirmation request — five steps, in this order. 1. Inquire into the reasons for the refusal and evaluate the validity and reasonableness of those reasons; doubtful reasons may indicate a risk of material misstatement or possible fraud. **2. Reassess the risks of material misstatement**, particularly on existence and completeness, and the possibility of fraud or management bias. **3. Perform alternative audit procedures** — examine subsequent payments to suppliers, purchase invoices and supporting documents, supplier statements and reconciliations, contracts, goods receipt notes and ledger entries. 4. If the auditor concludes the refusal is unreasonable, or is unable to obtain relevant and reliable audit evidence from the alternative procedures, communicate the matter to those charged with governance in accordance with SA 260. **5. Consider the effect on the opinion under SA 705** — a qualified opinion or a disclaimer of opinion, depending on materiality and pervasiveness.

Understanding explain it, and place it in context • 4 questions

- Define positive and negative confirmation in the Standard's own words — 'respond whether they agree or disagree' against 'respond only if they disagree'. The distinction is the whole question.

CSQ 3.2 • PYQ 2024-Sep [6] (c) • 3M • Pg 225	LEVEL I Understanding	Easy
TQ 3.2 • RTP 2020-May [7] (b) • Pg 222	LEVEL I Understanding	Medium
TQ 3.3 • MTP 2025-Mar S1 [6] (a) • 5M • Pg 222	LEVEL I Understanding	Medium
CSQ 3.1 • PYQ 2023-May [3] (a) • 4M • Pg 223	LEVEL I Understanding	Medium

Application use the Standard - apply it to the facts · 2 questions

- Where management refuses, run the five steps in order and finish with SA 260 and SA 705 by number. An answer that stops at 'perform alternative procedures' loses the reporting marks.

CSQ 3.3 · PYQ 2025-May [4] (a) · 5M · Pg 226

LEVEL II
Application

Medium

CSQ 3.4 · MTP 2026-Mar S1 [1] (c) {C} · 4M · Pg 228

LEVEL II
Application

Medium

Analysis break it down and take the parts separately · 1 question

- A question that gives a table of responses expects each group to be classified into one of the four categories and then a consequence stated for each. Deal with them group by group and say for which groups further procedures are needed.

TQ 3.1 · RTP 2018-Nov [7] (b) · Pg 221

LEVEL II
Analysis

Medium

Topic 4: Initial Audit Engagements-Opening Balances (SA 510)

L2P5-C4-T04

Read first Read ICAI Study Material Chapter 4, Audit Evidence — SA 510 'Initial Audit Engagements — Opening Balances': the meaning of an initial audit engagement, the objective, the audit procedures on opening balances, and the reporting consequences.

NOTES

Define the engagement before you do anything else. An **initial audit engagement** is an engagement in which either (1) the financial statements for the prior period were not audited; or (2) the financial statements for the prior period were audited by a predecessor auditor. So a newly appointed auditor is in an initial audit engagement **even where the predecessor gave an unmodified opinion**.

The objective, which has two limbs and both carry marks: to obtain sufficient appropriate audit evidence about whether 1. opening balances contain misstatements that materially affect the current period's financial statements; and 2. appropriate accounting policies reflected in the opening balances have been consistently applied in the current period's financial statements, or changes thereto are properly accounted for and adequately presented and disclosed in accordance with the applicable financial reporting framework.

The procedures, in the order the answers run them. First, read the most recent financial statements, if any, and the predecessor auditor's report thereon, if any, for information relevant to opening balances, including disclosures. Then obtain sufficient appropriate audit evidence about whether the opening balances contain material misstatements by (a) determining whether the

prior period's closing balances have been correctly brought forward to the current period or, when appropriate, whether any adjustments have been disclosed as prior period items in the current year's Statement of Profit and Loss; (b) determining whether the opening balances reflect the application of appropriate accounting policies; and **(c) performing one or more of the following** — perusing the copies of the audited financial statements, including other relevant documents such as supporting schedules, where the prior year financial statements were audited; evaluating whether audit procedures performed in the current period provide evidence relevant to the opening balances; or performing specific audit procedures to obtain evidence regarding the opening balances.

The two worked examples under limb (c) are worth learning, because scenarios are built on them. Current-period procedures give evidence on opening balances where, for instance, collection of opening accounts receivable or payment of opening accounts payable during the current period provides some evidence of their existence, rights and obligations, completeness and valuation at the beginning of the period. **Inventories are the exception** and need more: observing a current physical inventory count and reconciling it to opening inventory quantities, **performing audit procedures on the valuation of opening inventory items**, and **performing audit procedures on gross profit and cut-off**. For **non-current assets and liabilities** such as property, plant and equipment, investments and long-term debt, the auditor may **examine accounting records and obtain third-party confirmations**, for example confirmation from banks for long-term debt.

What drives how much work you do: the accounting policies followed by the entity; the nature of the account balances, classes of transactions and disclosures and the risks of material misstatement in the current period's financial statements; the significance of the opening balances relative to the current period's financial statements; and whether the prior period's financial statements were audited and, if so, whether the predecessor auditor's opinion was modified. A prior-year qualification on, say, valuation of receivables, together with material opening inventory and receivables, is the fact pattern that calls for **more extensive and carefully focused procedures**.

The two reporting consequences. If evidence shows the opening balances contain misstatements that could materially affect the current period's financial statements, the auditor shall perform additional audit procedures appropriate in the circumstances to determine the effect on the current period's financial statements and communicate the misstatements to the appropriate level of management and those charged with governance in accordance with SA 450. If the auditor is unable to obtain sufficient appropriate audit evidence regarding the opening balances, he shall express a qualified opinion or a disclaimer of opinion, as appropriate, in accordance with SA 705. The classic wrong answer is that a predecessor's audit excuses the incoming auditor from work on opening balances. It does not — reliance cannot be placed solely on the predecessor's report, though ordinarily the auditor can place reliance on the closing balances of the preceding period unless current-period procedures indicate the possibility of misstatement.

Understanding explain it, and place it in context · 2 questions

- Open with the two-limb definition of an initial audit engagement, then the two-limb objective. Four short sentences, four marks' worth of frame.

TQ 4.2 · RTP 2023-May [8] · Pg 232

LEVEL I
Understanding**Medium**

CSQ 4.2 · MTP 2025-Dec S2 [4] (a) · 5M · Pg 234

LEVEL I
Understanding**Medium****Application** use the Standard - apply it to the facts · 2 questions

- Say expressly that the present engagement is an initial audit engagement and why, before listing procedures. The scenario questions are all built on the auditor who thinks the predecessor's audit is enough.
- Finish with the reporting consequence — SA 450 for communicating misstatements, SA 705 for a qualified opinion or disclaimer.

TQ 4.1 · PYQ 2022-May [3] (c) · 3M · Pg 230

LEVEL II
Application**Easy**

CSQ 4.1 · MTP 2025-Aug S2 [1] (c) · 4M · Pg 232

LEVEL II
Application**Medium****Analysis** break it down and take the parts separately · 1 question

- Opening balances split into two asks: **whether they contain misstatements affecting this year**, and **whether the policies have been consistently applied**. Take them separately.
- Where the prior period was audited by another auditor, say what that permits — reviewing the predecessor's working papers — and what it does not: it does not discharge the current auditor's own responsibility.

CSQ 4.3 · MTP 2026-Apr S2 [3] (a) · 5M · Pg 234

LEVEL II
Analysis**Medium****Topic 5: Analytical Procedures (SA 520)**

L2P5-C4-T05

Read first Read ICAI Study Material Chapter 4, Audit Evidence — SA 520 'Analytical Procedures': the meaning of analytical procedures, substantive analytical procedures, reliability of data, precision of the expectation, the techniques, and investigating differences.

NOTES

The definition, then the two halves of it. Analytical procedures means evaluations of financial information through analysis of plausible relationships among both financial and non-financial

data, and also encompass such investigation as is necessary of identified fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount. The examiner asks for the examples in two sets. **Comparisons** of the entity's financial information with **comparable information for prior periods**; anticipated results of the entity, such as budgets or forecasts, or expectations of the auditor, such as an estimation of depreciation; and similar industry information, such as a comparison of the entity's ratio of sales to accounts receivable with industry averages or with other entities of comparable size in the same industry. **Relationships** among elements of financial information that would be expected to conform to a predictable pattern based on the entity's experience, such as gross margin percentages, and between financial information and relevant non-financial information, such as payroll costs to number of employees.

When designing and performing substantive analytical procedures, the auditor shall do four things, and this is the standard four-mark answer: 1. determine the suitability of particular substantive analytical procedures for given assertions, taking account of the assessed risks of material misstatement and tests of details, if any, for those assertions; 2. evaluate the reliability of data from which the auditor's expectation of recorded amounts or ratios is developed, taking account of source, comparability, and nature and relevance of information available, and controls over preparation; 3. develop an expectation of recorded amounts or ratios and evaluate whether the expectation is sufficiently precise to identify a misstatement that, individually or when aggregated with other misstatements, may cause the financial statements to be materially misstated; and 4. determine the amount of any difference of recorded amounts from expected values that is acceptable without further investigation.

Suitability. Substantive analytical procedures are generally more applicable to large volumes of transactions that tend to be predictable over time, the application resting on the expectation that relationships among data exist and continue in the absence of known conditions to the contrary.

Different types of analytical procedure provide different levels of assurance. The rental example is the one the answers use: predicting total rental income on a building divided into apartments, taking the rental rates, the number of apartments and vacancy rates into consideration, can provide persuasive evidence and may eliminate the need for further verification by means of tests of details, provided the elements are appropriately verified; by contrast, calculation and comparison of gross margin percentages as a means of confirming a revenue figure may provide less persuasive evidence, but may provide useful corroboration if used in combination with other audit procedures. Where controls are weak — for example over sales order processing — the auditor may place more reliance on tests of details rather than on substantive analytical procedures. Three further factors are asked by name: **account type** — income statement accounts tend to be more predictable because they reflect accumulated transactions over a period, whereas balance sheet accounts represent the net effect of transactions at a point in time or are subject to greater management judgement; **predictability** — a predictable relationship is one that may reasonably be expected to exist and continue over time; and **nature of the assertion** — predictive analytical procedures using data analytics can address **completeness, valuation or measurement**,

and occurrence.

Reliability of data — four factors, each with the example the answers give. **1. Source of the information available** — information may be more reliable when obtained from independent sources outside the entity. **2. Comparability of the information available** — broad industry data may need to be supplemented to be comparable to an entity that produces and sells specialised products. **3. Nature and relevance of the information available** — whether budgets have been established as results to be expected rather than as goals to be achieved. **4. Controls over the preparation of the information** that are designed to ensure its completeness, accuracy and validity — for example controls over the preparation, review and maintenance of budgets. **Precision of the expectation** turns on three matters: **the accuracy with which the expected results can be predicted** (greater consistency is expected in gross profit margins period to period than in discretionary expenses such as research or advertising); **the degree to which information can be disaggregated** (procedures may be more effectively applied to individual sections of an operation or components of a diversified entity than to the entity as a whole); and **the availability of the information, both financial and non-financial**, and, where available, its reliability.

The four techniques available as substantive analytical procedures. **Trend analysis** — comparison of current data with the prior period balance or with a trend in two or more prior period balances, evaluating whether the current balance moves in line with the established trend. **Ratio analysis** — useful for asset and liability accounts as well as revenue and expense accounts, because an individual balance sheet account is difficult to predict on its own, but its relationship to another account is often more predictable, for example the trade receivables balance related to sales; ratios may be compared over time, across entities in the group, or with other companies in the industry, and include **trade receivables or inventory turnover** and **freight expense as a percentage of sales revenue**. **Reasonableness tests** — unlike trend analysis these do not rely on events of prior periods but on **non-financial data for the audit period under consideration**, such as occupancy rates to estimate rental income or interest rates to estimate interest income or expense, and are generally more applicable to income statement accounts and certain accrual or prepayment accounts. **Structural modelling** — a modelling tool that constructs a statistical model from financial or non-financial data of prior accounting periods to predict current account balances, for example linear regression. The **commonly used ratios** listed separately are elements of income or loss as a percentage of sales, gross profit turnover, accounts receivable turnover, inventory turnover, and profitability, leverage and liquidity.

Investigating results — two limbs, and this is examined again and again. If analytical procedures identify fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount, the auditor shall investigate such differences by: **1. inquiring of management and obtaining appropriate audit evidence relevant to management's responses** — evidence obtained by evaluating those responses against the auditor's understanding of the entity and its environment and the other evidence obtained during the audit; and **2. performing other audit procedures as necessary in the circumstances** — needed where, for example, management is unable to provide an explanation, or the explanation together with

the evidence obtained is not considered adequate. **Do not stop at 'inquire of management'; the second limb is a separate mark.**

The two applied drills. Comparison of the Statement of Profit and Loss across years achieves four things: finding **the reasons for the increase or decrease in the amount of profits** of those years; ascertaining, through expense ratios, the extent of increase or decrease in items of expenditure in relation to sales and of trading profit in relation to sales; where differences are material, ascertaining the reasons and assessing whether the accounts have been manipulated to inflate or suppress profits; and identifying unusual transactions, amounts, ratios and trends that might indicate matters with audit implications. For **overall reasonableness of purchase quantity and price: consumption analysis** — scrutinise raw material consumed in the manufacturing account against previous years and closing stock and seek reasons for significant variations; **stock composition analysis** — raw material as a percentage of total stock compared with the previous year; **ratios** — creditors turnover and stock turnover compared with previous years; and **quantitative reconciliation** of closing stocks with opening stock, purchases and consumption. For **trade receivables, loans and advances**, the analytical review procedures are comparisons of closing balances with the previous year, of the relationship between current year balances and current year sales with budgets, of actual closing balances with budgeted figures, of the current year's ageing schedule with the previous year's, and of significant ratios with those of other firms in the same industry and with industry norms.

Remembering reproduce what you have learnt • 2 questions

- The four techniques — trend, ratio, reasonableness tests, structural modelling — are a list answer. Name all four, then define each in one sentence.

TQ 5.6 • PYQ 2022-Nov [4] (d) • 3M • Pg 240

LEVEL I
Remembering

Easy

CSQ 5.3 • PYQ 2022-May [2] (b) • 4M • Pg 246

LEVEL I
Remembering

Medium

Understanding explain it, and place it in context • 7 questions

- Quote the definition in full: 'plausible relationships among both financial and non-financial data'. The words 'non-financial' are what the examiner is checking for.
- Split the examples into comparisons and relationships. A question asking only for 'relationships' wants the gross margin and payroll-to-employees examples, not the prior period comparison.

TQ 5.2 • PYQ 2020-Nov [2] (d) • 3M • Pg 237

LEVEL I
Understanding

Easy

CSQ 5.2 • PYQ 2021-Jul [2] (d) • 3M • Pg 245

LEVEL I
Understanding

Easy

CSQ 5.4 • PYQ 2023-Nov [5] (c) • 3M • Pg 247

LEVEL I
Understanding

Easy

TQ 5.3 • RTP 2021-May [18] • Pg 238	LEVEL I Understanding	Medium
TQ 5.7 • RTP 2022-May [18] • Pg 240	LEVEL I Understanding	Medium
TQ 5.10 • MTP 2025-Nov S1 [4] (a) • 5M • Pg 243	LEVEL I Understanding	Medium
CSQ 5.1 • RTP 2018-May [18] • Pg 244	LEVEL I Understanding	Medium

Application use the Standard - apply it to the facts • 5 questions

- When the facts give a prediction built from non-financial data — apartments, rates, vacancy — say expressly that this is a substantive analytical procedure and why the relationship is plausible, then say what happens if the difference is significant.
- Investigation questions want both limbs and then the application to the facts. Write the rule, the two limbs, then the sentence beginning 'In the present case'.

CSQ 5.5 • PYQ 2024-May [4] (d) • 3M • Pg 248	LEVEL II Application	Easy
TQ 5.1 • RTP 2020-May [18] • Pg 236	LEVEL II Application	Medium
TQ 5.8 • RTP 2022-Nov [18] • Pg 241	LEVEL II Application	Medium
TQ 5.9 • RTP 2023-Nov [18] • Pg 242	LEVEL II Application	Medium
CSQ 5.6 • MTP 2026-Apr S2 [1] (c) {C} • 4M • Pg 249	LEVEL II Application	Medium

Analysis break it down and take the parts separately • 2 questions

- Where the facts criticise the data — aggressive budgets, general industry data, uncertain IT controls — map each fact onto one of the four reliability factors by name. That mapping is the answer.

TQ 5.4 • RTP 2021-Nov [17] • Pg 239	LEVEL II Analysis	Medium
TQ 5.5 • RTP 2021-Nov [18] • Pg 239	LEVEL II Analysis	Medium

Topic 6: Audit Sampling (SA 530)

L2P5-C4-T06

Read first Read ICAI Study Material Chapter 4, Audit Evidence — SA 530 'Audit Sampling': the meaning of audit sampling, sampling risk, sample design, sample size and selection, statistical and non-statistical sampling, the selection methods, and evaluating sample results.

NOTES

The definition, and it is quoted almost verbatim in the answers: audit sampling is the application of audit procedures to less than 100% of items within a population of audit relevance such that all sampling units have a chance of selection in order to provide the auditor with a reasonable basis on which to draw conclusions about the entire population. Sampling enables the auditor to obtain and evaluate audit evidence about some characteristic of the items selected, in order to form or assist in forming a conclusion concerning the population from which the sample is drawn, and **can be applied using either statistical or non-statistical sampling approaches**. Why sampling at all: **the traditional approach of checking all transactions is economically wasteful**, and with formal internal controls the possibilities of routine error and fraud have diminished, so the approach has shifted in favour of more attention towards the questions of principle and controls with a curtailment of non-consequential routine checking. Note the honest limits the answers state: sampling can never bring complete reliability; it cannot give precisely accurate results — it is a process of estimation and may have some error.

Sampling risk, and the two erroneous conclusions. Sampling risk is the risk that the auditor's conclusion based on a sample may be different from the conclusion if the entire population were subjected to the same audit procedure. It leads to two types of erroneous conclusion: (1) in the case of a test of controls, that controls are more effective than they actually are, or, in the case of tests of details, that a material misstatement does not exist when in fact it does — the auditor is primarily concerned with this type because it affects audit effectiveness and is more likely to lead to an inappropriate audit opinion; and (2) in the case of tests of controls, that controls are less effective than they actually are, or, in the case of tests of details, that a material misstatement exists when in fact it does not — this **affects audit efficiency**, as it usually leads to additional work to establish that the initial conclusion was wrong. **Say which of the two matters more and why; that sentence is a mark.**

The three requirements, and the definitions that go with them. **Sample design** — when designing an audit sample the auditor shall consider the purpose of the audit procedure and the characteristics of the population from which the sample will be drawn. **Sample size** — the auditor shall determine a sample size sufficient to reduce sampling risk to an acceptably low level.

Selection of items for testing — the auditor shall select items in such a way that each sampling unit in the population has a chance of selection. Under **purpose**, the auditor must define **what constitutes a deviation or misstatement**, so that all and only the relevant conditions are evaluated — a payment made by a customer before the confirmation date but received shortly after is **not** a misstatement for an existence test, and a wrong posting between customer accounts does not affect the total balance, though it may matter for fraud risk or the doubtful debts provision — and must perform procedures to obtain evidence that **the population from which the sample is drawn is complete**. Under **characteristics of the population**, for **tests of controls** the auditor assesses the **expected rate of deviation** (if it is unacceptably high he will normally decide not to perform tests of controls at all) and for **tests of details** the **expected misstatement** (if it is high, 100% examination or a large sample may be appropriate). **The three defined terms:** stratification — the process of dividing a population into sub-populations, each of which is a group of sampling units

which have similar characteristics (often monetary value); tolerable misstatement — a monetary amount set by the auditor in respect of which the auditor seeks to obtain an appropriate level of assurance that the monetary amount set by the auditor is not exceeded by the actual misstatement in the population; tolerable rate of deviation — a rate of deviation from prescribed internal control procedures set by the auditor in respect of which the auditor seeks to obtain an appropriate level of assurance that the rate of deviation set by the auditor is not exceeded by the actual rate of deviation in the population.

Stratification and value-weighted selection. Audit efficiency may be improved if the auditor stratifies a population by dividing it into discrete sub-populations which have an identifying characteristic; the objective is to reduce the variability of items within each stratum and therefore allow sample size to be reduced without increasing sampling risk. For tests of details the population is often stratified by **monetary value**, directing greater effort to larger items which may contain the greatest potential overstatement, or by a characteristic indicating higher risk, for example **ageing** when testing the allowance for doubtful accounts. The results of procedures applied to a sample within a stratum can only be projected to the items that make up that stratum — so if 20% of items make up 90% of value, the conclusion on that 90% is reached separately from the remaining 10%, and where a population has been stratified, misstatement is projected for each stratum separately and the projections are then combined. **Value-weighted selection** identifies the sampling unit as **the individual monetary units that make up the population**; the auditor selects monetary units and then examines the items containing them, so that audit effort is directed to the larger value items because they have a greater chance of selection, which can result in smaller sample sizes. It may be used in conjunction with the systematic method and is most efficient when selecting items using random selection.

The selection methods, each with its identifying fact. **Simple random sampling** — each unit of the whole population has an equal chance of being selected, using random number tables or a generator, which also **provides assurance that the auditor's bias does not affect the selection**; appropriate provided the population consists of reasonably similar units falling within a reasonable range, that is, a homogeneous population. **Systematic or interval sampling** — items are selected **at a fixed interval after a random starting point**, the interval being **population size ÷ sample size** (1,000 accounts and a sample of 100 gives an interval of 10, so the 5th, 15th, 25th and so on). The auditor must ensure the population does not contain a hidden pattern or arrangement that matches the sampling interval, and reduces that risk by **examining the population structure before applying the method** and by **using more than one random starting point**; the starting point is more likely to give a truly random sample if determined by a computerised random number generator or random number tables rather than haphazardly. **Block sampling** — selecting **a continuous group or sequence of items**, for example 50 consecutive cheques or the first 150 accounts of the last month; efficient and useful for looking at patterns such as consistency of signatures, but **it lacks randomness and may miss anomalies elsewhere in the population**. **Stratified sampling** — dividing the population into strata sharing a characteristic, such as balances above ₹20 lakhs, between ₹10 lakhs and ₹20 lakhs, and below ₹10 lakhs, and selecting **different**

percentages from each group according to risk or importance.

Statistical sampling, and why the answers always prefer it for a large population. In statistical sampling the sample results are measurable as to the adequacy and reliability of the audit objectives; in non-statistical sampling the auditor's opinion determines the sample size, but it cannot be measured how far the sample size would fulfil the audit objectives. Its features: testing is more scientific because it involves the mathematical laws of probability in determining the appropriate sample size; it has reasonably wide application where the population consists of a large number of similar items — compliance testing, trade receivables' confirmation, payroll checking, vouching of invoices and petty cash vouchers; and there is no personal bias of the auditor, so the sample results can be evaluated and projected on the whole population in a more reliable manner. The **advantages** listed: the sample size does not increase in proportion to the increase in the size of the area tested; **the sample selection is more objective and thereby more defensible**; it provides a means of estimating the minimum sample size associated with a specified risk and precision; it provides a means for deriving a 'calculated risk' and corresponding precision (sampling error); and it may provide a better description of a large mass of data than a complete examination, since non-sampling errors such as processing and clerical mistakes are not as large. The decision between statistical and non-statistical is a matter of the auditor's professional judgement, and sample size alone is not a valid criterion to distinguish the two approaches. Separately, the factors for deciding **the extent of checking on a sampling plan** are the size of the organisation under audit, the state of the internal control, the adequacy and reliability of books and records, the tolerable error range, and the degree of the desired confidence.

Sample size, and evaluating what the sample shows. For **tests of controls** the factors are **(1) the extent of reliance on internal controls** — greater planned reliance means more extensive testing and a larger sample; **(2) the tolerable rate of deviation** — a higher tolerable rate decreases sample size, a lower one increases it; **(3) the expected rate of deviation** — a higher expected rate increases sample size, and a high expected rate generally reduces the extent to which the auditor can rely on controls at all; **(4) the desired level of assurance** — greater assurance means a larger sample; and **(5) the size of the population** — **an increase in population size has a negligible effect on sample size** for large populations, while for small populations sampling may not be efficient at all. So of two identical populations with the same tolerable rate and the same planned reliance, the company with the higher expected deviation rate needs the larger sample. For **tests of details**, **an increase in the desired level of assurance increases sample size** and **appropriate stratification decreases it**, because the aggregate of sample sizes from the strata is generally less than a single sample from the whole population for the same sampling risk. On **evaluation**: the auditor shall evaluate (a) the results of the sample and (b) whether the use of audit sampling has provided a reasonable basis for conclusions about the population that has been tested; if it has not, he may request management to investigate misstatements identified and the potential for further misstatements and to make any necessary adjustments, or **tailor the nature, timing and extent of further audit procedures**, for example by extending the sample size, testing an alternative control or modifying related substantive procedures. Where deviations or misstatements are found, the auditor shall investigate their nature and cause and evaluate their possible effect on the purpose

of the audit procedure and on other areas of the audit; where many have a common feature — type of transaction, location, product line or period of time — the auditor may identify all items in the population with that feature and extend procedures to them, and must remember that such deviations or misstatements may be intentional and may indicate the possibility of fraud. **An anomaly is exceptional: only in extremely rare circumstances** may the auditor treat a misstatement or deviation as an anomaly, and then only after obtaining a high degree of certainty, by performing additional audit procedures, that it is not representative of the population; an anomaly may be excluded when projecting misstatements, but its own uncorrected effect must still be considered. For tests of details the auditor shall project misstatements found in the sample to the population; for tests of controls no explicit projection of deviations is necessary, since the sample deviation rate is also the projected deviation rate for the population as a whole.

Remembering reproduce what you have learnt · 3 questions

- Learn the three definitions — stratification, tolerable misstatement, tolerable rate of deviation — word for word. They are set as a three-mark question on their own.
- The advantages of statistical sampling are a five-item list. Marks follow the number of items, so list before you explain.

TQ 6.9 · MTP 2023-Sep [5] (a) · 3M · Pg 257	LEVEL I Remembering	Easy
TQ 6.10 · PYQ 2023-Nov [6] (b) · 4M · Pg 258	LEVEL I Remembering	Medium
CSQ 6.8 · PYQ 2026-May [1] (b) {C} · 5M · Pg 267	LEVEL I Remembering	Medium

Understanding explain it, and place it in context · 7 questions

- Quote the definition of audit sampling in full: 'less than 100% of items within a population of audit relevance such that all sampling units have a chance of selection'. The last clause is what distinguishes sampling from selecting specific items.

CSQ 6.2 · MTP 2022-Mar [3] (c) · 3M · Pg 261	LEVEL I Understanding	Easy
CSQ 6.4 · PYQ 2024-Sep [3] (d) · 3M · Pg 263	LEVEL I Understanding	Easy
TQ 6.4 · RTP 2021-May [15] · Pg 252	LEVEL I Understanding	Medium
TQ 6.5 · RTP 2021-May [16] · Pg 253	LEVEL I Understanding	Medium
TQ 6.6 · RTP 2021-Nov [15] · Pg 254	LEVEL I Understanding	Medium
TQ 6.7 · RTP 2019-Nov [15] · Pg 256	LEVEL I	Medium

	Understanding	
TQ 6.8 · RTP 2022-Nov [16] · Pg 257	LEVEL I Understanding	Medium

Application use the Standard - apply it to the facts · 8 questions

- When a scenario describes a selection, name the method first, then give its definition, then point to the fact in the question that identifies it — the fixed interval, the consecutive block, the groups by value.
- For a very large number of similar transactions the expected answer is statistical sampling, with random sampling as the method. Say why: probability, wide application, no personal bias.

TQ 6.1 · RTP 2018-Nov [14] · Pg 250	LEVEL II Application	Medium
TQ 6.11 · RTP 2023-Nov [15] · Pg 258	LEVEL II Application	Medium
CSQ 6.1 · RTP 2018-May [16] · Pg 259	LEVEL II Application	Medium
CSQ 6.3 · PYQ 2024-Sep [1] (b) {C} · 4M · Pg 262	LEVEL II Application	Medium
CSQ 6.6 · PYQ 2025-Sep [4] (c) · 4M · Pg 265	LEVEL II Application	Medium
CSQ 6.7 · MTP 2026-Mar S1 [3] (a) · 5M · Pg 266	LEVEL II Application	Medium
CSQ 6.9 · PYQ 2026-May [3] (a) · 5M · Pg 269	LEVEL II Application	Medium
TQ 6.2 · PYQ 2020-Nov [2] (c) · 3M · Pg 251	LEVEL II Application	Hard

Analysis break it down and take the parts separately · 1 question

- Where two companies are compared, set out the factors first, then take the one variable that differs — usually the expected deviation rate — and say which company needs the larger sample and why. Do not re-explain the identical factors twice.

CSQ 6.5 · MTP 2024-Nov [1] (b) {C} · 5M · Pg 264	LEVEL II Analysis	Medium
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Synthesis integrate the material and construct · 1 question

- Four things are asked — the **requirements, sample design, sample size** and **selection of items**. Use them as four headings; an undivided answer loses marks that are there for the asking.
- On design, say what the auditor must consider — the purpose of the procedure and the characteristics of the population. On size, the acceptable sampling risk.

TQ 6.3 · MTP 2021-Oct [4] (b) · 4M · Pg 252	LEVEL II	Hard
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Topic 7: Related Parties (SA 550)

L2P5-C4-T07

Read first Read ICAI Study Material Chapter 4, Audit Evidence — SA 550 'Related Parties': the risks arising from related party relationships, the engagement team discussion, inquiries of management, the risk assessment procedures and transactions outside the normal course of business.

NOTES

The responsibility, in one line: the auditor has a responsibility to perform audit procedures to identify, assess and respond to the risks of material misstatement arising from the entity's failure to appropriately account for related party relationships, transactions or balances. **Why these transactions carry higher risk** than transactions with unrelated parties, with the three examples the answers give: related parties may operate through an extensive and complex range of relationships and structures, with a corresponding increase in the complexity of related party transactions; information systems may be ineffective at identifying transactions and outstanding balances between an entity and its related parties; and related party transactions may not be conducted under normal market terms and conditions — for example, some may be conducted with no exchange of consideration.

Inquiries of management — three items, and they are the first half of any 'understanding' question. The auditor shall inquire of management regarding 1. the identity of the entity's related parties, including changes from the prior period; **2. the nature of the relationships between the entity and these related parties**; and 3. whether the entity entered into any transactions with these related parties during the period and, if so, the type and purpose of the transactions.

The other risk assessment procedures — the controls limb, which is the second half. The auditor shall inquire of management **and others within the entity**, and perform other risk assessment procedures considered appropriate, to obtain an understanding of the controls, if any, that management has established to: 1. identify, account for, and disclose related party relationships and transactions in accordance with the applicable financial reporting framework; 2. authorise and approve significant transactions and arrangements with related parties; and 3. authorise and approve significant transactions and arrangements outside the normal course of business. Split the answer the way the Standard does — inquiries of management first, then the other risk assessment procedures. Marks are lost by running them together. And note the flag: a related party transaction involving no exchange of consideration is the Standard's own indicator of a transaction outside the normal course of business, so where the facts say that, the third limb is the one being tested and you must say why it is engaged.

Transactions outside the entity's normal course of business — the six examples: 1. complex equity transactions, such as corporate restructurings or acquisitions; 2. transactions with offshore entities in jurisdictions with weak corporate laws; 3. the leasing of premises or the rendering of

management services by the entity to another party if no consideration is exchanged; **4. sales transactions with unusually large discounts or returns**; 5. transactions with circular arrangements, for example, sales with a commitment to repurchase; **6. transactions under contracts whose terms are changed before expiry**.

Maintaining alertness when inspecting records and documents. The records or documents that may provide information about related party relationships and transactions are: **entity income tax returns; information supplied by the entity to regulatory authorities; shareholder registers to identify the entity's principal shareholders**; statements of conflicts of interest from management and those charged with governance; **records of the entity's investments and those of its pension plans**; contracts and agreements with key management or those charged with governance; significant contracts and agreements not in the entity's ordinary course of business; specific invoices and correspondence from the entity's professional advisors; **life insurance policies acquired by the entity; significant contracts re-negotiated by the entity during the period; internal auditors' reports**; and documents associated with the entity's filings with a securities regulator, for example prospectuses.

The engagement team discussion, which SA 550 ties to SA 315 and SA 240. The discussion those Standards require shall include specific consideration of the susceptibility of the financial statements to material misstatement due to fraud or error that could result from the entity's related party relationships and transactions, and the matters to be addressed are: 1. the nature and extent of the entity's relationships and transactions with related parties, using for example the auditor's record of identified related parties updated after each audit; 2. an emphasis on the importance of maintaining professional scepticism throughout the audit regarding the potential for material misstatement associated with related party relationships and transactions; 3. the circumstances or conditions of the entity that may indicate the existence of related party relationships or transactions that management has not identified or disclosed — a complex organisational structure, use of special-purpose entities for off-balance sheet transactions, or an inadequate information system; 4. the records or documents that may indicate the existence of related party relationships or transactions; 5. the importance that management and those charged with governance attach to the identification, appropriate accounting for, and disclosure of related party relationships and transactions, and the related risk of management override of relevant controls; and **6. in the context of fraud, how related parties may be involved in fraud** — for example how special-purpose entities controlled by management might be used to facilitate earnings management, or how transactions between the entity and a known business partner of a key member of management could be arranged to facilitate misappropriation of the entity's assets.

One question printed under this topic is in fact answered from SA 210 'Agreeing the Terms of Audit Engagement', so know that list too. Before accepting an engagement the auditor must obtain the agreement of management that it **acknowledges and understands its responsibility**: for the preparation of the financial statements in accordance with the applicable financial reporting framework, including where relevant their fair presentation; for such internal control as

management considers necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; and to provide the auditor with (1) access to all information of which management is aware that is relevant to the preparation of the financial statements, such as records, documentation and other matters, (2) additional information that the auditor may request for the purpose of the audit, and (3) unrestricted access to persons within the entity from whom the auditor determines it necessary to obtain audit evidence.

Understanding explain it, and place it in context · 6 questions

- Where the question asks how the auditor obtains an understanding of related party relationships, give two headings — inquiries of management, and inquiries about controls — with three items under each. Six items, six chances at a mark.

TQ 7.2 · PYQ 2023-Nov [3] (d) · 3M · Pg 272	LEVEL I Understanding	Easy
TQ 7.1 · RTP 2021-Nov [8] · Pg 271	LEVEL I Understanding	Medium
TQ 7.3 · MTP 2025-Jul S1 [4] (b) · 5M · Pg 272	LEVEL I Understanding	Medium
CSQ 7.1 · PYQ 2020-Nov [2] (a) · 5M · Pg 273	LEVEL I Understanding	Medium
CSQ 7.3 · MTP 2025-Dec S2 [1] (b) · 5M · Pg 275	LEVEL I Understanding	Medium
CSQ 7.4 · PYQ 2026-Sep [5] (a) · 5M · Pg 276	LEVEL I Understanding	Medium

Application use the Standard - apply it to the facts · 1 question

- Pick up the fact in the scenario that triggers the Standard — no consideration exchanged, a restructuring with new related parties, sub-contract payments to a firm in which a director is managing partner — and name which limb it engages before listing the procedures.

CSQ 7.2 · PYQ 2022-May [1] (b) {C} · 5M · Pg 274	LEVEL II Application	Medium
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Topic 8: Using the Work of Internal Auditors (SA 610)

L2P5-C4-T08

Read first Read ICAI Study Material Chapter 4, Audit Evidence — SA 610 'Using the Work of Internal Auditors': the activities of the internal audit function, evaluating and using its work, coordination, and direct assistance.

NOTES

The sentence to open with, because it decides most of the scenario questions: the external auditor has sole responsibility for the audit opinion expressed, and that responsibility is not reduced by the external auditor's use of the work of the internal audit function or by direct assistance from internal auditors. The external auditor shall make all significant judgements in the audit engagement. So an engagement partner who takes the internal auditor's ageing of debtors for want of time and then blames the internal auditor for wrong provisioning **is not on any ground that the Standard recognises.**

What the internal audit function does, and why an automated-control failure is its business. The activities of an internal audit function include **evaluation of internal control** — the function may be assigned specific responsibility for reviewing controls, evaluating their operation and recommending improvements — and the examination of financial and operating information. Where an application control, such as the automated levy of interest on delayed customer payments, **fails to operate**, that is a deficiency in the operation of a control forming part of internal control over revenue and receivables, resulting in understatement of interest income and incorrect customer balances. Identifying such failures, evaluating their effect, quantifying the amount not charged so far as practicable, and reporting to management with recommendations for remediation falls squarely within the internal audit function's activities.

What the external auditor must consider before relying on that work: determine whether the work of the internal audit function, or direct assistance from internal auditors, can be used and, if so, in which areas and to what extent; evaluate the organisational status of the internal audit function and the relevant policies and procedures that support the objectivity of the internal auditors; **consider the level of competence of the function**; consider whether the function applies a systematic and disciplined approach, including quality control; **evaluate whether the work performed is adequate for the purposes of the audit**; and, where internal auditors give direct assistance, **provide appropriate direction, supervision and review of their work.**

When to use less of the function's work and do more yourself — four circumstances, and they are a five-mark answer on their own. To prevent undue reliance, the external auditor shall plan to use less of the function's work and perform more of the work directly: 1. the more judgement is involved in (a) planning and performing relevant audit procedures and (b) evaluating the audit evidence gathered; 2. the higher the assessed risk of material misstatement at the assertion level, with special consideration given to risks identified as significant; 3. the less the internal audit function's organisational status and relevant policies and procedures adequately support the objectivity of the internal auditors; and **4. the lower the level of competence of the internal audit function.**

Direct assistance. Direct assistance means the use of internal auditors to perform audit procedures under the direction, supervision and review of the external auditor. **Two written agreements must be obtained before it begins:** (a) from an authorised representative of the entity, that the internal auditors will be allowed to follow the external auditor's instructions and that the entity will not intervene in the work the internal auditor performs for the external auditor;

and (b) from the internal auditors, that they will keep confidential specific matters as instructed by the external auditor and inform the external auditor of any threat to their objectivity.

Management's written approval alone is not enough — the internal auditors' own agreement is a separate requirement and a separate mark. Direct assistance shall not be used at all where there are significant threats to the objectivity of the internal auditor or where the internal auditor lacks sufficient competence. And even where they are objective and competent, the external auditor shall not use internal auditors for: (a) procedures which involve making significant judgements in the audit; (b) procedures relating to higher assessed risks of material misstatement where the judgement required in performing the relevant audit procedures or evaluating the audit evidence gathered is more than limited; (c) procedures relating to work with which the internal auditors have been involved and which has already been, or will be, reported to management or those charged with governance by the internal audit function; or (d) procedures relating to decisions the external auditor makes in accordance with this SA regarding the internal audit function and the use of its work or direct assistance.

The 'more than limited judgement' test, worked the way the answers work it. Where valuation of trade receivables is an area of higher assessed risk: checking the accuracy of the ageing involves limited judgement, so it may be assigned to an internal auditor providing direct assistance; evaluating the adequacy of the provision based on that ageing involves more than limited judgement, so it may not. On the same test, evaluating the reasonableness of management's assumptions used in estimating a provision for pending legal claims is a significant judgement and is prohibited — and **the stated motive of saving audit time is not a permitted consideration.**

Coordination with the internal audit function is effective when, for example: 1. discussions take place at appropriate intervals throughout the period; 2. the external auditor informs the internal audit function of significant matters that may affect the function; and 3. the external auditor is advised of and has access to relevant reports of the internal audit function and is informed of any significant matters that come to the attention of the function when such matters may affect the work of the external auditor, so that the external auditor is able to consider the implications of such matters for the audit engagement.

Remembering reproduce what you have learnt · 1 question

- The four prohibited categories of direct assistance and the four circumstances for using less of the function's work are different lists. Learn them apart — questions ask for one or the other, never both.

CSQ 8.5 · PYQ 2026-Jan [6] (b) · 5M · Pg 282

LEVEL I
Remembering

Medium

Understanding explain it, and place it in context · 1 question

- Define direct assistance in the Standard's words — 'under the direction, supervision and review of the external auditor' — before anything else. That clause is what separates direct assistance from using the function's own work.

TQ 8.1 · MQ · Pg 278

LEVEL I
Understanding**Medium****Application** use the Standard - apply it to the facts · 3 questions

- Every scenario here turns on one test: how much judgement does the procedure require. State the test, apply it to the specific procedure in the facts, then conclude that it may or may not be assigned.
- Where the facts show the engagement partner blaming the internal auditor, open with the sole-responsibility sentence. It is the first mark in the answer.

CSQ 8.2 · PYQ 2024-May [3] (d) · 3M · Pg 279

LEVEL II
Application**Easy**

CSQ 8.3 · PYQ 2025-Jan [4] (a) · 5M · Pg 280

LEVEL II
Application**Medium**

CSQ 8.4 · RTP 2025-Jan [12] · Pg 281

LEVEL II
Application**Medium****Analysis** break it down and take the parts separately · 2 questions

- Both scenarios ask whether the statutory auditor may take **direct assistance** in a particular area. **State the prohibition first**, then apply it to the area named.
- Direct assistance may not be used where the judgement involved is significant or the assessed risk is higher. Both scenarios are built on exactly that, so name the area's risk assessment before concluding.

CSQ 8.1 · MTP 2024-Mar [6] (a) · 4M · Pg 279

LEVEL II
Analysis**Medium**

CSQ 8.6 · PYQ 2026-Sep [1] (b) {C} · 5M · Pg 283

LEVEL II
Analysis**Medium**

CHAPTER 5

Audit of Items of Financial Statements

20 Topics · 93 Classified Questions · Importance: A

ICAI SKILL PROFILE ICAI band for this paper: Level I 40-60% · Level II 40-60% — this chapter reads **on profile**

Level I — Comprehension & Knowledge **53.1%** 198 of 373 marks

Level II — Analysis & Application **46.9%** 175 of 373 marks

This chapter sits inside ICAI's own band for the paper — 53% Level I against 40-60%. Prepare it in those proportions: know the method, then drill it.

Topic 1: Assertions Income Statement Captions Comprising Revenue and Expense Balances

L2P5-C5-T01

Read first Read ICAI Study Material Chapter 5, Audit of Items of Financial Statements — the assertions for income statement captions comprising revenue and expense balances.

NOTES

The rule in one line: for a revenue or expense caption the auditor is testing **transactions and events**, and the answers name **five assertions** for these — **(a) Occurrence** — transactions and events relating to the caption have been recorded, have occurred and pertain to the entity; **(b) Completeness** — all transactions and events that should have been recorded have been recorded; **(c) Accuracy** — amounts and other data relating to recorded transactions and events have been recorded appropriately; **(d) Cut-off** — transactions and events have been recorded in the correct accounting period; **(e) Classification** — transactions and events have been recorded in the proper accounts. Learn the five words and the one-line gloss each; the one-mark questions give you a procedure and want the word back.

The mapping the examiner keeps reusing. These are the printed answers, verbatim: 'Employee benefit expense in respect of all personnel have been fully accounted for' → Completeness; 'Discounts on sales has been properly adjusted/accounted for' → Accuracy or Measurement; 'Employee benefit expense recorded during the period relates to the current accounting period only' → Cut Off; 'Recorded sales represent goods which were ordered by valid customers and were despatched and invoiced in the period' → Occurrence; 'Depreciation has been properly charged on all assets' → Valuation and allocation. Note the last one — the procedure reads like an expense, but the answer gives the balance-sheet assertion, because what is being tested is the carrying amount of the asset.

The terminology change, and it is a trap. The Scanner flags it on every assertion answer: under the Study Material applicable from May 2027 examination, the assertion for **balance sheet captions**

is termed '**Valuation and allocation**' and for statement of profit and loss captions 'Accuracy or Measurement'. Under the earlier Study Material these were '**Valuation**' and '**Measurement**'. Write the current term; if you write the old one, write it as 'Accuracy or Measurement (earlier Measurement)' rather than gamble.

Why cut-off is a separate assertion. The answer gives the reason and it carries the mark: cut-off ensures **all income and expenses are reported in the correct accounting period**, and it is kept separate because the substantive procedures to verify it are typically different from those applied to the other components of completeness. Completeness by contrast means all transactions that were supposed to be recorded have been recognised in the financial statements — transactions have not been omitted.

The classic wrong answer is to give 'Accuracy' where the procedure is about period. Read the words of the procedure: if it says 'relates to the current accounting period only' or 'in the period', it is **Cut-off** or **Occurrence**; if it says '**all**' or '**fully accounted for**', it is **Completeness**; if it says 'properly adjusted', 'measured' or 'calculated', it is **Accuracy or Measurement**; if it says '**proper accounts**' or '**correct expense head**', it is **Classification**.

Remembering reproduce what you have learnt · 2 questions

- Name all five assertions for transactions and events before you explain any of them. The marks follow the number of assertions named.

TQ 1.1 · PYQ 2018-May [2] (a) (ii) · 1M · Pg 288

LEVEL I
Remembering

Easy

TQ 1.2 · MTP 2023-Mar [6] (e) · 3M · Pg 288

LEVEL I
Remembering

Easy

Topic 2: Assertions Balance Sheet Captions Comprising Assets, Liabilities and Equity Balances

L2P5-C5-T02

Read first Read ICAI Study Material Chapter 5, Audit of Items of Financial Statements — the assertions for balance sheet captions comprising assets, liabilities and equity balances.

NOTES

The rule in one line: for a balance sheet caption the auditor tests account balances at the period end, and the printed mapping is **Existence, Rights and Obligations, Completeness, Valuation and allocation**, and **Presentation and Disclosure**. The examiner tests this by giving a procedure and asking for the word.

The mapping, from the printed answers: 'Year end inventory verification' → **Existence Assertion**; 'The title deeds of the lands disclosed in the Balance Sheet are held in the name of the company'

→ Rights and Obligations Assertion; 'All liabilities are properly recorded in the financial statements'
 → Completeness Assertion; 'Related party transactions are shown properly' → Presentation and Disclosure Assertion; 'Depreciation has been properly charged on all assets' → Valuation and allocation Assertion. Again the Scanner's note: 'Valuation and allocation' is the term from the Study Material applicable from May 2027; the earlier term was '**Valuation**'.

Valuation applied — loans and advances and other current assets. The ten-mark answer runs six steps in this order: **(1) assess the allowance for doubtful accounts**, reviewing the process the company followed to derive it, comparing it for consistency with the method used last year and determining whether the method is appropriate for the underlying business environment; **(2) obtain the ageing report** split between not currently due, 30 days old, 30-60 days, 60-180 days, 180-365 days and more than 365 days, and obtain the list of loans and advances under litigation and compare with the previous year; **(3) scrutinise the analysis** to identify doubtful items, discuss with management why any are not provided for, perform further testing where disputes exist and **reach a final conclusion on the adequacy of the bad and doubtful provision**; **(4) assess bad loans/advances write-offs** by preparing a schedule of movements on provision accounts and amounts written off; **(5) check that write-offs or other reductions** have been approved by an **appropriate and authorised member of senior management**, for example the financial controller or finance director; **(6) check the restatement of foreign currency loans and advances and other current assets.**

Valuation applied — finished goods and goods for resale. Eight steps, in order: **(1) enquire what costs are included**, how they were established, and ensure **overheads included have been determined on normal costs** and are reasonable against the draft financial statements; **(2) value at net realisable value where lower than cost**, and where you write an item down, check whether the related **work in progress and raw materials have also been written down**; **(3) follow up obsolete, damaged or slow-moving items** and ascertain their possible realisable value, requesting an inventory ageing split — less than 30 days, 30-60, 60-90, 90-180, 180-365 and more than 365 days; **(4) follow up any inventories noted as damaged or obsolete at the time of observance of physical counting**; **(5) compare recorded costs with replacement costs**; **(6) examine vendor price lists** to see whether recorded cost is less than current prices; **(7) calculate the inventory turnover ratio** — a significantly lower ratio may reveal obsolete inventory; **(8) in manufacturing environments test overhead allocation rates** and ensure only **direct labour, direct material and overhead** have been included, and verify the correct application of lower of cost or net realisable value.

The classic wrong answer is to give 'Existence' for anything to do with an asset. Existence is about the item **being there**; **Rights and Obligations** is about the entity **owning** it — title deeds, invoices in the entity's name, confirmations from lenders holding the deeds. A question about title is never answered by 'Existence'.

The order of the answer is worth marks. Where the question asks for procedures 'for valuation (assertion)', do not drift into existence or completeness procedures. Each caption has its own

printed valuation list; give that list, numbered, and stop.

Understanding explain it, and place it in context · 5 questions

- Say what each assertion is about in six words — existence is 'it is there', rights is 'we own it', completeness is 'nothing omitted', valuation is 'carried at the right amount', presentation is 'shown and disclosed properly'.

TQ 2.1 · PYQ 2018-May [2] (a) (i) · 1M · Pg 289	LEVEL I Understanding	Easy
TQ 2.2 · PYQ 2018-May [2] (a) (iii) · 1M · Pg 289	LEVEL I Understanding	Easy
TQ 2.3 · PYQ 2018-May [2] (a) (iv) · 1M · Pg 289	LEVEL I Understanding	Easy
TQ 2.4 · PYQ 2018-May [2] (a) (v) · 1M · Pg 290	LEVEL I Understanding	Easy
TQ 2.5 · PYQ 2018-Nov [3] (c) · 10M · Pg 290	LEVEL I Understanding	Hard

Topic 3.1: Balance Sheet Captions: Share Capital

L2P5-C5-T3.1

Read first Read ICAI Study Material Chapter 5, Audit of Items of Financial Statements — the balance sheet caption Share Capital, including securities premium, shares issued at a discount and sweat equity shares.

NOTES

Securities premium — five permitted applications, and the question is always whether the list is exhaustive of one item. The securities premium account may be applied by the company: (1) towards the issue of unissued shares of the company to the members as fully paid bonus shares; (2) **in writing off the preliminary expenses of the company**; (3) in writing off the expenses of, or the commission paid or discount allowed on, any issue of shares or debentures of the company; (4) in providing for the premium payable on the redemption of any redeemable preference shares or of any debentures of the company; (5) **for the purchase of its own shares or other securities under Section 68**. So the statement that it may **only** be applied towards bonus shares is **wrong** — say that sentence expressly, because the question is set as a 'Comment'.

Section 53 — shares at a discount. (1) A company shall not issue shares at a discount, except in the case of an issue of sweat equity shares under Section 54. (2) **Any share issued by a company at a discounted price shall be void.** (2A) Notwithstanding sub-sections (1) and (2), a company may issue shares at a discount to its creditors when its debt is converted into shares in pursuance of any **statutory resolution plan or debt restructuring scheme**, in accordance with guidelines,

directions or regulations specified by the Reserve Bank of India under the Reserve Bank of India Act, 1934 or the Banking (Regulation) Act, 1949.

Section 53(3) — the consequence, and the figures carry the marks. Where a company fails to comply, such company and every officer who is in default shall be liable to a penalty which may extend to an amount equal to the amount raised through the issue of shares at a discount or five lakh rupees, whichever is less; and the company shall also be liable to refund all monies received with interest at the rate of twelve per cent per annum from the date of issue of such shares to the persons to whom they were issued. This is Section 53(3) as substituted by the Companies (Amendment) Act, 2019, with effect from 02-11-2018.

Sweat equity shares — the definition, verbatim. Under **Section 54**, sweat equity shares means equity shares issued by the company to employees or directors at a discount or for consideration other than cash for providing know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called. Where the facts say key employees or directors are being rewarded for technical know-how or process improvements, **name the instrument as sweat equity shares first** and then apply the conditions.

The four conditions the auditor verifies under Section 54: (1) **special resolution** — approval of the shareholders by special resolution; (2) **details in the resolution** — the resolution must state the **number of sweat equity shares**, the **current market price**, the **consideration, if any**, and the **class of directors or employees** to whom they are to be issued; (3) compliance with SEBI regulations if the shares are listed on a recognised stock exchange, and with the Rules prescribed under the Companies Act, 2013 if the company is unlisted; (4) **existing class of shares** — sweat equity can be issued only out of a **class of equity shares already issued** by the company; a new class cannot be created just for this.

The auditor's own checks. For a discount issue, the auditor verifies that no shares have been issued at a discount by reading the minutes of the meetings of directors and shareholders authorising the issue of share capital and the issue price. For a discount issue to creditors, the auditor ensures it is strictly in line with an approved resolution or restructuring scheme and complies with the applicable RBI guidelines and regulations.

Promoter shareholding — four disclosures: (1) **name of the promoters**; (2) the number of shares held by the promoters; (3) percentage of total shares held by the promoters; (4) percentage change during the year in the promoters' shareholding.

Understanding explain it, and place it in context · 1 question

- Quote Section 53 in its sub-sections — (1), (2), (2A), (3). The sub-section numbering itself signals to the examiner that you know the exception from the rule.

Application use the Standard - apply it to the facts · 4 questions

- The fact pattern almost always contains a discount issue or a know-how issue. Name the section first, state the rule and its exception, then apply it to the facts, then state the consequence (void, penalty, refund with interest at twelve per cent). An answer that only says 'not allowed' loses the consequence marks.

CSQ 3.1.1 · PYQ 2022-Nov [2] (a) · 4M · Pg 293	LEVEL II Application	Medium
CSQ 3.1.3 · PYQ 2024-May [5] (a) · 4M · Pg 295	LEVEL II Application	Medium
TQ 3.1.1 · PYQ 2019-May [4] (d) · 3M · Pg 292	LEVEL II Application	Hard
TQ 3.1.2 · PYQ 2019-Nov [3] (b) · 4M · Pg 293	LEVEL II Application	Hard

Analysis break it down and take the parts separately · 1 question

- Where the facts involve creditors and a restructuring, take the general prohibition and the 2A exception one at a time and say which limb the facts fall in. Do not treat a debt-to-equity conversion as a plain discount issue.

CSQ 3.1.4 · PYQ 2026-May [5] (a) · 5M · Pg 296	LEVEL II Analysis	Medium
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Topic 3.2: Balance Sheet Captions: Reserves And Surplus

L2P5-C5-T3.2

Read first Read ICAI Study Material Chapter 5, Audit of Items of Financial Statements — the balance sheet caption Reserves and Surplus, and the Schedule III disclosure of Other Equity.

NOTES

The definition, and it is short enough to write in full: reserves are the amounts appropriated out of profits that are not intended to meet any liability, contingency, commitment or diminution in the value of assets known to exist as at the date of the Balance Sheet. The four negatives — **liability, contingency, commitment, diminution in value of assets** — are the mark-bearing part; leave one out and the definition is incomplete.

Why reserves matter: they are a **vital source of financing by internal means**, held for distribution of dividend, financing the expansion of the company, or strengthening the company financially. The company utilises a reserve **according to the nature and type of such reserve**.

Revenue reserve versus capital reserve. Revenue reserves represent profits that are available for distribution to shareholders, or for purposes such as supplementing divisible profits in lean years, financing an extension of the business, augmenting working capital, or generally strengthening the

company's financial position. Capital reserve represents a reserve which does not include any amount regarded as free for distribution and **can be utilised only for certain limited purposes** — the printed examples are **securities premium and capital redemption reserve**.

The proviso the examiner likes: if a company appropriates revenue profit for being credited to the asset replacement reserve with the objective that it is to be used for a capital purpose, such a reserve shall also be in the nature of a capital reserve. So the test is **the purpose the reserve is earmarked for**, not the source of the profit out of which it was created.

Ind AS compliant Schedule III — sub-classification of Other Equity. Has the company sub-classified other equity into: (1) Share application money pending allotment; (2) Equity component of compound financial instruments; (3) Capital Reserve; (4) Securities premium reserve; (5) Other reserves (specify nature); (6) Retained earnings; (7) Debt instruments through other comprehensive income; (8) Equity instruments through other comprehensive income; (9) Effective portion of cash flow hedges; (10) Revaluation surplus; (11) Exchange difference on translation of financial statements of a foreign operation; (12) Other items of other comprehensive income (specify nature), and **money received against share warrants**.

For each component of Other Equity, eight movement disclosures: (1) balance at the beginning of the reporting period; (2) changes in accounting policy or prior period error; (3) restated balance at the beginning of the reporting period; (4) total comprehensive income for the year; (5) dividends; (6) transfer to retained earnings; (7) any other change (to be specified); (8) balance at the end of the reporting period — to the extent applicable. Note the structure of the answer: **first the sub-classification list, then the movement list**; a script that gives only one of the two halves loses half the marks.

Understanding explain it, and place it in context • 2 questions

- Give both halves of the Schedule III answer: the twelve components and then the eight movement lines. Head them separately so the examiner can see both lists.

TQ 3.2.1 • PYQ 2019-Nov [3] (c) • 3M • Pg 297

LEVEL I
Understanding

Easy

TQ 3.2.2 • MTP 2022-Sep [6] (d) • 3M • Pg 298

LEVEL I
Understanding

Easy

Topic 3.3: Balance Sheet Captions: Borrowings

L2P5-C5-T3.3

Read first Read ICAI Study Material Chapter 5, Audit of Items of Financial Statements — the balance sheet caption Borrowings, including Schedule III disclosure of short term borrowings and the audit of bank borrowings.

NOTES

Schedule III (Part I) — short term borrowings, five disclosure limbs. (1) Short term borrowings shall be classified as (a) loans repayable on demand — (i) from banks (ii) from other parties; (b) loans and advances from related parties; (c) deposits; (d) other loans and advances (specify nature). (2) Borrowings shall further be sub-classified as secured and unsecured, and the nature of security shall be specified separately in each case. (3) Where loans have been guaranteed by directors or others, the aggregate amount of such loans under each head shall be disclosed. (4) Period and amount of default as on the balance sheet date in repayment of loans and interest shall be specified separately in each case. **(5) Current maturities of long term borrowings shall be disclosed separately.**

Classifying a cash credit or overdraft. A credit facility given by a bank to meet **working capital requirements** and **repayable on demand** is a **cash credit facility / overdraft facility**. The outstanding amount **reflects a borrowing** and is classified as a short-term borrowing — loans repayable on demand from banks — under current liabilities, and **further sub-classified as secured** where security exists. Where the security is primary charge on current assets and collateral of a director's residential house, **the nature of security must be specified** and because the loans are guaranteed by directors, the aggregate amount of such loans must be disclosed.

Additional Regulatory Information where borrowings are secured on current assets. The company shall disclose (a) whether quarterly returns or statements of current assets filed by the company with banks or financial institutions are in agreement with the books of accounts; and **(b) if not, a summary of reconciliation and reasons for material discrepancies**. This is an easy four-mark limb that candidates routinely miss.

Vouching borrowings from a bank — eight steps, in this order. The auditor **rolls out and obtains independent balance confirmations from all lenders** and then: (1) ascertains that the confirmation asks for all information likely to be relevant to the tests of debt and related interest balances — applicable interest rates, due dates, collateral and security interests; **(2) sends reminders for non-replies**; (3) compares the balances per confirmations to the books of account, asks for reconciliations where there are differences and tests the supporting documents for reconciling items on a test-check basis; (4) reconciles the balances in the overdraft or loan accounts with the pass book and confirms that balance by a certificate from the bank as at the year end; (5) obtains independent balance confirmation showing balances, particulars of securities deposited or charge created, and confirms the same has been correctly disclosed, duly registered with the Registrar of Companies and recorded in the Register of charges; (6) verifies the authority under which the loan or draft was raised — in the case of a company only the Board of Directors is authorised to raise a loan or borrow from a bank; (7) confirms that the restraint in Section 180 of the Companies Act, 2013 as regards the maximum amount of loan the company can raise has not been contravened; (8) ascertains the purpose for which the loan was raised and the manner in which it was utilised, and that this has not prejudicially affected the entity.

Testing that borrowings are valid claims — the rights and obligations list. **(1) Review the board minutes for approval of new lending agreements** and ensure new loan agreements or bond

issuances were authorised and significant debt commitments approved by the board; (2) check the details of loans recorded — interest rate, nature and repayment terms — to the loan agreement, and verify that borrowing limits imposed by the agreements are not exceeded; (3) roll out and obtain independent balance confirmations under SA 505 in respect of all borrowings from lenders; (4) verify the details of leases and hire purchase creditors recorded to the underlying contracts or agreements; (5) in the case of debentures, examine the trust deed for terms and dates of redemption, borrowing restrictions and compliance with covenants; (6) when debt is retired, ensure a discharge is received on the assets securing the debt; (7) obtain written representation that all liabilities recorded represent a valid claim by the lenders. Where the facts state a **pari passu charge**, add (8) **ensure a valid pari passu charge has been created on the company's assets**, and where the facts give movement figures, add (9) trace fresh borrowings and repayments to the bank statements and books of account to confirm the movement of funds.

The one Standard named in this topic is SA 505 — it is the authority for rolling out independent balance confirmations to lenders. Do not attribute the confirmation procedure to any other Standard; the answers name only SA 505.

Understanding explain it, and place it in context · 1 question

- Where the question asks 'how is short term borrowing disclosed', give the five Schedule III limbs in order and do not stray into audit procedures.

TQ 3.3.1 · PYQ 2023-Nov [4] (b) · 4M · Pg 300

LEVEL I
Understanding

Medium

Application use the Standard - apply it to the facts · 3 questions

- A fact pattern with a figure difference between the bank certificate and the ledger is asking for the confirmation-and-reconciliation steps first. Start with the independent confirmation, then the comparison and reconciliation, then the authority and Section 180 checks.

CSQ 3.3.1 · PYQ 2024-Sep [2] (b) · 4M · Pg 300

LEVEL II
Application

Medium

CSQ 3.3.3 · RTP 2024-Sep [13] · Pg 303

LEVEL II
Application

Medium

CSQ 3.3.4 · PYQ 2025-Sep [5] (b) · 5M · Pg 304

LEVEL II
Application

Medium

Analysis break it down and take the parts separately · 1 question

- When the facts give fresh borrowings and repayments during the year, close the answer by tracing those movements to the bank statements. That last step is what converts a general procedure list into an answer on these facts.

Topic 3.4: Balance Sheet Captions: Trade Receivables

L2P5-C5-T3.4

Read first Read ICAI Study Material Chapter 5, Audit of Items of Financial Statements — the balance sheet caption Trade Receivables, including cut-off procedures, external confirmations and the Schedule III ageing schedule.

NOTES

Tests of controls over sales, as part of the debtors' audit. The points to consider are: **only legitimate sales lead to trade receivables**; **all sales are made to approved customers**; **all sales are properly recorded in the books of accounts**; once recorded, debtors can only be settled through cash receipts or with the authority of a responsible official; **there is segregation of duties at every stage of the sales transaction** — accounting for debtors, collecting payments, sending reminders; **debtors are collected in a timely manner**; where debtors are not collected on time, reminders are sent and legal action is taken if necessary; **balances are reviewed regularly**; and an effective follow-up system exists, with adequate provision for bad debts made by preparing a comprehensive ageing schedule of the debtors. Where the question asks for 'any four points', pick four and number them — do not write nine and hope.

When management refuses to allow a confirmation request. The auditor shall: perform alternative audit procedures designed to obtain relevant and reliable audit evidence; inquire as to management's reasons for the refusal and seek audit evidence as to their validity and reasonableness; evaluate the implications of the refusal on the auditor's assessment of the risks of material misstatement, including the risk of fraud; and if the auditor concludes that **management's refusal is unreasonable**, or is unable to obtain relevant and reliable audit evidence from alternative procedures, then **communicate with those charged with governance** and determine the implication for the audit and the auditor's opinion in accordance with SA 705. Note the order — alternative procedures and inquiry come **before** any escalation, and the only Standard the answer names is **SA 705**.

Completeness of trade receivables is a cut-off question. The printed reasoning is that **without a cut-off, sales could be understated or overstated**, so the auditor performs cut-off procedures: for invoices issued during the last few days of the reporting year, i.e. around the cut-off date, and included in debtors, check that the goods have actually been despatched and are not lying with the company; ensure that all goods despatched prior to the period end have been invoiced and included in debtors, on a test check basis; ensure that no goods despatched after the year end have been invoiced and included in debtors for the period under audit.

Export receivables — the same completeness test with the shipping documents added. (1) Check that in respect of invoices raised in the last few days nearing the cut-off date, goods have actually

been despatched and are not lying with the company; (2) check stock records, e-way bill and transporter receipt regarding actual movement of goods, which gives assurance that the export invoices booked as revenue actually moved out of the premises; (3) ensure that all goods invoiced prior to the cut-off date have been included in export receivables, on test check basis; (4) ensure that no goods despatched after the year end have been included, by tracing entries in export sales and the stock records of the next year, verifiable also from e-way bills; (5) match invoices to despatch/shipping details, and match invoice dates to despatch dates to see if sales are recorded in the correct accounting period; (6) test invoices in the receivable report — select invoices from the ageing report and compare with supporting documentation to ensure they are billed with the correct names, dates and amounts.

Schedule III (Part I) — the trade receivables ageing schedule. The four rows are (i) Undisputed Trade Receivables – considered good; (ii) Undisputed Trade Receivables – considered doubtful; (iii) Disputed Trade Receivables – considered good; (iv) Disputed Trade Receivables – considered doubtful. The columns are the periods outstanding from the due date of payment — less than 6 months, 6 months to 1 year, 1-2 years, 2-3 years, more than 3 years — and Total. Two footnotes carry marks: similar information shall be given where no due date of payment is specified, in which case disclosure shall be from the date of the transaction, and **unbilled dues shall be disclosed separately**.

The recurring confusion: students answer a **completeness** question with **existence** procedures. Completeness of receivables is tested by looking for what is **missing** — invoices not raised for goods despatched before year end — so the direction of testing runs **from the despatch and stock records into the receivables ledger**, not from the ledger outwards.

Remembering reproduce what you have learnt · 1 question

- A disclosure or documents question. **List what is required, in the order the answer gives it**, and do not stop at three items if the schedule requires more.
- Where the facts name export receivables, say which additional disclosure that attracts.

CSQ 3.4.3 · RTP 2022-Nov [20] · Pg 307

LEVEL I
Remembering

Medium

Understanding explain it, and place it in context · 2 questions

- Where the question caps the answer ('any four points'), obey the cap. Extra points do not earn extra marks and cost you time on the next question.

TQ 3.4.1 · PYQ 2025-May [4] (c) · 4M · Pg 305

LEVEL I
Understanding

Medium

CSQ 3.4.1 · PYQ 2020-Nov [4] (b) · 4M · Pg 306

LEVEL I
Understanding

Medium

Application use the Standard - apply it to the facts · 2 questions

- A fact pattern where an invoice dated 31 March is unrecorded is a cut-off question. Say 'completeness is achieved through cut-off' in your opening line, then give the three cut-off checks.

CSQ 3.4.2 · PYQ 2022-Nov [3] (c) · 3M · Pg 307

LEVEL II
Application

Easy

CSQ 3.4.4 · MTP 2023-Mar [4] (c) · 6M · Pg 308

LEVEL II
Application

Hard

Topic 3.5: Balance Sheet Captions: Cash and Cash Equivalents

L2P5-C5-T3.5

Read first Read ICAI Study Material Chapter 5, Audit of Items of Financial Statements — the balance sheet caption Cash and Cash Equivalents, including the Schedule III disclosures and the verification of bank reconciliation statements.

NOTES

Schedule III (Part I) — five disclosure limbs for cash and cash equivalents. (1) Cash and cash equivalents shall be classified as (a) balances with banks; (b) cheques, drafts on hand; (c) cash on hand; (d) others (specify nature). (2) Earmarked balances with banks (for example, for unpaid dividend) shall be separately stated. (3) Balances with banks to the extent held as margin money or security against the borrowings, guarantees or other commitments shall be disclosed separately. (4) Repatriation restrictions, if any, in respect of cash and bank balances shall be separately stated. (5) Bank deposits with more than 12 months' maturity shall be disclosed separately.

The bank reconciliation statement — the first check is the signature. The auditor should ensure the BRS is signed by authorised personnel so that responsibility can be assigned in case of any errors. Then tally the balance as per the bank book to the bank confirmation or statement.

Then the three classes of reconciling item, each with its own procedure. (a) **Cheques issued but not presented for payment** — check all material items to the underlying bank book forming part of the books of account, request bank statements of the subsequent period and verify whether the cheques issued have subsequently been cleared; where cheques have become stale, i.e. 3 months or more have lapsed since the issue date, they should not appear in the BRS and should instead be taken back to liabilities. (b) **Cheques deposited but not credited by the bank** — request **bank deposit slips duly acknowledged by the bank** and verify subsequent credit by tallying to the subsequent period's statement; where cheques have **not cleared beyond a reasonable time**, seek brief descriptions from management and, if the explanations are unsatisfactory, verify that revenue recognition relating to such parties was in order and as per the company's revenue recognition policy. (c) **Amounts or charges debited or credited by the bank but not accounted for** — request the bank statements for the period and tally them, and if the amounts are material, ensure management records the adjustments in its books.

Existence and completeness of cash balances — physical verification is the backbone. (1) Count cash on hand at the period end at ALL locations — head office, branch and petty cash — and where simultaneous counting is not possible, arrange for the locations not counted to be sealed, or reconcile the count to the period-end balance by rolling back the intervening transactions. (2) Reconcile the counted balance to the cash book and the general ledger, and obtain explanations for differences. (3) **Deal with imprest advances to employees separately** — obtain confirmations or acknowledgements from the holders and examine subsequent settlement, **because these are amounts recoverable rather than cash in hand**. (4) Check cut-off around the period end so that receipts and payments fall in the right year, and inspect for any cash held that is restricted or not freely available. (5) Verify the presentation and disclosure of cash and cash equivalents in accordance with the applicable financial reporting framework.

The trap the Scanner plants in the cash fact pattern: separate cash books at different locations create the risk of the same cash being counted twice, or of transfers in transit; and rough cash records are not books of account and must be traced into the cash book rather than accepted. Say both sentences — they are the difference between a generic count answer and one on these facts.

A stale cheque is a liability, not a reconciling item. This is the point most often lost. Three months from the date of issue and it comes out of the BRS and goes back to creditors.

Remembering reproduce what you have learnt · 2 questions

- The ask is the **Schedule III disclosure**, so answer with the schedule's own heads and sub-heads rather than with audit procedures.
- Name the components of cash and cash equivalents separately — balances with banks, cheques on hand, cash on hand — because the marks follow the items named.

TQ 3.5.1 · RTP 2023-May [20] (a) · Pg 310

LEVEL I
Remembering

Medium

CSQ 3.5.2 · PYQ 2026-Sep [4] (b) · 5M · Pg 312

LEVEL I
Remembering

Medium

Application use the Standard - apply it to the facts · 1 question

- For a BRS question, structure the answer by the type of reconciling item — cheques issued not presented, cheques deposited not credited, bank debits and credits not accounted — and give the procedure under each. A flat list of checks scores less than a structured one.

CSQ 3.5.1 · MTP 2024-Jul [4] (c) · 4M · Pg 310

LEVEL II
Application

Medium

Topic 3.6: Balance Sheet Captions: Inventories

L2P5-C5-T3.6

Read first Read ICAI Study Material Chapter 5, Audit of Items of Financial Statements — the balance sheet caption Inventories, together with SA 501 on attendance at physical inventory counting.

NOTES

Valuation, by class of inventory — learn the three lists separately, because the question names the class. **Raw materials and consumables:** (1) ascertain what elements of cost are included, e.g. carriage inward, non-refundable duties; (2) if standard costs are used, enquire into the basis of the standards, how they are compared with actual costs and how variances are analysed and accounted for; (3) test check cost prices used with purchase invoices received in the months prior to counting; (4) follow up valuation of all damaged or obsolete inventories noted during observance of physical counting with a view to establishing a realistic net realisable value. **Work in progress:** (1) ascertain how the various stages of production or value addition are measured, and where estimates are made, understand the basis for the estimates; (2) ascertain what elements of cost are included, and if overheads are included, ascertain the basis and compare it with the costing and financial data maintained by the entity; (3) **ensure that material costs exclude any abnormal wastage factors.**

Finished goods and goods for resale — eight steps, and the obsolescence limb is the one examined. (1) Enquire what costs are included, how they were established, and ensure overheads included are on normal costs and reasonable against the financial statements; (2) value at net realisable value where lower than cost, and where an item is written down verify whether the related work in progress and raw materials have also been written down; (3) follow up items that are obsolete, damaged or slow moving and ascertain their possible realisable value, requesting an inventory ageing analysis and following up items noted as damaged or obsolete at physical verification; (4) **compare recorded costs with replacement costs;** (5) examine vendor price lists to determine if recorded cost is less than current prices; (6) calculate the inventory turnover ratio — obsolete inventory may be revealed if the ratio is significantly lower; (7) in manufacturing environments, test overhead allocation rates and ensure only direct labour, direct material and overhead have been included; (8) verify the correct application of the lower of cost or net realisable value principle.

AS 2 applied to a computation. Inventory is recognised at the lower of cost and net realisable value. Costs that could not be reasonably allocated to the cost of production (for example general and administrative costs) and any abnormal wastage are excluded from the cost of inventory, and an acceptable valuation basis such as FIFO or weighted average must have been used. In the printed sum, allocated transport cost is added, because it relates to bringing the inventory to its location, while **abnormal wastage is excluded;** cost after adjustment was ₹25,23,000 (₹25,25,000 less ₹2,000) against an NRV of ₹25,24,000, so the closing stock is carried at ₹25,23,000, being the lower. Show the adjustment, then the comparison, then the conclusion.

SA 501, Audit Evidence – Specific Considerations for Selected Items — two situations, and the answers name the Standard by its full title. **Counting on a date other than the date of the financial statements:** the auditor shall, in addition to the required procedures, carry out audit procedures to obtain audit evidence about whether changes in inventory between the count date and the financial statement date have been properly recorded, or whether the perpetual inventory records have been appropriately adjusted; the matters to consider in designing those procedures are **the reliability of the entity's perpetual inventory records** and the reasons for significant differences between the information obtained during the count and the perpetual records. **Where attendance is impracticable:** the auditor shall make or observe physical counts on an alternative date and perform audit procedures on intervening transactions, and if attendance is impracticable due to the nature and location of the inventory, shall perform alternative audit procedures to obtain sufficient appropriate audit evidence regarding the existence and condition of inventory — for example inspection of documentation relating to the subsequent sale of specific inventory items acquired or purchased prior to the physical inventory counting.

Planning attendance at physical inventory counting — nine matters. (1) The nature of the inventory; (2) the stages of completion for work in progress; (3) the risks of material misstatement related to inventory; (4) the effectiveness of internal controls related to inventory; (5) whether adequate procedures are expected to be established and proper instructions issued for physical inventory counting; (6) the timing of the physical inventory counting; (7) whether the entity maintains a perpetual inventory system; (8) the locations where inventory is held, including the materiality of the inventory and the risks of material misstatement at different locations, to determine the appropriateness of attendance at each location; (9) whether the assistance of an auditor's expert is necessary to obtain sufficient appropriate audit evidence.

Rights and ownership of inventory, including stock with third parties. Vouch recorded purchases to underlying documentation — purchase requisition, purchase order, receiving report, vendor invoice and cancelled cheque or payment file; **evaluate the consigned goods; examine client correspondence, sales and receivables records, purchase documents; determine the existence of collateral agreements; review consignment agreements; review material purchase commitment agreements;** examine invoices for evidence of ownership, i.e. the invoices shall be in the name of the client; **obtain confirmation for significant items of inventory;** and for inventory held by a third party, insist on a declaration from the third party on its business letterhead, signed by authorised personnel, confirming that the items belong to the entity and are held on behalf of and for the benefit of the entity under audit.

Existence and completeness — the analytical and reconciliation set. Perform analytical procedures — inventory turnover ratio (cost of goods sold over average inventory), vertical analysis (inventory over total assets) and budget versus actual comparison; **examine non-financial information such as weights and other measurements;** perform purchase and sales cut-off tests, tracing shipping documents — bills of lading, receiving reports, warehouse records and inventory records — to the accounting records immediately before and after year end; with respect to tagged inventory, perform tests for omitted transactions and tests for invalid transactions; **verify**

the clerical and arithmetical accuracy of inventory listings; reconcile physical inventory amounts with perpetual records and with ledger control totals; reconcile inventories belonging to the client but held with third parties such as transporters, warehouses and port authorities; and ensure goods received on a consignment basis have been properly segregated from other items of inventory.

Remembering reproduce what you have learnt • 2 questions

- The nine planning matters under SA 501 are a straight list question. Number them and give the eighth in full — locations, materiality and risk at different locations — because it is the longest and most often abbreviated away.

TQ 3.6.1 • RTP 2022-Nov [19] • Pg 313

LEVEL I
Remembering

Medium

TQ 3.6.3 • PYQ 2025-Sep [6] (a) • 5M • Pg 314

LEVEL I
Remembering

Medium

Understanding explain it, and place it in context • 5 questions

- When asked for valuation procedures, first identify the class of inventory the question names. Raw materials, work in progress and finished goods have different printed lists; giving the wrong list scores nothing.

CSQ 3.6.1 • PYQ 2021-Jan [3] (d) • 3M • Pg 315

LEVEL I
Understanding

Easy

CSQ 3.6.2 • RTP 2021-Nov [20] • Pg 315

LEVEL I
Understanding

Medium

CSQ 3.6.7 • RTP 2025-Jan [13] • Pg 320

LEVEL I
Understanding

Medium

CSQ 3.6.8 • PYQ 2025-May [6] (a) • 5M • Pg 321

LEVEL I
Understanding

Medium

CSQ 3.6.10 • MTP 2026-Apr S2 [5] (b) • 5M • Pg 324

LEVEL I
Understanding

Medium

Application use the Standard - apply it to the facts • 6 questions

- For a case with a count on a date other than the balance sheet date, name SA 501 with its full title, state the requirement, then apply it: test that the movements between the count date and the year end were properly recorded.

TQ 3.6.2 • PYQ 2023-Nov [3] (b) • 4M • Pg 313

LEVEL II
Application

Medium

CSQ 3.6.3 • PYQ 2024-May [1] (b) {C} • 4M • Pg 316

LEVEL II
Application

Medium

CSQ 3.6.4 · MTP 2024-Jul [3] (b) · 5M · Pg 317	LEVEL II Application	Medium
CSQ 3.6.5 · MTP 2024-Nov [6] (c) · 4M · Pg 318	LEVEL II Application	Medium
CSQ 3.6.6 · MTP 2024-Dec S2 [4] (a) · 5M · Pg 319	LEVEL II Application	Medium
CSQ 3.6.9 · PYQ 2025-Sep [1] (c) {C} · 4M · Pg 322	LEVEL II Application	Medium

Topic 3.7: Balance Sheet Captions: PPE

L2P5-C5-T3.7

Read first Read ICAI Study Material Chapter 5, Audit of Items of Financial Statements — the balance sheet caption Property, Plant and Equipment, including recognition, elements of cost, depreciation and rights over PPE.

NOTES

Recognition criteria — two conditions, both must be met. The cost of an item of PPE should be recognised as an asset if, and only if, (1) it is probable that future economic benefits associated with the item will flow to the enterprise; and (2) the cost of the item can be measured reliably.

Elements of cost — three limbs, and the third is where the marks hide. The cost of an item of PPE comprises: (i) its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates; (ii) any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management; and (iii) the initial estimate of the costs of dismantling, removing the item and restoring the site on which it is located — referred to as decommissioning, restoration and similar liabilities — the obligation for which the enterprise incurs either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period. So dismantling cost of an old plant incurred so that a new plant can be set up at the existing location forms part of the cost of the new PPE.

What is capitalised and what is not — the printed sorting. Capitalise: site preparation, installation, testing of the machinery before use, and professional fees paid to engineers, because they are **directly attributable to making the asset ready for use**. **Charge to revenue: staff training and advertising**, because they do not bring the asset to its intended working condition and are not part of the cost of PPE. The four named examples of costs that are **not** costs of an item of PPE are (1) costs of opening a new facility or business, such as inauguration costs; (2) costs of introducing a new product or service; (3) costs of conducting business in a new location or with a new class of customer; (4) administration and other general overhead costs.

Valuation of PPE — why it matters and the three checks. The reasoning the answer gives: the value of PPE depreciates due to efflux of time, use and obsolescence; the diminution represents an

item of cost to the entity for earning revenue during the period; unless this cost in the form of depreciation is charged to the accounts, the profit or loss would not be correctly ascertained and the values of PPE would be shown at higher amounts. The procedures: (1) verify that the entity has charged depreciation on all items of PPE unless an item is non-depreciable, like freehold land; (2) assess that the depreciation method used reflects the pattern in which the asset's future economic benefits are expected to be consumed by the entity — straight line method, diminishing value method or unit of production method, as applicable; (3) verify whether management has done an impairment assessment to determine whether an item of PPE is impaired, as per the requirements of AS 28 – Impairment of Assets.

Rights and obligations over PPE — five steps, in order. (1) In addition to the procedures for verifying completeness of additions, while testing additions verify that all PPE purchase invoices are in the name of the entity, which entitles legal title of ownership to that entity; (2) for all additions to land and building in particular, check the conveyance deed or sale deed to verify whether the entity is the legal and valid owner; **(3) insist on and verify title deeds for immovable property acquired;** (4) where the entity has given such immovable property as security for borrowings and the original title deeds are not likely to be available with the entity, request management to obtain a confirmation from the respective lenders that they are holding the original title deeds as security; (5) verify the register of charges available with the entity to assess whether any charge has been created against the PPE.

Assertions on PPE — two levels, and the examiner asks for both. For **transactions and events:** **Occurrence, Completeness, Accuracy, Cut-off, Classification**, each with its one-line meaning. For the **specific assertions implied in a Plant and Machinery extract:** (a) the firm owns the plant and machinery; (b) the historical cost of the plant and machinery is the amount shown; (c) the plant and machinery physically exists; (d) the asset is being utilised in the business of the company productively; (e) the total charge of depreciation to date is the accumulated figure, of which the year's figure relates to the year under audit; (f) the amount of depreciation has been calculated on a recognised basis and the calculation is correct.

Remembering reproduce what you have learnt · 1 question

- The question prints an extract and asks for the **assertions implied** in it. **Name the assertion for each line of the extract**, not one assertion for the whole.
- Use the Study Material's current wording: for a balance sheet caption it is **Valuation and allocation**, not 'Valuation' alone.

TQ 3.7.1 · MTP 2021-Mar [2] (a) · 6M · Pg 325

LEVEL I
Remembering

Hard

Understanding explain it, and place it in context · 3 questions

- State the two recognition conditions and the three elements of cost as numbered limbs. These are quoted definitions; paraphrasing costs marks.

TQ 3.7.2 • RTP 2023-May [19] • Pg 326	LEVEL I Understanding	Medium
CSQ 3.7.3 • MTP 2024-Jul [6] (Or) (c) • 4M • Pg 329	LEVEL I Understanding	Medium
CSQ 3.7.5 • MTP 2024-Nov [5] (c) • 4M • Pg 331	LEVEL I Understanding	Medium

Application use the Standard - apply it to the facts • 4 questions

- Where the facts list several expenditures, take them one by one and say capitalise or charge to revenue, with the reason in the same sentence — 'directly attributable to bringing the asset to the location and condition necessary', or 'not directly attributable, hence charged to the Statement of Profit and Loss'.

CSQ 3.7.1 • PYQ 2021-Dec [3] (b) • 4M • Pg 328	LEVEL II Application	Medium
CSQ 3.7.2 • PYQ 2024-May [5] (b) • 4M • Pg 329	LEVEL II Application	Medium
CSQ 3.7.4 • PYQ 2024-Sep [4] (b) • 4M • Pg 330	LEVEL II Application	Medium
CSQ 3.7.6 • PYQ 2026-Jan [4] (b) • 5M • Pg 332	LEVEL II Application	Medium

Analysis break it down and take the parts separately • 1 question

- Where the property is mortgaged and the title deeds are with a lender, do not stop at 'check the title deed'. Say the deeds will not be with the entity and that a confirmation must be obtained from the lender, and add the register of charges check.

TQ 3.7.3 • MTP 2025-Nov S1 [5] (b) • 5M • Pg 327	LEVEL II Analysis	Medium
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Topic 3.8: Balance Sheet Captions: Intangible Assets

L2P5-C5-T3.8

Read first Read ICAI Study Material Chapter 5, Audit of Items of Financial Statements — the balance sheet caption Intangible Assets, and AS 26 recognition, amortisation and disposals.

NOTES

AS 26 recognition — two conditions and one prohibition. Recognition of an item as an intangible asset requires the enterprise to demonstrate that the item meets the definition and the recognition criteria: (1) it is probable that the future economic benefit attributable to the asset will flow to the enterprise — the enterprise uses judgement to assess the degree of certainty attached to the flow of future economic benefits on the basis of the evidence available at the time of initial

recognition, giving greater weight to external evidence; and **(2) the cost of the asset can be measured reliably**. In assessing probability, reasonable and supportable assumptions should be used, representing management's best estimate of the set of economic conditions that will exist over the useful life of the asset.

The prohibition, and it is the answer to most case scenarios: no intangible asset arising from research, or from the research phase of an internal project, should be recognised; expenditure on research or on the research phase should be recognised as an expense when it is incurred. So money spent on research activities **cannot** be recognised as an internally generated intangible asset, and presenting it under Property, Plant and Equipment is **incorrect** — it must be recognised as an expense.

Software, and where it sits. Where the software is not an integral part of the related hardware, it is classified as an intangible asset and is presented in the balance sheet **under intangible assets, not under fixed assets**. The classification turns on **integral or not integral to the hardware** — say that test expressly.

Valuation and amortisation — three checks. (1) **Verify that the entity has charged amortisation on all intangible assets**; (2) verify that the amortisation method used reflects the pattern in which the asset's future economic benefits are expected to be consumed by the entity; (3) **verify whether management has done an impairment assessment**, for which the auditor checks whether the entity has applied AS 28 – Impairment of Assets for determining the manner of reviewing the carrying amount of its intangible asset and determining the recoverable amount of the asset to determine the impairment loss, if any. The reasoning to open with: the value of intangible assets may diminish due to efflux of time, use and/or obsolescence, and unless this cost in the form of amortisation is charged to the accounts, profit or loss would not be correctly ascertained and the values would be shown at higher amounts.

Completeness of intangible assets — the movement test, then additions. (1) Verify the movement in the intangible assets schedule compiled by management — opening balances plus additions less deletions equals closing balances — and tally the closing balances to the entity's books of account; (2) **check the arithmetical accuracy of the movement schedule**; (3) for additions during the period, obtain a listing of all additions and then: for all material additions verify whether the expenditure meets the criteria for recognition of an intangible asset as per AS 26; **ensure no intangible asset arising from research is recognised**; check the certificate, report or other similar documentation maintained by the entity to verify the date of use of the intangible, which could be linked to the date of commencement of commercial production or economic use; verify whether the additions (acquisitions) have been approved by appropriate entity personnel; and verify whether proper internal processes and procedures such as inviting competitive quotations or proper tenders were followed prior to finalising the vendor, by testing those documents on a sample basis.

Deletions — and the direction of testing is the point. Completeness ran from the underlying records to the financial statements; deletions run the other way, from the recorded disposals back to their authorisation and out to the resulting effect on the carrying amount. (1) Obtain the

schedule of deletions during the year and check that each is supported by the approval of the appropriate authority and by the agreement, invoice or other evidence of the transfer or retirement; (2) understand from management the reason and rationale for the deletion and the manner of disposal, obtain the management approval and disposal note, and verify the process followed for sale of the discarded asset — competitive quotes, tenders and the basis of calculation of sale proceeds; (3) verify that the cost and the accumulated amortisation relating to the deleted asset have both been removed from the books and that the resulting gain or loss has been correctly computed and recognised in the statement of profit and loss; (4) trace the deletions through to the fixed asset register and to the disclosure of the reconciliation of the gross and net carrying amounts at the beginning and end of the period; (5) perform an overall check for deletions NOT recorded, by enquiring into assets no longer in use and by reviewing the amortisation charge for assets that have ceased to be amortised.

The trap on deletions: an intangible asset may be derecognised on retirement rather than sale, where no future economic benefits are expected from its use or disposal. Candidates who look only for a sale consideration miss that limb.

Remembering reproduce what you have learnt · 1 question

- The ask names a single assertion — **completeness** — so answer only with the procedures that test it. Procedures for existence or valuation earn nothing here.
- Completeness for an asset is tested from the source records inward: from the additions register and the capitalisation policy to the ledger, not the other way round.

TQ 3.8.2 · MTP 2024-Nov [4] (a) · 5M · Pg 334

LEVEL I
Remembering

Medium

Application use the Standard - apply it to the facts · 4 questions

- Where the balance sheet extract misclassifies items, correct each line separately: software not integral to hardware belongs in intangible assets; research expenditure belongs in the Statement of Profit and Loss. Then give the audit procedures asked for.

TQ 3.8.1 · PYQ 2021-Jul [4] (c) · 3M · Pg 333

LEVEL II
Application

Easy

CSQ 3.8.1 · PYQ 2019-May [4] (a) · 4M · Pg 336

LEVEL II
Application

Medium

CSQ 3.8.2 · PYQ 2025-Jan [3] (a) · 5M · Pg 337

LEVEL II
Application

Medium

CSQ 3.8.3 · PYQ 2026-Sep [6] (Or) (c) · 4M · Pg 338

LEVEL II
Application

Medium

Topic 3.9: Balance Sheet Captions: Trade Payables and Other Current Liabilities

L2P5-C5-T3.9

Read first Read ICAI Study Material Chapter 5, Audit of Items of Financial Statements — the balance sheet caption Trade Payables and Other Current Liabilities, including the MSME disclosures under Schedule III.

NOTES

Why liabilities are audited as hard as assets — one sentence that carries a mark: verification of liabilities is as important as that of assets because omission, understatement or overstatement of liabilities would result in the financial statements not showing a true and fair view of the entity's state of affairs.

Existence of trade payables and other current liabilities — five procedures, in order. (1) Check whether there are controls in place to ensure that any purchase or expense invoice does not get recorded more than once, and that payable balances are automatically recorded in the general ledger at the time of recording the expense; (2) obtain the accounts payable ageing report and trace its balances to the general ledger, investigating reconciling items where there are differences, and examining journal entries carefully, especially for large amounts; (3) contact vendors directly and independently and ask them to confirm the amounts of accounts payable as at the period end — this should necessarily be done for all significant accounts payable balances and for parties from whom material purchases have been made during the period, even where the period-end balance of such parties is not significant; (4) if there are any related party payables, review whether they were properly authorised and whether the value of such transactions was reasonable and at arm's length; (5) review a trend line of purchases or expenses and accounts payable, or a comparison of the two over time, to see if there are any unusual trends, and make inquiries about reasons for changes in trends.

Valuation of trade payables — five procedures, and two of them are the ones students forget. (1) Review the process followed by the company to identify whether any old creditor balances or liabilities need to be written back, comparing the consistency of the method with the previous year and determining whether the method is appropriate for the underlying business environment; (2) obtain the ageing schedule of payable balances and the list of vendors with whom the company has disputes, as well as any claims from customers under litigation, and compare these with the previous year; (3) verify that write-backs of liability balances assessed as no longer payable have been approved by an appropriate and authorised member of senior management, such as the CEO or Managing Director; (4) check that the restatement of foreign currency trade payables has been done properly in accordance with AS 11, The Effects of Changes in Foreign Exchange Rates; (5) understand management's process for identifying the principal amount and the interest due thereon remaining unpaid to any Micro, Small and Medium Enterprises suppliers at the end of the accounting year, and perform test checks on that process to assess whether the auditor can rely on it.

Examination in depth of a payment to a creditor — four documents, and they run backwards from the payment. **(1) The invoice and statement of account received from the supplier; (2) the entry in the inventory record showing that the goods were received;** (3) the Goods Received Note and Inspection Certificate showing that the goods on receipt were verified and inspected; (4) the copy of the original order and the authority showing that the goods were in fact ordered by an authority which was competent to do so.

Micro and Small Enterprises — the Schedule III (Part I) disclosures the auditor verifies in the notes. (1) The principal amount and the interest payable remaining unpaid to Micro and Small Enterprise suppliers as at the end of the financial year, disclosed separately; (2) the interest paid under Section 16 of the MSMED Act, 2006 for delayed payments, along with the amount paid to suppliers after the appointed day during the year; (3) the interest payable due to delay in making payments that were eventually paid after the appointed day during the year, shown without including the additional interest specified under the MSMED Act, 2006; **(4) the amount of interest accrued but unpaid at the end of the accounting year;** (5) any further interest that continues to remain unpaid in subsequent years until it is actually paid to the Micro or Small Enterprise — important because such interest may not be allowed as a deductible expense under Section 23 of the MSMED Act, 2006.

The trade payables ageing schedule. Four rows — **(i) MSME; (ii) Others; (iii) Disputed Dues – MSME; (iv) Disputed Dues – Others** — against periods outstanding from the due date of payment: less than 1 year, 1-2 years, 2-3 years, more than 3 years, and Total. As with receivables, similar information shall be given where no due date of payment is specified, in which case disclosure shall be from the date of the transaction, and **unbilled dues shall be disclosed separately.** Note the buckets differ from the receivables schedule — payables start at **less than 1 year**, receivables at **less than 6 months**.

Remembering reproduce what you have learnt • 2 questions

- State the assertions or the disclosures the question asks for, and keep trade payables separate from other current liabilities — the ageing buckets differ.
- For payables the ageing starts at **less than 1 year**; for receivables at **less than 6 months**. That difference is a mark.

CSQ 3.9.2 • PYQ 2026-Jan [6] (Or) (c) • 4M • Pg 341

LEVEL I
Remembering

Medium

CSQ 3.9.3 • PYQ 2026-May [4] (b) • 5M • Pg 342

LEVEL I
Remembering

Medium

Understanding explain it, and place it in context • 1 question

- Close an existence-of-liabilities answer with the sentence about why verification of liabilities matters as much as assets. It is a printed sentence and it is free marks.

TQ 3.9.1 · MTP 2025-Dec S2 [2] (a) · 5M · Pg 339

LEVEL I
Understanding

Medium

Application use the Standard - apply it to the facts · 1 question

- Where the facts mention invoices recorded close to the year end, lead with the duplicate-recording control and the vendor confirmation. Where they mention imports or foreign suppliers, do not omit the AS 11 restatement check.

CSQ 3.9.1 · RTP 2023-Nov [19] · Pg 340

LEVEL II
Application

Medium

Topic 3.10: Balance Sheet Captions: Loans and Advances and Other Current Assets

L2P5-C5-T3.10

Read first Read ICAI Study Material Chapter 5, Audit of Items of Financial Statements — the balance sheet caption Loans and Advances and Other Current Assets, including security documents and the additional regulatory information on loans to promoters, directors and KMPs.

NOTES

Security documents — the printed table, and it is a straight three-mark answer. **Shares and debentures** — the scrip and the endorsement thereon of the name of the transferee, in the case of transfer. **Life Insurance Policy** — assignment of the policy in favour of the lender, duly registered with the insurer. **Hypothecation of goods** — the deed of hypothecation or other document creating the charge, together with a statement of inventories held at the Balance Sheet date. Answer it in a two-column table: **type of security** against **documents to be seen**.

Classification of a refundable statutory balance. Accumulated **input tax credit in the Electronic Credit Ledger**, refundable to the company under the GST law, is classified under current assets and, within current assets, under 'Other current assets'. Say both steps — current assets, then Other current assets.

Verifying a balance with statutory authorities — four procedures. (1) In relation to balances with statutory authorities like GST input credit, prepare a reasonability analysis with respect to purchases by applying the applicable rate to the purchases, and in case of any variance with the asset recorded by the entity, request reasons from the entity; (2) **obtain copies of the statutory GST returns filed on the GST portal**; (3) if the refundable amount as on the balance sheet date is still outstanding, verify whether the amount recorded as per the books of account tallies with the claim made with the authorities subsequently, by going to the GST portal; (4) if the refundable amount as on the balance sheet date is received subsequently, verify it from the bank statement.

Additional Regulatory Information — loans and advances to promoters, directors, KMPs and related parties. The disclosure is required where loans or advances in the nature of loans are granted to promoters, directors, KMPs and related parties (as defined under the Companies Act,

2013), either severally or jointly with any other person, that are (a) repayable on demand or (b) without specifying any terms or period of repayment. Note the trigger: it is not every loan, only those **repayable on demand or with no stated terms**.

What has to be disclosed, and how the percentage is worked out. For each **type of borrower — promoter, director, KMP, related party** — disclose the **amount of loan or advance in the nature of loan outstanding** and the percentage to the total loans and advances in the nature of loans. The percentage is computed on the **closing outstanding**, not on the maximum granted during the year: in the printed illustration, on total outstanding loans of ₹120 lakh, the promoter's ₹15 lakh is 12.5%, the director's ₹25 lakh is 20.833%, the KMP's ₹5 lakh is 4.167% and the related party's ₹10 lakh is 8.333%. The classic wrong answer uses the maximum amount granted during the year as the denominator. Show the working as amount over total times 100.

Understanding explain it, and place it in context · 1 question

- The ask is **what documents the auditor can verify** for each kind of security. Answer security by security, naming the document.
- Say what each document proves — title, charge, or valuation — rather than listing names alone.

TQ 3.10.1 · MTP 2020-May [5] (d) · 3M · Pg 344

LEVEL I
Understanding

Easy

Application use the Standard - apply it to the facts · 1 question

- For a statutory-balance question, answer in two parts as the question asks: first the classification in the balance sheet, then the audit procedures. Do not merge them.

CSQ 3.10.2 · PYQ 2024-May [4] (c) · 3M · Pg 346

LEVEL II
Application

Easy

Analysis break it down and take the parts separately · 1 question

- Where the question gives both the maximum loan during the year and the closing outstanding, use the closing outstanding for both the amount column and the percentage, and show the division working for each borrower.

CSQ 3.10.1 · MTP 2024-Mar [5] (a) · 4M · Pg 345

LEVEL II
Analysis

Medium

Topic 3.11: Balance Sheet Captions: Provisions and Contingent Liabilities

L2P5-C5-T3.11

Read first Read ICAI Study Material Chapter 5, Audit of Items of Financial Statements — the balance sheet caption Provisions and Contingent Liabilities, together with the Schedule III ratios disclosed as additional regulatory information.

NOTES

Provisions, assertion by assertion — this is how the printed answer is laid out, and laying yours out the same way earns the marks. **Existence:** inspect underlying agreements, like the agreement with customers to assess warranty commitments, and any legal and other claims on the entity.

Completeness: obtain a list of all provisions and compare them with the balances in the ledger; and obtain written representation from management that it has made all provisions which were required to be made as per recognised accounting principles. **Valuation and allocation:** obtain the underlying working and the basis for each of the provisions made and verify that the same is complete and accurate; and obtain the expert's report and underlying working for the provision amount, and request the assessment made by a legal expert in relation to the likelihood of the liability devolving on the entity.

The full procedure list for provisions and contingent liabilities. (1) Obtain a list of all provisions and compare them with balances in the ledger; (2) inspect the underlying agreements, like the agreement with customers to assess warranty commitments, and any legal and other claims on the entity, i.e. litigations; (3) obtain the underlying working and the basis for each of the provisions made from management and verify whether the same is complete and accurate; (4) wherever required, obtain the expert's report, calculation and underlying working for the provision amount — for example, for warranty involving complex calculations some entities get that valued through an actuary; (5) request management to share the actuarial valuation report, and in case of any matter under legal dispute, request the assessment made by a legal expert in relation to the likelihood of a liability devolving on the entity, i.e. whether probable, possible or remote; (6) verify the underlying assumptions used by the expert with the data shared by management.

AS 29 — disclosure for each class of contingent liability at the balance sheet date, four limbs plus a proviso. (1) A brief description of the nature of the contingent liability and, where practicable; (2) an estimate of the amount as per the measurement principle prescribed for provisions in AS 29; (3) **an indication of the uncertainty relating to outflow;** (4) **the possibility of any reimbursement.** And the proviso: where any of the information required above is not disclosed because it is not practicable to do so, that fact should be stated.

Using a management's expert — SA 500, Audit Evidence. Where management engages an actuary to value gratuity, the auditor evaluates the **competence, capabilities and objectivity** of that expert by considering: whether the expert is employed by the entity or is an outside party; **whether the expert is independent in respect of the entity; the auditor's previous experience of the work of the expert;** and knowledge of the expert, his qualification, membership of a professional body or industry association. The auditor also obtains an **understanding of the work of that expert** by considering: whether the auditor has expertise to evaluate the work of the expert; **evaluating the assumptions and methods used by the management;** and evaluating the nature of internal or external data used by the expert. Answer in the two blocks the Standard uses — **competence, capabilities and objectivity**, then **understanding of the work.**

Provisions of a bank — five steps. (1) Ensure the compliances for various regulatory requirements

for provisioning, as contained in the various circulars, have been fulfilled; (2) obtain an understanding as to how the bank computes provision on standard assets and non-performing assets — primarily checking the basis of classification of loans and receivables into standard, sub-standard, doubtful, loss and non-performing assets — and verify the loan classification on a sample basis; (3) obtain the detailed break-up of standard loans and non-performing loans and agree the outstanding balances with the general ledger; (4) obtain the tax provision computation from the bank's management and verify the nature of items debited and credited to the profit and loss account to ascertain that the same are appropriately considered in the tax provision computation; (5) examine the other provisions for expenses against the circumstances warranting the provisioning and the adequacy of the same, by discussing and obtaining explanations from the bank's management.

Schedule III ratios as additional regulatory information, and the 25% rule. Three ratios the answers print in full: **Current Ratio = Current Assets / Current Liabilities**, which measures the company's ability to meet its short-term obligations out of its current assets; **Debt-Equity Ratio = Total Debt / Shareholder's Equity**, which indicates the proportion of debt used to finance the company relative to shareholder's equity; and **Return on Equity = Net Profit (after tax) / Average Shareholder's Equity × 100**, which measures the profitability of the company relative to its equity base. Each must be **disclosed along with the corresponding figure for the previous reporting period**, and if there is a variation of 25% or more compared to the previous reporting period, the company must explain the reasons for the change. Further, the company shall explain the items included in the numerator and denominator for computing the ratios.

Applying the 25% rule — show the variation working. In the printed illustration the disclosure **did not** meet Schedule III because the company had not explained the items included in the numerator and denominator and had **not explained the changes**. The variations computed were **current ratio 2.50 against 2.30 — 8.69%**, **inventory turnover ratio 3.00 against 6.00 — 50%**, **trade receivables turnover ratio 1.75 against 5.00 — 65%** and **net profit ratio 13% against 10% — 30%**; so explanations were required for inventory turnover, trade receivables turnover and net profit ratio, being the three that moved by **more than 25%**. Compute the percentage change for every ratio given, then name the ones that cross the threshold, then state the conclusion.

Remembering reproduce what you have learnt · 3 questions

- The question asks for a stated number of ratios. **Give exactly that number**, each with its formula as Schedule III defines it.
- Add the 25 per cent variation rule if the question leaves room: a ratio varying by more than 25 per cent from the previous year needs an explanation.

TQ 3.11.3 · PYQ 2024-Sep [2] (c) · 3M · Pg 348

LEVEL I
Remembering

Easy

CSQ 3.11.1 · PYQ 2023-May [3] (d) · 3M · Pg 350

LEVEL I
Remembering

Easy

CSQ 3.11.3 · MTP 2026-Mar S1 [5] (c) · 4M · Pg 352

LEVEL I
Remembering

Medium

Understanding explain it, and place it in context · 2 questions

- For AS 29, give all four disclosure limbs and the 'not practicable' proviso. The proviso is a separate mark.

TQ 3.11.2 · MTP 2021-Mar [6] (e) · 3M · Pg 348

LEVEL I
Understanding

Easy

TQ 3.11.1 · PYQ 2020-Nov [6] (a) · 4M · Pg 347

LEVEL I
Understanding

Medium

Application use the Standard - apply it to the facts · 2 questions

- Where a management's expert is involved, name SA 500 and split your answer into competence, capabilities and objectivity on one side, and understanding of the work on the other. A single undifferentiated list loses the structure marks.

CSQ 3.11.2 · RTP 2024-May [13] · Pg 351

LEVEL II
Application

Medium

TQ 3.11.4 · PYQ 2024-Sep [5] (b) · 4M · Pg 349

LEVEL II
Application

Hard

Topic 3.12: Balance Sheet Captions: Miscellaneous

L2P5-C5-T3.12

Read first Read ICAI Study Material Chapter 5, Audit of Items of Financial Statements — the miscellaneous balance sheet disclosures, including proceedings for holding benami property.

NOTES

The rule in one line: where proceedings have been initiated or are pending against the company for holding any benami property under the Benami Transactions (Prohibition) Act, 1988 (45 of 1988) and the rules made thereunder, the company must make the disclosure **even where the property is not recorded in its books of account**. That last point is the whole question — the absence of the property from the books is not a reason to stay silent.

The seven items to be disclosed. (1) Details of such property, including the year of acquisition; (2) the amount thereof; (3) details of the beneficiaries; (4) if the property is in the books, then reference to the item in the Balance Sheet; (5) if the property is not in the books, then the fact shall be stated with reasons; (6) where there are proceedings against the company under this law as an abettor of the transaction or as the transferor, then those details shall be provided; (7) the nature of the proceedings, the status of the same and the company's views on the same.

Note the two alternative limbs at items (4) and (5). The disclosure branches on whether the property is **in the books** or **not in the books** — one leads to a cross-reference to the balance sheet

line, the other to a statement of the fact with reasons. Answer both limbs even where the facts engage only one, because the question asks for the disclosure requirement, not just the outcome.

This topic is thin in the Scanner. Only one printed question, on benami property disclosure, sits under this head. Learn that list cold — it is a four-mark answer with seven numbered items and there is nothing to interpret.

Application use the Standard - apply it to the facts · 1 question

- The question is usually framed as advice to the company. Open by naming the Act in full — the Benami Transactions (Prohibition) Act, 1988 (45 of 1988) — then give the list, then note that the property not being in the books does not remove the requirement.

TQ 3.12.1 · PYQ 2022-May [5] (b) · 4M · Pg 353

LEVEL II
Application

Medium

Topic 4.1: Statement of Profit and Loss Captions: Sale of Products and Services

L2P5-C5-T4.1

Read first Read ICAI Study Material Chapter 5, Audit of Items of Financial Statements — the statement of profit and loss caption Sale of Products and Services, including goods on sale or return, sale of scrap and the Schedule III disclosures on sales.

NOTES

Goods sent out on sale or return — the answer is a table of document against what you verify in it.

Sale or Return Day Book: examine it for the manner of accounting; check actual movement of goods from the despatch register or goods outward register; **note the period of approval in the case of different goods and customers; verify whether goods returned have been properly reversed in the day book.** **Order Book or Confirmation Book:** examine this register to verify sales confirmed by customers and goods held by customers at their end as sale or return stock. **Sales Register:** ensure that sales have been recognised whenever (1) approval is received from the party, (2) goods are appropriated by the party, or (3) the period of approval has expired and the goods have not been returned. **Stock Registers and Statements:** ensure closing stock includes goods lying with customers where the period of approval has not expired, and **ensure goods validly returned by customers are duly accounted in stock.**

The three revenue-recognition triggers for sale or return are the mark-bearing part — approval received, goods appropriated by the party, or period of approval expired without return. Learn all three; giving only 'when the customer approves' loses two of them.

Testing that sales are not overstated — the fictitious-sales list. (1) Check whether a single sales invoice is recorded twice, or a cancelled sales invoice has been recorded; **(2) test check a few invoices with their relevant entries in the sales journal;** (3) obtain confirmation from a few

customers to ensure the genuineness of the sales transaction; **(4) check whether any fictitious customers and sales have been recorded**; (5) check whether any shipments were done without the consent and agreement of the customer, especially at the year end, to inflate the sales figure; **(6) check whether unearned revenue has been recorded as earned**; **(7) check whether any substantial uncertainty exists about collectability**; (8) check whether customer obligations are contingent on other actions such as financing or resale.

Accuracy of sales — the in-depth trace. (a) Trace a select number of transactions from inception to completion — this is an in-depth examination; (b) for example, take a few sales transactions and review them from the receipt of the sales order to the payment of the receivable balance, checking every underlying document to ensure it is properly recorded at every stage and that the measurement accurately reflects all incentives and discounts, with revenue recognition aligned to the entity's revenue recognition policy; (c) if the client is engaged in export sales, ensure compliance with Accounting Standard 11; (d) understand the client's operations and related GAAP issues, such as point of sale revenue recognition versus percentage of completion, where applicable; (e) compare the rate of sales involving related parties and assess them for collectability, and review whether these transactions were properly authorised and whether their values are reasonable and at arm's length.

Sale of scrap — seven steps, and they run from control to reasonableness. (1) Review the internal control as regards generation, storage and disposal of scrap; (2) check whether the organisation is maintaining a reasonable record for the generation of scrap; (3) analyse the raw material used, production and generation pattern of scrap and compare the same with figures of the earlier year; (4) check the rates at which scrap has been sold and compare the rate with the previous year; (5) vouch sales with invoices raised, the advertisement for tender and the rate contract with scrap dealers; (6) ensure there exists a proper control procedure to identify scrap and good units, and that good units are not mixed up with scrap and sold as scrap; (7) make an overall assessment of the value of realisation from scrap as to its reasonableness.

Schedule III (Part I) — disclosures on sales. Whether disclosure of sales in respect of each class of goods has been made; whether revenue from operations is disclosed separately in the notes as revenue arising from sale of products (including excise duty), sale of services and other operating revenues; whether brokerage and discount on sales, other than usual trade discount, has been disclosed; and whether transactions with related parties are appropriately disclosed in notes to accounts. Note the wording — it is **discount on sales other than usual trade discount** that must be disclosed.

Understanding explain it, and place it in context · 3 questions

- Where the question asks for 'any four' procedures on overstatement of sales, pick four from the printed eight and number them. Do not paraphrase them into one long sentence.

TQ 4.1.3 • PYQ 2021-Jul [4] (a) • 4M • Pg 356

LEVEL I
Understanding

Medium

CSQ 4.1.2 • PYQ 2025-May [3] (a) • 5M • Pg 357

LEVEL I
Understanding

Medium

Application use the Standard - apply it to the facts • 2 questions

- A fact pattern showing a sharp rise in sales is a fictitious-sales question. Open by connecting the fact — 'the increase raises the risk that revenue is overstated' — then give the procedures. The link sentence is what makes it an application answer.

TQ 4.1.2 • MTP 2021-Mar [5] (d) • 3M • Pg 355

LEVEL II
Application

Easy

CSQ 4.1.1 • PYQ 2023-May [3] (c) • 3M • Pg 357

LEVEL II
Application

Easy

Topic 4.2: Statement of Profit and Loss Captions: Other Income Comprising Interest Income, Dividend Income, Gain/Loss on Sale of Investments etc.

L2P5-C5-T4.2

Read first Read ICAI Study Material Chapter 5, Audit of Items of Financial Statements — the statement of profit and loss caption Other Income, comprising interest income, dividend income and gain or loss on sale of investments.

NOTES

Interest income from fixed deposits — four procedures, in order. (1) Obtain a listing of fixed deposits opened during the period under audit along with the applicable interest rate and the number of days for which the deposit was outstanding during the period, and verify the arithmetical accuracy of the interest calculation made by the entity by multiplying the deposit amount with the applicable rate and the number of days during the period; (2) for deposits still outstanding at the period end, trace the same to the direct confirmation obtained from the respective bank or financial institution; (3) obtain a confirmation of interest income from the bank and verify that the interest income as per the bank reconciles to the calculation shared by the entity; (4) obtain a copy of Form 26AS — TDS withheld by the bank or financial institution — and reconcile the interest reflected therein to the calculation shared by the client. Form 26AS is the independent corroboration in this answer; leaving it out costs a mark.

Dividend income — the recognition test is the whole answer. Verify that dividends are recognised in the statement of profit and loss only when the entity's right to receive payment of the dividend is established, provided it is probable that the economic benefits associated with the dividend will flow to the entity and **the amount of the dividend can be measured reliably**. For a dividend declared at a general meeting, the right to receive is established on the date of declaration, and the income is recognised then rather than on receipt. The trap in the case scenario is the date: if

the declaration falls **inside** the financial year under audit, the income belongs to that year even though the money may arrive later. The auditor verifies the declaration against the investee's records and the counterparty's own accounts.

Gain or loss on sale of investment in mutual funds. Verify that it is **recorded as other income only on transfer of title from the entity** and that it is determined as the difference between the redemption price and the carrying value of the investments. For this purpose, obtain the mutual fund statement and trace the gain or loss as recorded in the books of account to the gain or loss as reflected in the statement.

Disclosure of other income. Ensure that under the **Ind AS compliant Schedule III to the Companies Act, 2013**, 'other income' has been classified as interest income, dividend income, and other non-operating income (net of expenses directly attributable to such income). Note the parenthesis — **net of expenses directly attributable to such income** — it is part of the printed head.

Undisclosed income found in a search — the Schedule III additional information. The company shall give details of any transaction not recorded in the books of account that has been surrendered or disclosed as income during the year in the tax assessments under the Income Tax Act, 1961, and it must also state whether the previously unrecorded income and the related assets have been properly recorded in the books of account during the year. Two limbs: the **details of the surrendered transaction**, and **whether the income and the related assets have now been recorded**.

Remembering reproduce what you have learnt · 1 question

- Take the issues in the question's own numbering and state the treatment for each — what is recognised, when, and under which caption.
- Other income is where cut-off and classification errors hide. Say which caption each item belongs to before you discuss recognition.

CSQ 4.2.1 · PYQ 2026-Sep [3] (c) · 4M · Pg 361

LEVEL I
Remembering

Medium

Understanding explain it, and place it in context · 1 question

- Answer each stream of other income under its own heading — interest income, dividend income, gain or loss on mutual funds — and then the disclosure requirement. The marks are allocated stream by stream.

TQ 4.2.1 · PYQ 2018-May [3] (c) · 10M · Pg 359

LEVEL I
Understanding

Hard

Topic 4.3: Statement of Profit and Loss Captions: Purchases

L2P5-C5-T4.3

Read first Read ICAI Study Material Chapter 5, Audit of Items of Financial Statements — the statement of profit and loss caption Purchases, including analytical procedures over purchase quantity and price.

NOTES

Analytical procedures over the reasonableness of purchase quantity and price — four heads, and they are the answer every time this is asked. **(1) Consumption Analysis:** scrutinise raw material consumed as per the manufacturing account and compare the same with previous years and with closing stock, and ask for reasons from management if any significant variations are found. **(2) Stock Composition Analysis:** collect reports from management for the composition of stock, i.e. raw materials as a percentage of total stock, compare the same with previous years, and ask for reasons from management in case of significant variations. **(3) Ratios:** compare the creditors turnover ratio and the stock turnover ratio of the current year with previous years. **(4) Quantitative reconciliation:** review the quantitative reconciliation of closing stocks with opening stock, purchases and consumption.

Name the four heads before you explain them. The printed answers set them out as labelled heads — Consumption Analysis, Stock Composition Analysis, Ratios, Quantitative Reconciliation — and the marks follow the number of heads named. An answer that describes the work without naming the heads reads as one procedure, not four.

Occurrence of purchases — that recorded purchases represent goods actually received or services availed. **(1)** Check whether any fictitious vendors have been booked or purchases recorded, by reviewing the vendor selection process followed by the entity and performing procedures to ensure the existence of the vendors; **(2)** check whether the goods were received at the factory gate and whether there exists an entry in the security gate inward register; **(3) check whether quality inspection of goods was done;** **(4)** check whether a goods receipt note was prepared and signed by appropriate client personnel; **(5)** check whether the purchase invoice was approved as per the delegation of authority and whether a 3-way or 2-way match was done; **(6) check whether the stock record has been updated by the stores personnel.**

The occurrence chain runs gate to ledger: gate inward entry → quality inspection → goods receipt note → approved invoice with a 3-way or 2-way match → stock record updated. Recite it in that order; it shows the examiner you understand it as a control chain rather than a list.

Close with the conclusion the examiner wants stated. Where controls are weak, the auditor must perform detailed substantive and control procedures to obtain sufficient appropriate audit evidence that purchases recorded during the year represent genuine transactions relating to goods actually received or services availed; if these procedures provide satisfactory evidence the occurrence assertion may be considered appropriately addressed, otherwise appropriate

modifications or reporting implications may arise.

Understanding explain it, and place it in context · 1 question

- The ask is the **analytical procedures** for purchases, so every point must be a comparison or a ratio, not a vouching step.
- Name what each comparison would reveal — a movement in the purchase price, a change in the mix, or an unrecorded liability.

TQ 4.3.2 · PYQ 2019-Nov [3] (d) · 3M · Pg 363

LEVEL I
Understanding

Easy

Application use the Standard - apply it to the facts · 2 questions

- Where the facts mention delayed goods receipt notes and weak vendor onboarding, tie the procedures back to those two weaknesses: the vendor existence check answers the onboarding weakness, the GRN and gate register checks answer the delay.

CSQ 4.3.1 · MTP 2026-Mar S1 [2] (a) · 5M · Pg 364

LEVEL II
Application

Medium

CSQ 4.3.2 · MTP 2026-Apr S2 [2] (a) · 5M · Pg 365

LEVEL II
Application

Medium

Analysis break it down and take the parts separately · 1 question

- Where the question asks for overall reasonableness, **work from the expectation**: say what you would expect purchases to be, from what, and then what a difference would mean.
- Cover the month-on-month and year-on-year comparisons and the relationship with production or sales volume.

TQ 4.3.1 · PYQ 2019-May [4] (b) · 4M · Pg 362

LEVEL II
Analysis

Medium

Topic 4.4: Statement of Profit And Loss Captions: Employee Benefit Expenses

L2P5-C5-T4.4

Read first Read ICAI Study Material Chapter 5, Audit of Items of Financial Statements — the statement of profit and loss caption Employee Benefit Expenses, including payroll controls and the related assertions.

NOTES

What the auditor is verifying about employee benefit expense — five statements, and each maps to an assertion. (1) Employee benefit expense has been incurred during the period in respect of

the personnel employed by the entity, and does not include the cost of any unauthorised personnel — occurrence; (2) employee benefit expenses in respect of all personnel have been fully accounted for — completeness; (3) employee benefit expenses recognised during the period relate to the current accounting period only — cut-off; (4) employee benefit expense has been measured and calculated accurately, and any adjustments such as tax deducted at source have been correctly reconciled and accounted for — accuracy or measurement; (5) employee benefit expense has been fairly allocated between operating expenses incurred in production activities, general and administrative expenses, and the cost of personnel relating to any self-constructed assets other than inventory — classification and allocation.

Hiring, appraisal and retirement — the controls-then-substantive structure. (1) Test the controls the entity has set around the employee benefit payment process to determine how strong and reliable they are; if they are strong, the auditor can minimise the amount of transaction testing. The **common internal controls over the employee benefit payment cycle** are maintaining attendance records, the employee master, authorisation and approval of monthly payroll processing and disbursement, computation of employee deductions like payroll taxes, and accrual of other benefits like gratuity, leave encashment and bonus. (2) Select a random sample of transactions and examine the related appointment letters, appraisal letters, attendance records, HR policies and employee master. **(3) Performing substantive audit procedures is a must** — substantive analytical procedures will consist of monthly expense reasonability, comparison with the previous accounting period, any analysis the auditor finds relevant, and most important, setting an expectation in relation to the expense incurred during the period and comparing that with the client's business operations and overall trends in the industry.

The full procedure list for auditing employee benefit expenses. (1) Obtain an understanding of the entity's process of capturing employee attendance — there is always a risk that an entity could record expense for fictitious employees, so the auditor may meet the employees in person on a sample basis, or select a sample and ask the payroll department to share their bank details or identity proofs; (2) obtain a list of employees as at the period end along with a monthly movement split between new hires, leavers and continuing employees; (3) for a random sample of new hires, obtain the appointment letter and verify whether the salary for the first and subsequent months was processed as per the agreed terms; (4) for a random sample of resigned employees, obtain their full and final computation and verify whether all dues, including post-retirement benefits like gratuity and leave encashment, have been paid, and whether the employee's acknowledgement on the final computation has been obtained; (5) obtain the monthly salary registers for all 12 months and compile a monthly payroll reasonability by calculating the average salary per employee per month, comparing with the previous year and the preceding month and analysing reasons for variance — annual increments, senior employees joining or leaving, bonus pay-outs; (6) verify if accrual or provision has been made for all employee benefits and obligations like bonus, gratuity and leave encashment; (7) where provident fund and employee state insurance are applicable, compile a reasonability by applying the rate to the basic wages and comparing to the amount recorded in books, and obtain monthly deposit challans to verify that the month-on-month liability was subsequently deposited with the authorities within the defined timelines; (8)

perform analytical procedures on overall reasonableness, which may include production per employee analysis — analyse units produced per employee, compare with previous years and present industry trends, and ask management for reasons for significant variations.

Where the expense has risen sharply, the answer needs one more step. Perform a detailed variance analysis by obtaining a break-up of the increase into components such as increase due to headcount, annual increments, bonus payouts, change in salary structure, actuarial remeasurement losses, or change in statutory contribution rates, and correlate the increase with supporting documentation such as board approvals for increments, bonus declarations, revised employment contracts and actuarial valuation reports, obtaining management explanations for any abnormal or unexplained variances.

The two assertions the examiner asks for by name. 'Employee benefit expenses recognised during the period relate to the current accounting period only' is the cut-off assertion — it ensures **all income and expenses are reported in the correct accounting period**, and it is a separate assertion because the substantive procedures to verify it are typically different from those applied to the other components of completeness. 'Employee benefit expenses in respect of all personnel have been fully accounted for' is the completeness assertion — all transactions that were supposed to be recorded have been recognised in the financial statements; transactions have not been omitted.

Understanding explain it, and place it in context · 2 questions

- Where the question asks you to identify an assertion, give the name and then the one-line definition. The definition is the second half of the mark.

TQ 4.4.2 · MTP 2022-Sep [6] (e) · 3M · Pg 367

LEVEL I
Understanding

Easy

TQ 4.4.3 · RTP 2025-Sep [14] · Pg 368

LEVEL I
Understanding

Medium

Application use the Standard - apply it to the facts · 2 questions

- For a payroll case with high turnover, use the new-hire and leaver samples as your lead procedures — appointment letters for joiners, full and final computations with acknowledgement for leavers. That is what the facts were built for.

CSQ 4.4.1 · MTP 2026-Mar S1 [5] (b) · 5M · Pg 368

LEVEL II
Application

Medium

TQ 4.4.1 · PYQ 2019-May [4] (c) · 3M · Pg 366

LEVEL II
Application

Hard

Topic 4.5: Statement of Profit And Loss Captions: Depreciation And Amortisation

L2P5-C5-T4.5

Read first Read ICAI Study Material Chapter 5, Audit of Items of Financial Statements — the statement of profit and loss caption Depreciation and Amortisation.

NOTES

Why it matters, in the words the answer uses: depreciation and amortisation expense generally constitutes a significant part of an entity's overall expenses and has a direct impact on the profit or loss of the entity. Open with that sentence; it frames the attributes that follow.

The eight attributes the auditor considers, in order. (1) Obtain an understanding of the entity's accounting policies related to depreciation and amortisation; (2) ensure the company policy for charging depreciation and amortisation is as per the relevant provisions of the Companies Act and the applicable accounting standards; (3) check whether the depreciation has been calculated after making adjustment of residual value from the cost of the assets; **(4) check whether the depreciation and amortisation charges are valid;** (5) check whether the depreciation and amortisation charges are accurately calculated and recorded; (6) check whether all depreciation and amortisation charges are recorded in the appropriate period; (7) ensure that the parts (components) of each item of property, plant and equipment that are to be depreciated separately have been properly identified; (8) check whether the most appropriate depreciation method for each separately depreciable component has been used.

Note how attributes (4), (5) and (6) map to assertions — **valid** is occurrence, accurately calculated and recorded is accuracy, **recorded in the appropriate period** is cut-off. Saying so in your answer costs a line and shows the examiner you know why the attribute is on the list.

Components are the limb candidates forget. Two of the eight attributes — **identifying the parts of each item of PPE to be depreciated separately** and using the most appropriate method for each separately depreciable component — are about component accounting. If the question asks for 'any five attributes', include at least one of these; they are the ones that lift a routine answer.

Residual value is deducted before the charge is computed — depreciation is calculated after making adjustment of residual value from the cost of the assets. The classic wrong answer computes depreciation on gross cost and says nothing about residual value.

Remembering reproduce what you have learnt · 1 question

- This is a pure list question — 'mention any five attributes'. Number them, give exactly the number asked for, and choose the five that are most distinct from one another.

TQ 4.5.1 · PYQ 2018-May [3] (b) · 5M · Pg 371

LEVEL I
Remembering

Medium

Topic 4.6: Statement of Profit and Loss Captions: Other Expenses Like Power and Fuel, Rent, Repair to Building, Plant and Machinery, Insurance, Travelling, Legal and Professional, Miscellaneous expenses.

L2P5-C5-T4.6

Read first Read ICAI Study Material Chapter 5, Audit of Items of Financial Statements — the statement of profit and loss caption Other Expenses, including power and fuel, rent, repairs, insurance, travelling, legal and professional and miscellaneous expenses, and the CSR disclosures.

NOTES

The six attributes for vouching other expenses — this is the most repeated answer in the chapter.

(1) Whether the expenditure pertained to the current period under audit; (2) whether the expenditure qualified as revenue and not capital expenditure; (3) whether the expenditure had valid supporting documents, like travel tickets, insurance policy or third party invoice; **(4) whether the expenditure has been classified under the correct expense head;** (5) whether the expenditure was authorised as per the delegation of authority matrix; (6) whether the expenditure was in relation to the entity's business and not a personal expenditure.

The distinction the question is built on: for expenses like rent, power and fuel the auditor may choose to analyse the monthly trends, but for other expenses — travelling, insurance, repairs, miscellaneous — the auditor generally prefers to vouch and verify the six attributes. Where management argues that irregular expenses cannot usefully be trend-analysed, the answer is that in cases where analytical procedures are not effective, the auditor should rely on detailed vouching to verify the genuineness, accuracy, classification and business relevance of expenses.

Refund of general insurance premium — five steps. The refund may be because of an earlier provisional payment of premium, or a policy might have been cancelled at a later date. **(1) Ascertain the reasons for the refund of insurance premium; (2) examine the insurance policy or cover note to find out the amount of premium;** (3) verify the advice of refund received from the insurance company — when a refund is admitted the insurance company sends an advice, which is evidence as a covering letter to the cheque for the refund, and sometimes a cheque is issued after a receipt is sent in advance to the insurance company; **(4) scrutinise the correspondence between the insurance company and the client;** (5) check entries in the bank book or the bank statement, and if necessary verify the counterfoil of the pay-in-slips.

Some expenses can be verified independently — know the three printed examples. The cost of importing goods which are subject to an ad valorem duty at a uniform rate can be verified from the amount of duty paid; the quantity of sugar sold by a sugar mill can be verified independently from the amount of excise duty or GST paid; and the amount of any income or expense which has a direct relationship with the amount of profits or of sales can be verified independently — for example, commission paid to a manager calculated on the basis of net profits, or commission paid to a selling agent as a percentage of sales. The principle: where an amount has a fixed arithmetical relationship with another independently evidenced amount, it can be corroborated from that

other amount.

CSR disclosures where the company is covered by Section 135 of the Companies Act, 2013. Beyond the amount required to be spent, the amount spent and the shortfall, the auditor verifies disclosure of: **(1) the total of previous years' shortfall; (2) the reason for the amount not spent, i.e. the reason for the shortfall; (3) the nature of the CSR activities;** (4) details of related party transactions, i.e. contribution to a trust controlled by the company in relation to CSR expenditure, as per the relevant Accounting Standard; (5) where a provision is made with respect to a liability incurred by entering into a contractual obligation, the movements in the provision during the year shown separately. Where the question asks for the full list, add the three the other answer prints first — the amount required to be spent during the year, the total expenditure incurred, and any shortfall at the end of the year.

One more assertion to carry: 'Recorded sales represent goods which were ordered by valid customers and were despatched and invoiced in the period' is the occurrence assertion, which ensures that transactions recognised in the financial statements have occurred and relate to the entity.

Remembering reproduce what you have learnt · 2 questions

- The six attributes are worth learning word for word. They recur across several years and both the question and the answer use the same six phrases.

TQ 4.6.1 · RTP 2021-May [19] · Pg 372

LEVEL I
Remembering

Medium

TQ 4.6.5 · PYQ 2025-May [6] (Or) (c) · 4M · Pg 375

LEVEL I
Remembering

Medium

Understanding explain it, and place it in context · 2 questions

- Where the question contrasts trend analysis with vouching, say which expenses go to which route before listing the attributes. The contrast is the point of the question.

TQ 4.6.4 · PYQ 2022-May [3] (b) · 4M · Pg 375

LEVEL I
Understanding

Medium

TQ 4.6.6 · RTP 2025-Sep [14] (d) · Pg 376

LEVEL I
Understanding

Medium

Application use the Standard - apply it to the facts · 2 questions

- For the CSR question, read what the question excludes — it often says 'other than the amount spent, amount not spent, amount required to be spent' — and start your list after those. Repeating the excluded items wastes the answer.

TQ 4.6.3 · PYQ 2021-Dec [4] (d) · 3M · Pg 374

LEVEL II

Easy

	Application	
CSQ 4.6.1 · MTP 2026-Apr S2 [5] (c) · 4M · Pg 376	LEVEL II Application	Medium

Analysis break it down and take the parts separately · 1 question

- The question lists several expense heads. **Take them as a group and give the procedures that apply to all**, then name the head-specific test where one exists.
- For each head say what the auditor compares it against — last year, the budget, or the underlying driver such as area occupied or units consumed.

TQ 4.6.2 · PYQ 2021-Dec [3] (c) · 3M · Pg 373	LEVEL II Analysis	Medium
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CHAPTER 6

Audit Documentation

12 Topics • 23 Classified Questions • Importance: C

ICAI SKILL PROFILE ICAI band for this paper: Level I 40-60% • Level II 40-60% — this chapter reads **on profile**

Level I — Comprehension & Knowledge **51.1%** 46 of 90 marks

Level II — Analysis & Application **48.9%** 44 of 90 marks

This chapter sits inside ICAI's own band for the paper — 51% Level I against 40-60%. Prepare it in those proportions: know the method, then drill it.

Topic 1: Definition of Audit Documentation

L2P5-C6-T01

CONCEPT BASE — no exam question asked yet • essential for full preparation

Read first Read ICAI Study Material Chapter 6, Audit Documentation — the definition of audit documentation under SA 230.

NOTES

The definition, and every answer in this chapter starts with it: as per **SA 230 'Audit Documentation'**, audit documentation refers to the record of audit procedures performed, relevant audit evidence obtained, and conclusions the auditor reached. The terms 'working papers' or 'work papers' are also sometimes used.

Three items, and the examiner counts them. A question that says 'audit documentation refers to the record of three items' is asking you to name **procedures performed, audit evidence obtained** and **conclusions reached** — not to describe a file. Give the three, then move on to objective, nature or purpose as the question demands.

Working papers and audit documentation are the same thing in this chapter. Where an answer speaks of working papers being the auditor's property, or of working papers acting as evidence in a court of law, it is speaking of audit documentation as defined above. Do not treat them as two concepts.

Topic 2: Objective of the Auditor

L2P5-C6-T02

Read first Read ICAI Study Material Chapter 6, Audit Documentation — the objective of the auditor under SA 230.

NOTES

The objective, in the Standard's own two limbs: the objective of the auditor is to prepare documentation that provides (a) **a sufficient and appropriate record of the basis for the auditor's report**; and (b) evidence that the audit was planned and performed in accordance with SAs and applicable legal and regulatory requirements.

The objective and the nature are two separate asks, and questions almost always want both. Follow the objective with the nature: audit documentation provides (a) evidence of the auditor's basis for a conclusion about the achievement of the overall objectives of the auditor; and (b) evidence that the audit was planned and performed in accordance with SAs and applicable legal and regulatory requirements. **Notice that the second limb is common to both lists** — write it in both places, because the marks are allotted list by list.

Applying it to a fact pattern. Where the working papers are incomplete and do not explain the basis for the conclusions reached — on revenue recognition, inventory valuation or verification of fixed assets — the conclusion to state is that the auditor is required to ensure that the audit working papers properly document the procedures performed, evidence obtained and conclusions reached, so that the documentation supports the auditor's report and demonstrates that the audit was conducted in accordance with the Standards on Auditing and applicable legal and regulatory requirements.

Understanding explain it, and place it in context · 1 question

- Give the objective in two lettered limbs and the nature in two lettered limbs. Four short clauses; an answer written as one paragraph will lose one of them.

TQ 2.1 · RTP 2023-Nov [6] (b) · Pg 383

LEVEL I
Understanding

Medium

Application use the Standard - apply it to the facts · 1 question

- In a case scenario, state the objective and the nature first and only then say what the auditor in the question must do. An answer that jumps to 'CA P should complete his working papers' loses the requirement marks.

CSQ 2.1 · MTP 2026-Mar S1 [6] (Or) (c) · 4M · Pg 383

LEVEL II
Application

Medium

Topic 3: Nature of Audit Documentation

L2P5-C6-T03

CONCEPT BASE — no exam question asked yet · essential for full preparation

Read first Read ICAI Study Material Chapter 6, Audit Documentation — the nature of audit documentation under SA 230.

NOTES

The nature, in two limbs: audit documentation provides (a) evidence of the auditor's basis for a conclusion about the achievement of the overall objectives of the auditor; and (b) evidence that the audit was planned and performed in accordance with SAs and applicable legal and regulatory requirements.

This topic never appears on its own. It is set together with the meaning, the objective or the purpose — 'explain the objective and nature', 'explain the nature and purpose'. Answer whichever pairing the question asks for, under separate headings, because the marks are split between them.

Documentation is evidence about the audit, not about the entity. That is the distinction the nature limbs draw: audit evidence supports the auditor's conclusions on the financial statements, while audit documentation evidences the basis for the conclusion and the fact that the audit was planned and performed in accordance with the SAs.

Topic 4: Purpose of Audit Documentation

L2P5-C6-T04

Read first Read ICAI Study Material Chapter 6, Audit Documentation — the purposes of audit documentation under SA 230.

NOTES

The purposes of audit documentation as per SA 230 — a twelve-item list, and marks follow the number of items named: **1. it helps in assisting the engagement team to plan and perform the audit;** 2. it helps in assisting members of the engagement team responsible for supervision to direct and supervise the audit work and to discharge their review responsibilities; **3. documentation enables the engagement team to be accountable for its work;** 4. it helps to retain a record of matters of continuing significance to future audits; **5. it enables the conduct of quality control reviews and inspections;** 6. it enables the conduct of external inspections in accordance with applicable legal, regulatory or other requirements; 7. working papers are necessary to record and demonstrate the audit work from one year to another; **8. it draws conclusion from the evidence obtained;** 9. working papers are necessary to standardise the audit procedures to improve the efficiency of the audits; 10. it facilitates the delegation of work as a means to quality control of work performed; 11. working papers provide guidance to the audit staff with regard to the manner of checking the schedules; 12. working papers act as evidence in a court of law when a charge of negligence is brought against the auditor.

List first, expand afterwards. Because the marks track the count of purposes, write all twelve as a

numbered list before adding any explanation. A well-written essay naming five purposes scores below a bare list of twelve.

The question is usually set in three parts — meaning, nature and purpose — so head them separately. Meaning: the record of audit procedures performed, relevant audit evidence obtained and conclusions reached. Nature: evidence of the auditor's basis for a conclusion about the achievement of the overall objectives of the auditor, and evidence that the audit was planned and performed in accordance with SAs and applicable legal and regulatory requirements. Purpose: the twelve items above.

Item 12 is the one students forget and examiners like: working papers act as evidence in a court of law when a charge of negligence is brought against the auditor. Pair it with item 3, accountability of the engagement team, when a scenario turns on the auditor having to defend the work done.

Understanding explain it, and place it in context · 1 question

- If the question asks for meaning, nature and purpose together, use three headings. Running them into one answer is how candidates lose the nature marks entirely.

TQ 4.1 · RTP 2019-May [6] (a) · Pg 385

LEVEL I
Understanding

Medium

Topic 5: Form, Content and Extent of Audit Documentation

L2P5-C6-T05

Read first Read ICAI Study Material Chapter 6, Audit Documentation — the form, content and extent of audit documentation under SA 230, including the experienced auditor test.

NOTES

The experienced auditor test is the heart of this topic. The auditor shall prepare audit documentation sufficient to enable an experienced auditor, having no previous connection with the audit, to understand: (a) the nature, timing and extent of the audit procedures performed to comply with the SAs and applicable legal and regulatory requirements; (b) the results of the audit procedures performed, and the audit evidence obtained; and (c) significant matters arising during the audit and the conclusions reached thereon, and significant professional judgements made in reaching those conclusions. **Three heads, and the mark allocation follows them.** Use the phrase '**an experienced auditor having no previous connection with the audit**' in your answer — it is the Standard's own test, and quoting it back shows you are answering the documentation requirement rather than describing an audit file in general.

In documenting the nature, timing and extent of audit procedures performed, the auditor shall record three things: **(a) the identifying characteristics of the specific items or matters tested; (b)**

who performed the audit work and the date such work was completed; and (c) who reviewed the audit work performed and the date and extent of such review.

The trap, and it is set as a whole question: recording the nature, timing and extent of procedures alone does not meet the requirements of SA 230. The three-item record above and the three-head experienced auditor test are **cumulative**, not alternatives. So the view that documenting nature, timing and extent by itself satisfies the Standard is **not valid**.

The form, content and extent depend on seven factors: 1. the size and complexity of the entity; 2. the nature of the audit procedures to be performed; 3. the identified risks of material misstatement; 4. the significance of the audit evidence obtained; 5. the nature and extent of exceptions identified; 6. the need to document a conclusion or the basis for a conclusion not readily determinable from the documentation of the work performed or audit evidence obtained; 7. the audit methodology and tools used.

What you need not document, with the examples the answers give. Audit documentation provides evidence that the audit complies with the SAs, but it is neither necessary nor practicable for the auditor to document every matter considered, or professional judgment made, in an audit, and it is unnecessary to document separately — as in a checklist, for example — compliance with matters for which compliance is demonstrated by documents included within the audit file. For example: an adequately documented audit plan demonstrates that the auditor has planned the audit; a signed engagement letter in the audit file demonstrates that the auditor has agreed the terms of the audit engagement with management, or where appropriate those charged with governance; an auditor's report containing an appropriately qualified opinion demonstrates that the auditor has complied with the requirement to express a qualified opinion in the circumstances specified in the SAs. For requirements that apply generally throughout the audit there may be several ways of demonstrating compliance: there may be no single way in which the auditor's professional scepticism is documented, but the documentation may still evidence it — for example specific procedures performed to corroborate management's responses to the auditor's inquiries — and that the engagement partner has taken responsibility for the direction, supervision and performance of the audit may be evidenced by, for example, documentation of the engagement partner's timely involvement in aspects of the audit, such as participation in the team discussion required by SA 315.

Remembering reproduce what you have learnt · 1 question

- The seven factors governing form, content and extent are a straight list question. Number them; do not explain them unless the question asks.

CSQ 5.1 · PYQ 2026-Sep [2] (b) (ii) · 3M · Pg 389

LEVEL I
Remembering

Easy

Understanding explain it, and place it in context · 4 questions

- Quote the experienced auditor test in full, including 'having no previous connection with the audit'. Dropping that clause loses the point of the requirement.

TQ 5.1 · PYQ 2015-Nov [6] (a) · 4M · Pg 386	LEVEL I Understanding	Medium
TQ 5.2 · RTP 2021-May [6] (b) · Pg 387	LEVEL I Understanding	Medium
TQ 5.3 · MTP 2021-Oct [3] (a) · 4M · Pg 387	LEVEL I Understanding	Medium
TQ 5.4 · RTP 2025-May [14] · Pg 388	LEVEL I Understanding	Hard

Topic 6: Example of Audit Documentation

L2P5-C6-T06

Read first Read ICAI Study Material Chapter 6, Audit Documentation — examples of audit documentation, what need not be included, documentation of discussions, and documentation of matters arising after the date of the auditor's report.

NOTES

Examples of audit documentation, asked as a four-item or seven-item list: audit programmes; analyses; issue memoranda; summaries of significant matters; letters of confirmation and representation; **checklists;** and correspondence (including e-mails) relating to significant matters.

What the auditor need not include, and this is the most-set question in the topic: as per SA 230, the auditor need not include in audit documentation **1. superseded drafts of working papers and financial statements; 2. notes that reflect incomplete or preliminary thinking; 3. previous copies of documents corrected for typographical or other errors; 4. duplicates of documents.** Applied to the classic fact pattern — a bundle of draft inventory sheets filed alongside the final inventory sheet — the answer is that only the final inventory sheet, being the concluded and verified figure, together with the supporting working papers relevant and necessary to justify the auditor's conclusions, should form part of the audit documentation. Audit documentation should contain only those working papers that are necessary to support the auditor's opinion; keeping large numbers of draft sheets **increases file volume and adds no audit value**, so the assistant's approach is **not correct**.

Documentation of discussions on significant matters. The auditor shall document discussions of significant matters with management, those charged with governance and others, including the nature of the significant matters discussed, and when and with whom the discussions took place. If the auditor identifies information that is inconsistent with the auditor's final conclusion on a significant matter, he shall document **how the inconsistency was addressed**. On the receivables-crisis fact pattern the expected documentation is the **minutes of the discussions with**

management, recording the matters discussed, the individuals representing management and the auditor, the amount of provision recommended by the auditor, the amount of provision finally accepted and provided by management, and any other relevant supporting information.

Documentation of matters arising after the date of the auditor's report. If, in **exceptional circumstances**, the auditor performs new or additional audit procedures or draws new conclusions after the date of the auditor's report, he shall document **1. the circumstances encountered**; 2. the new or additional audit procedures performed, audit evidence obtained, and conclusions reached, and their effect on the auditor's report; and 3. when and by whom the resulting changes to audit documentation were made and reviewed.

Whether the client can demand the file. As per **Standard on Quality Control (SQC) 1**, unless otherwise specified by law or regulation, audit documentation is the property of the auditor. **The auditor is not obliged to provide audit documentation to the client.** He may, at his discretion, make portions of, or extracts from, audit documentation available to clients, provided such disclosure does not undermine the validity of the work performed or, in the case of assurance engagements, the independence of the auditor or of his personnel.

Remembering reproduce what you have learnt · 1 question

- The four items that need not be included are a four-mark list on their own. Learn them in order and do not paraphrase 'superseded drafts' into 'old papers'.

CSQ 6.3 · PYQ 2025-Sep [4] (a) · 5M · Pg 392

LEVEL I
Remembering

Hard

Understanding explain it, and place it in context · 1 question

- Where the question asks for 'any four examples of audit documentation', give four from the printed list and stop. Inventing examples of your own risks losing the mark.

CSQ 6.2 · RTP 2022-Nov [6] (a) · Pg 391

LEVEL I
Understanding

Medium

Application use the Standard - apply it to the facts · 2 questions

- A two-part question — what to exclude, and whether the client is entitled to the file — needs both Standards named: SA 230 for the exclusions and SQC 1 for ownership. Naming only SA 230 loses half the answer.
- State the verdict on the assistant's or auditor's approach expressly: 'No, the approach is not correct.' Then give the reason.

CSQ 6.1 · PYQ 2024-Sep [3] (b) · 4M · Pg 390

LEVEL II
Application

Medium

CSQ 6.4 · PYQ 2026-Jan [3] (b) · 5M · Pg 393

LEVEL II

Medium

Topic 7: Timely Preparation of Audit Documentation

L2P5-C6-T07

CONCEPT BASE — no exam question asked yet • essential for full preparation

Read first Read ICAI Study Material Chapter 6, Audit Documentation — timely preparation of audit documentation under SA 230.

NOTES

The requirement in one line: SA 230 requires that the auditor shall prepare audit documentation on a timely basis, that is, **during the course of the audit**, not after it.

Why timeliness matters, in the words the answers use: preparing sufficient and appropriate audit documentation on a timely basis helps to enhance the quality of the audit and facilitates the effective review and evaluation of the audit evidence obtained and conclusions reached before the auditor's report is finalised. And the corollary: documentation prepared after the audit work has been performed is likely to be less accurate than documentation prepared at the time such work is performed.

Do not confuse timely preparation with the assembly of the final audit file. Timely preparation is a requirement of **SA 230** and runs **during** the audit; **assembly of the final audit file** is an **administrative process** governed by **SQC 1**, for which the time limit is ordinarily not more than 60 days after the date of the auditor's report. The 60 days is not a period within which documentation may be prepared. Preparing the documents only after the audit is over is not appropriate, however soon the file is then assembled.

The reporting-date consequence: putting papers into the file afterwards and **dating them with the current date** is **not permissible at all**. It shows that part of the audit documentation was prepared later and puts a question mark on the quality of the audit.

Topic 8: Audit File

L2P5-C6-T08

CONCEPT BASE — no exam question asked yet • essential for full preparation

Read first Read ICAI Study Material Chapter 6, Audit Documentation — the audit file, its form and its retention.

NOTES

The auditor shall assemble the audit documentation in an audit file, and the file is the physical or electronic container in which the documentation supporting the auditor's report is held.

Form: the file may be maintained in physical or electronic form. A belief that **paper form is mandatory is incorrect** — the answers correct that view expressly in a fact pattern where the auditor prepared everything on paper because he thought he had to.

Retention: as per SQC 1, audit documentation should be retained for a period of not less than 7 years. A firm that retains its audit files for only four years from the date of the audit report is **not in compliance**. Note that the retention period comes from **SQC 1**, not from SA 230 — name the right Standard.

Once the assembly of the final audit file has been completed, the auditor shall not delete or discard audit documentation of any nature before the end of its retention period. That prohibition bites **after** assembly is complete; administrative changes during assembly are a different matter and are dealt with in the next topic.

Topic 9: Assembly of Final Audit File

L2P5-C6-T09

Read first Read ICAI Study Material Chapter 6, Audit Documentation — assembly of the final audit file, the 60-day limit under SQC 1, and permissible changes during assembly.

NOTES

The rule in one line: the auditor shall assemble the audit documentation in an audit file and complete the administrative process of assembling the final audit file on a timely basis after the date of the auditor's report. SQC 1, 'Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services', requires firms to establish policies and procedures for the timely completion of the assembly of audit files, and an appropriate time limit within which to complete the assembly of the final audit file is ordinarily not more than 60 days after the date of the auditor's report.

What assembly is, and is not. The completion of the assembly of the final audit file after the date of the auditor's report is an administrative process that does not involve the performance of new audit procedures or the drawing of new conclusions. Changes may, however, be made to the audit documentation during the final assembly process, if they are administrative in nature. So discarding superseded supporting schedules and correcting cross-referencing errors, with **no new audit conclusions drawn**, is permissible — provided it is done within the 60 days.

Work the scenario as an arithmetic question, because that is how it is marked. Take the date of the auditor's report, count the days to the date of assembly, and say whether it is within or beyond 60 days. A report dated 18 August with the file assembled on 10 October is **within** the limit, so the

administrative changes stand. A report dated 20 August with the file assembled in March of the following year, or a file assembled **more than six months** after the report, is **beyond** the limit and is **non-compliance with SQC 1**. Three months, being 90 days, is likewise **not in accordance with the Standard**.

The puzzle SA 230 and SQC 1 appear to create, and how to resolve it. SA 230 requires the auditor to prepare audit documentation on a timely basis, because doing so enhances the quality of the audit and facilitates the effective review and evaluation of the audit evidence obtained and conclusions reached before the auditor's report is finalised. SQC 1 gives 60 days after the date of the auditor's report for the assembly of the final audit file, because assembly is only an administrative process that involves no new audit procedures and no new conclusions. The two are not in conflict: documentation is prepared during the audit; only the assembly of the file happens after the report.

Two further limbs the scenarios turn on. First, after the assembly of the final audit file has been completed, the auditor shall not delete or discard audit documentation of any nature before the end of its retention period, which under SQC 1 is **not less than 7 years**. Second, adding papers to the file long afterwards and dating them with the current date is not permissible at all — it shows that part of the documentation was prepared after the event and **puts a question mark on the quality of the audit**, because documentation prepared after the audit work has been performed is likely to be less accurate than documentation prepared at the time such work is performed.

Understanding explain it, and place it in context • 1 question

- Explain the 60 days by what assembly is: an administrative process with no new procedures and no new conclusions. Without that sentence the time limit looks arbitrary and the explanation marks go.

CSQ 9.3 • RTP 2025-Jan [14] • Pg 397

LEVEL I
Understanding

Medium

Application use the Standard - apply it to the facts • 3 questions

- State the rule, then compute the gap between the report date and the assembly date, then give the verdict. An answer that states the rule and stops has not answered the question.
- Where several defaults appear in one scenario — late preparation, paper-only belief, late assembly, short retention — deal with each under its own numbered head and conclude on each.

CSQ 9.1 • PYQ 2024-May [1] (d) {C} • 3M • Pg 395

LEVEL II
Application

Easy

CSQ 9.2 • RTP 2024-May [14] • Pg 396

LEVEL II
Application

Medium

TQ 9.1 • MTP 2024-Dec S2 [1] (c) • 4M • Pg 394

LEVEL II
Application

Hard

Topic 10: Documentation of Significant Matters and Related Significant Professional Judgements

L2P5-C6-T10

Read first Read ICAI Study Material Chapter 6, Audit Documentation — documentation of significant matters and related significant professional judgements under SA 230.

NOTES

The requirement: the auditor shall prepare audit documentation sufficient to enable an experienced auditor, having no previous connection with the audit, to understand significant matters arising during the audit, the conclusions reached thereon, and significant professional judgements made in reaching those conclusions. Judging the significance of a matter requires an objective analysis of the facts and circumstances.

Examples of significant matters — a four-item list, and marks follow the items: 1. matters that give rise to significant risks; 2. results of audit procedures indicating (a) that the financial statements could be materially misstated, or (b) a need to revise the auditor's previous assessment of the risks of material misstatement and the auditor's responses to those risks; 3. circumstances that cause the auditor significant difficulty in applying necessary audit procedures; 4. findings that could result in a modification to the audit opinion or the inclusion of an Emphasis of Matter paragraph in the auditor's report.

Expand each item the way the printed answers expand it, because the later attempts award marks for the explanation as well as the item. Significant risks are areas where there is a higher possibility of material misstatement, so they need greater attention and fuller documentation. Difficulty in applying procedures covers, for example, **lack of evidence, uncooperative management, or complex transactions**. Findings affecting the report cover a modified opinion — qualified, adverse or disclaimer — or an Emphasis of Matter paragraph.

The factor the question names, and you must address it directly: an important factor in determining the form, content and extent of audit documentation of significant matters is the extent of professional judgement exercised in performing the work and evaluating the results. Documentation of the professional judgements made, where significant, explains the auditor's conclusions and reinforces the quality of the judgement. Such matters are of particular interest to those responsible for reviewing audit documentation, including those carrying out subsequent audits, when reviewing matters of continuing significance — for example, when performing a retrospective review of accounting estimates.

The one-line summary the answers close with: significant matters are those that require high professional judgement, involve significant risks or audit difficulties, or have the potential to affect the auditor's final opinion or report. Use it as your closing sentence; it ties the four examples back to the requirement.

Application use the Standard - apply it to the facts · 3 questions

- The ask is what documentation **enables an experienced auditor to understand** the significant matters. Answer with what must be recorded, not with why documentation matters.
- Cover the nature, timing and extent of the procedures, the results and the evidence obtained, and the significant judgements with the conclusions reached.

TQ 10.1 · RTP 2022-Nov [6] (b) · Pg 398	LEVEL II Application	Medium
TQ 10.2 · RTP 2024-Sep [14] · Pg 399	LEVEL II Application	Medium
TQ 10.3 · PYQ 2026-May [3] (c) · 4M · Pg 400	LEVEL II Application	Medium

Topic 11: Completion Memorandum or Audit Documentation Summary

L2P5-C6-T11

Read first Read ICAI Study Material Chapter 6, Audit Documentation — the completion memorandum or audit documentation summary under SA 230.

NOTES

What it is: as per SA 230 'Audit Documentation', the auditor may consider it helpful to prepare and retain as part of the audit documentation a completion memorandum (that is, a summary) that describes the significant matters identified during the audit and how they were addressed.

Note the word 'may' — it is helpful, not mandatory.

Why it is helpful — three reasons, and they are the marks: 1. such a summary may facilitate effective and efficient review and inspection of the audit documentation, particularly for large and complex audits; 2. the preparation of such a memorandum may assist the auditor's consideration of the significant matters; 3. it may help the auditor to consider whether there is any individual relevant SA objective that the auditor cannot achieve that would prevent the auditor from achieving the overall objectives of the auditor.

The two-part question is the standard form: explain the completion memorandum, then test the assembly date against the 60-day limit. Keep them separate. Where an audit report was issued on 20 August and the junior completed the assembly of the final audit file in March of the following year, that is **more than 60 days after the date of the auditor's report** and therefore **non-compliance with SQC 1**, so the team member's approach was **incorrect** — and say so in terms.

Do not describe the memorandum as a summary of the financial statements or of the audit programme. It summarises **the significant matters identified and how they were addressed**, and nothing else. That is the sentence that earns the definition mark.

Understanding explain it, and place it in context · 1 question

- Give the meaning in one sentence and the significance in three numbered reasons. The third reason — the relevant SA objective that cannot be achieved — is the one most candidates omit.

TQ 11.1 · PYQ 2019-May [3] (d) · 3M · Pg 401

LEVEL I
Understanding

Easy

Application use the Standard - apply it to the facts · 1 question

- Where the same question also gives an assembly date, answer it under a second heading with SQC 1 and the 60-day limit, and conclude on whether the approach was correct.

CSQ 11.1 · PYQ 2025-May [1] (c) {C} · 4M · Pg 402

LEVEL II
Application

Medium

Topic 12: Ownership of Audit Documentation

L2P5-C6-T12

Read first Read ICAI Study Material Chapter 6, Audit Documentation — ownership of audit documentation, access by the client and the principal auditor, and the auditor's lien.

NOTES

The rule, and note which Standard each answer cites. Standard on Quality Control (SQC) 1 provides that, unless otherwise specified by law or regulation, audit documentation is the property of the auditor; one printed answer states the same proposition as **SA 230 'Audit Documentation'** — **working papers are the property of the auditor**. Either way the proposition is the same: **the working papers belong to the auditor**. He may, at his discretion, make portions of, or extracts from, audit documentation available to clients, provided such disclosure does not undermine the validity of the work performed or, in the case of assurance engagements, the independence of the auditor or of his personnel. The auditor should adopt reasonable procedures for custody and confidentiality of his working papers, and is not required to provide the management, the client or other auditors access to his working papers.

The branch auditor point, set as a 'comment on the statement' question. The main auditor of a company does not have a right of access to the working papers of the branch auditor. The principal auditor has to consider the report of the branch auditor and has a right to seek clarification and to visit the branch, but cannot ask for a copy of the working papers, and the branch auditor is under no compulsion to give photocopies of his working papers to the principal auditor. So the statement that the branch auditor's working papers are also the property of the principal auditor and of the management **is incorrect**.

The lien, and the four conditions that must all be satisfied. Under the general principles of law, any person having lawful possession of somebody else's property, on which he has worked, may

retain that property for non-payment of his dues on account of the work done on it. Applied to an auditor, a lien arises only where **(1) the documents belong to the client**; **(2) they came into the auditor's possession with the client's authority**; **(3) the auditor has actually done work on those documents**; and **(4) fees for that work remain unpaid**.

The worked conclusion, which is how the question is marked. An auditor who retains documents of the company **on which he has not worked**, saying he may need them for future reference, fails condition (3): no lien arises over them and he cannot retain them even if fees are outstanding. As for his **own working papers**, they are **his property under SQC 1, so no question of lien arises on them**. The retention of the company's documents on which he has not worked is therefore **not justified**.

Two different questions, and students merge them. **Ownership** answers 'whose papers are these?' — the auditor's, under SQC 1, with a discretion to share extracts. **Lien** answers 'may the auditor keep the client's own books and documents?' — only where all four conditions are met. An answer that cites SQC 1 to justify retaining the client's records has answered the wrong question.

Understanding explain it, and place it in context · 1 question

- State the ownership rule with its proviso — the discretion to share extracts, and the two things such disclosure must not undermine. The proviso is a mark of its own.

TQ 12.1 · MTP 2021-Mar [3] (d) · 3M · Pg 403

LEVEL I
Understanding

Hard

Application use the Standard - apply it to the facts · 1 question

- For a lien scenario, run the four conditions one by one against the facts and say which one fails. Then deal with the auditor's own working papers separately.
- Where the question is a statement to comment on, end with the verdict in terms: 'therefore, the statement given in the question is incorrect'.

TQ 12.2 · PYQ 2022-May [5] (a) · 4M · Pg 404

LEVEL II
Application

Hard

CHAPTER 7

Completion and Review

6 Topics • 49 Classified Questions • Importance: B

ICAI SKILL PROFILE ICAI band for this paper: Level I 40-60% • Level II 40-60% — this chapter reads **on profile**

Level I — Comprehension & Knowledge **54.9%** 118 of 215 marks

Level II — Analysis & Application **45.1%** 97 of 215 marks

This chapter sits inside ICAI's own band for the paper — 55% Level I against 40-60%. Prepare it in those proportions: know the method, then drill it.

Topic 1: Subsequent Events (SA 560)

L2P5-C7-T01

Read first Read ICAI Study Material Chapter 7, Completion and Review — Subsequent Events (SA 560), including the two types of events and the auditor's duties in each of the three periods.

NOTES

The rule in one line: SA 560, “Subsequent Events”, deals with the auditor's responsibilities relating to subsequent events. Subsequent events means 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. Financial reporting frameworks ordinarily identify **two types** of event: (1) those that provide evidence of conditions that existed at the date of the financial statements, and (2) those that provide evidence of conditions that arose after the date of the financial statements. SA 700 explains that the date of the auditor's report informs the reader that the auditor has considered the effect of events and transactions of which he becomes aware and that occurred up to that date.

The four risk-assessment procedures, and they are the marks (asked again and again, as a plain list and inside case scenarios): (1) obtaining an understanding of any procedures management has established to ensure that subsequent events are identified; (2) inquiring of management and, where appropriate, those charged with governance whether any subsequent events have occurred which might affect the financial statements; (3) reading minutes, if any, of the meetings of the entity's owners, management and those charged with governance held after the date of the financial statements, and inquiring about matters discussed at meetings for which minutes are not yet available; (4) **reading the entity's latest subsequent interim financial statements, if any.** The answers add that such information may also come from accounting records for the period after the date of the financial statements and the entity's latest available budget, and that **written representations under SA 580** are obtained on the point. The procedures must cover the period from the date of the financial statements to the date of the auditor's report, or as near as practicable thereto, and the auditor is **not expected to repeat procedures** that have already given

satisfactory conclusions.

Period 2 — facts known after the date of the auditor's report but before the financial statements are issued. Start with the sentence the examiner wants: the auditor has no obligation to perform any audit procedures regarding the financial statements after the date of the auditor's report. But when such a fact becomes known that, had it been known at the date of the report, **may have caused the auditor to amend the report**, the auditor shall (1) discuss the matter with management and, where appropriate, those charged with governance; **(2) determine whether the financial statements need amendment**; and, if so, (3) inquire how management intends to address the matter in the financial statements. If management amends and the auditor performs the procedures on the amendment, the new auditor's report shall not be dated earlier than the date of approval of the amended financial statements. If **management refuses to amend**: where the report has **not yet been provided to the entity**, the auditor **modifies the opinion** and then issues the report; where the report has **already been provided**, the auditor notifies management and those charged with governance not to issue the financial statements to third parties before the amendments are made, and if they are issued nevertheless, **takes appropriate action to seek to prevent reliance on the report**.

Period 3 — facts known after the financial statements have been issued. Again the auditor has no obligation to perform any audit procedures after issue. But where such a fact becomes known, he shall: **discuss with management and TCWG; determine whether the financial statements need amendment; inquire how management intends to address the matter**; if management amends, perform the audit procedures necessary in the circumstances on the amendment; review the steps taken by management to ensure that anyone in receipt of the previously issued financial statements together with the auditor's report is informed of the situation; extend the audit procedures to the date of the new auditor's report and provide a new report on the amended financial statements; include in the new report a modified opinion as applicable, or an Emphasis of Matter or Other Matter paragraph referring to a note that more extensively discusses the reason for the amendment and referring to the earlier report. If management does not inform recipients and does not amend where the auditor believes amendment is needed, the auditor **notifies management that he will seek to prevent future reliance on the report**, and if they still do not act, **takes appropriate action to seek to prevent reliance on the auditor's report**.

Classifying the events — this is where the case scenario marks sit. **Adjusting (conditions existed at the date of the financial statements): declaration of insolvency of a major debtor** between the date of the financial statements and the date of the auditor's report, which is evidence on recoverability of the amount due as at the date of the financial statements — provision must be created or the debtor written off, **mere disclosure is not sufficient; settlement of a legal claim out of court at a reduced amount** where a provision was already made — evidence of the best estimate of the liability at the year end, so the **excess provision is reversed**. Non-adjusting (conditions arose after the date of the financial statements): **issue of new share capital; a planned merger; destruction of substantial inventories by fire** after the reporting date — **disclosure only**, unless it affects the going concern assumption.

The conclusion the examiner wants stated. Where management has merely disclosed an adjusting event instead of adjusting the figures, say so in terms: non-provision for an insolvent debtor and non-reversal of an excess provision are material misstatements, and unless management makes the adjustments the auditor should modify the opinion in accordance with SA 705. Disclosure alone is enough for the non-adjusting items. So the treatment is **partially incorrect**. The classic **wrong answer** is to treat every post-year-end event the same — always split the list into the two types first, say which are adjusting and which are not, and only then give the auditor's response.

Remembering reproduce what you have learnt · 1 question

- Name the four risk-assessment procedures before explaining any of them. Marks follow the number of procedures named.

TQ 1.3 · MTP 2025-Dec S2 [6] (c) · 4M · Pg 412

LEVEL I
Remembering

Medium

Understanding explain it, and place it in context · 4 questions

- Give the definition of subsequent events in full — it has two halves, the period up to the date of the report and facts known after it. An answer that gives only the first half loses marks.

TQ 1.1 · PYQ 2021-Jul [3] (a) · 4M · Pg 410

LEVEL I
Understanding

Medium

TQ 1.2 · RTP 2021-Nov [7] (b) · Pg 411

LEVEL I
Understanding

Medium

CSQ 1.2 · RTP 2024-May [16] · Pg 414

LEVEL I
Understanding

Medium

CSQ 1.7 · PYQ 2026-Sep [2] (a) · 5M · Pg 421

LEVEL I
Understanding

Medium

Application use the Standard - apply it to the facts · 3 questions

- Fix the date of the auditor's report and the date of issue on the facts first, then say which of the three periods you are in. The duty changes with the period, and the examiner is testing whether you placed the facts correctly.
- Where the question gives a list of post-year-end events, classify each one as adjusting or non-adjusting with a reason, then state the treatment, then conclude on whether management's treatment is right.

CSQ 1.1 · PYQ 2020-Nov [1] (b) {C} · 5M · Pg 413

LEVEL II
Application

Medium

CSQ 1.4 · PYQ 2026-Jan [5] (a) · 5M · Pg 416

LEVEL II
Application

Medium

CSQ 1.6 · MTP 2026-Apr S2 [3] (b) · 5M · Pg 420

LEVEL II
Application

Medium

Analysis break it down and take the parts separately · 2 questions

- When management refuses to amend, take the two situations separately — report not yet provided, and report already provided. The answer that runs them together loses half the marks.

CSQ 1.3 · PYQ 2024-Sep [1] (a) {C} · 4M · Pg 415

LEVEL II
Analysis

Medium

CSQ 1.5 · MTP 2026-Mar S1 [3] (b) · 5M · Pg 418

LEVEL II
Analysis

Medium

Topic 2: Meaning of Going Concern and its Significance (SA 570)

L2P5-C7-T02

Read first Read ICAI Study Material Chapter 7, Completion and Review — meaning and significance of going concern, and the auditor's responsibilities and reporting under SA 570.

NOTES

Meaning, in the words the answers use: going concern is one of the fundamental accounting assumptions. The enterprise is normally viewed as a going concern, that is, **as continuing in operation for the foreseeable future**, and it is assumed that the enterprise has neither the intention nor the necessity of liquidation or of curtailing materially the scale of its operations. Under the going concern basis of accounting the financial statements are prepared on the assumption that the entity will continue its operations for the foreseeable future. General purpose financial statements are prepared using the going concern basis unless management either intends to liquidate the entity or to cease operations, or has no realistic alternative but to do so.

Significance — it changes how the statements are drawn up. When the going concern basis is appropriate, assets and liabilities are recorded on the basis that the entity will be able to realise its assets and discharge its liabilities in the normal course of business. When the entity is **not** viewed as a going concern, **the financial statements are prepared on a liquidation basis** — inventories may need to be written down as they may be sold at a lower price, and assets may have to be recorded at the likely prices they will fetch.

The three objectives of the auditor under SA 570, and they are also his responsibilities: (1) to obtain sufficient appropriate audit evidence regarding, and conclude on, the appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements; (2) to conclude, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern; and **(3) to report in accordance with this SA.** Add the limitation the examiner rewards: as described in **SA 200**, the potential effects of inherent limitations on the auditor's ability to detect material misstatements are **greater for future events or conditions**, the auditor cannot predict them, and so the absence of any reference to a material uncertainty in the auditor's report cannot be viewed as a guarantee as to the entity's ability to continue as a going

concern.

Examples of events or conditions — learn them under their heads, because the question names the head. **Financial:** net liability or net current liability position; fixed-term borrowings approaching maturity without realistic prospects of renewal or repayment, or excessive reliance on short-term borrowings to finance long-term assets; indications of withdrawal of financial support by creditors; negative operating cash flows indicated by historical or prospective financial statements; adverse key financial ratios. **Operating:** management's intentions to liquidate the entity or to cease operations; loss of key management without replacement; loss of a major market, key customers, franchises, licences or principal suppliers; labour difficulties; shortages of important supplies; emergence of a highly successful competitor. **Factors relevant to management's judgement** on the assessment: the **degree of uncertainty increases the further into the future** the event or its outcome lies, which is why frameworks specify the period to be covered; the **size and complexity of the entity**, the nature and condition of its business and the degree to which it is affected by external factors; and that any judgement about the future is based on information available at the time it is made, so subsequent events may produce outcomes inconsistent with judgements that were reasonable when made.

Where such events or conditions are identified, the additional procedures are: (1) where management has not yet performed an assessment, requesting management to make its assessment; (2) **evaluating management's plans for future actions** — whether the outcome is likely to improve the situation and whether the plans are feasible in the circumstances; (3) where a cash flow forecast has been prepared and its analysis is a significant factor, (a) evaluating the reliability of the underlying data generated to prepare the forecast and (b) determining whether there is adequate support for the assumptions underlying the forecast; (4) considering whether any additional facts or information have become available since the date of management's assessment; and (5) requesting written representations from management and, where appropriate, TCWG, regarding their plans for future actions and the feasibility of those plans. When a question asks only about the cash flow forecast, limbs (a) and (b) of item 3 are the whole answer.

Reporting — the two-way split the examiner keeps setting. Where the auditor concludes that the **use of the going concern basis is appropriate but a material uncertainty exists**, he first determines whether the financial statements (i) adequately disclose the principal events or conditions and management's plans to deal with them, and (ii) disclose clearly that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern and that it may therefore be unable to realise its assets and discharge its liabilities in the normal course of business. Then: (a) **disclosure adequate — express an unmodified opinion** and include a **separate section headed "Material Uncertainty Related to Going Concern"** that draws attention to the note and states that these events or conditions indicate a material uncertainty and **that the auditor's opinion is not modified in respect of the matter**. (b) **disclosure not adequate — express a qualified opinion or an adverse opinion**, as appropriate, in accordance with SA 705, and in the Basis for Qualified (Adverse) Opinion section state that a material uncertainty exists ... and

that the financial statements do not adequately disclose this matter.

The trap. A material uncertainty does **not** by itself mean a modified opinion. If the disclosure is adequate the opinion stays **unmodified** and the uncertainty goes into its own “**Material Uncertainty Related to Going Concern**” section — not into an Emphasis of Matter paragraph and not into the opinion. It is only **inadequate disclosure** that pushes you into SA 705. Equally, losses alone do not defeat the assumption: where a company has losses but **is able to meet its financial commitments** and revenue is expected to grow, management has **neither the intention nor the necessity of liquidation**, so the going concern basis is appropriate.

Remembering reproduce what you have learnt • 1 question

- List the three objectives in the Standard's order, then expand. The third objective, 'to report in accordance with this SA', is a mark on its own and is the one most often dropped.
- When asked for five examples, give them from the head the question names — financial or operating. Mixing the heads costs marks.

CSQ 2.1 • PYQ 2018-Nov [1] (c) {C} • 5M • Pg 427

LEVEL I
Remembering

Medium

Understanding explain it, and place it in context • 10 questions

- Link the significance of going concern to the two bases of preparation — normal course of business against liquidation basis — and give the inventory write-down example. That contrast is what the marks are for.

TQ 2.1 • RTP 2021-May [8] (a) • Pg 422

LEVEL I
Understanding

Medium

TQ 2.2 • RTP 2021-May [8] (b) • Pg 423

LEVEL I
Understanding

Medium

TQ 2.3 • PYQ 2021-Jan [5] (a) • 4M • Pg 424

LEVEL I
Understanding

Medium

TQ 2.4 • RTP 2021-Nov [7] (a) • Pg 425

LEVEL I
Understanding

Medium

TQ 2.5 • PYQ 2025-May [2] (b) • 5M • Pg 425

LEVEL I
Understanding

Medium

CSQ 2.2 • PYQ 2023-May [5] (a) • 4M • Pg 428

LEVEL I
Understanding

Medium

CSQ 2.3 • PYQ 2025-Jan [3] (b) • 5M • Pg 430

LEVEL I
Understanding

Medium

CSQ 2.5 • RTP 2024-Sep [16] • Pg 434

LEVEL I
Understanding

Medium

CSQ 2.6 • MTP 2024-Nov [6] (Or) (c) • 4M • Pg 435

LEVEL I
Understanding

Medium

CSQ 2.7 · PYQ 2026-Sep [1] (c) {C} · 4M · Pg 436

LEVEL I
Understanding

Medium

Application use the Standard - apply it to the facts · 2 questions

- Set out SA 570's requirement first, apply it to the facts, then state the reporting outcome in terms: unmodified opinion plus a separate 'Material Uncertainty Related to Going Concern' section, or qualified/adverse under SA 705.
- Where the question splits into 'disclosure made' and 'disclosure not made', answer the two limbs separately and name the section heading in each.

CSQ 2.4 · MTP 2024-Jul [2] (a) · 5M · Pg 433

LEVEL II
Application

Medium

TQ 2.6 · MTP 2025-Dec S2 [3] (b) · 5M · Pg 426

LEVEL II
Application

Hard

Topic 3: Evaluation of Misstatements Identified During the Audit (SA 450)

L2P5-C7-T03

Read first Read ICAI Study Material Chapter 7, Completion and Review — evaluation of misstatements identified during the audit under SA 450.

NOTES

The rule in one line: under **SA 450** the auditor shall communicate on a timely basis all misstatements accumulated during the audit with the appropriate level of management, unless prohibited by law or regulation, and shall **request management to correct those misstatements**.

Why timely communication matters — the “usefulness” marks. It enables management to evaluate whether the items are misstatements, to inform the auditor if it disagrees, and to take action as necessary. And the **correction by management of all misstatements**, including those communicated by the auditor, enables management to maintain accurate accounting books and records and reduces the risks of material misstatement of future financial statements because of the cumulative effect of immaterial uncorrected misstatements related to prior periods.

If management refuses to correct some or all of the misstatements communicated, the auditor shall **obtain an understanding of management's reasons for not making the corrections** and shall take that understanding into account when evaluating whether the financial statements as a whole are free from material misstatement. Do not jump straight to a modified opinion — the understanding step comes first.

Written representation on uncorrected misstatements: the auditor shall request a written representation from management and, where appropriate, those charged with governance, whether they believe the effects of uncorrected misstatements are immaterial, individually and in aggregate, to the financial statements as a whole, and a summary of such items shall be included

in or attached to the written representation.

Documentation under SA 450 — three items, and they carry the whole of a three-mark question: (a) **the amount below which misstatements would be regarded as clearly trivial**; (b) all misstatements accumulated during the audit and whether they have been corrected; and (c) the auditor's conclusion as to whether uncorrected misstatements are material, individually or in aggregate, and the basis for that conclusion.

The assurance point the chapter uses this topic to test: under SA 200, “Overall Objectives of the Independent Auditor...”, the auditor's objectives are (a) to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling him to express an opinion, and (b) to report on the financial statements and communicate as required by the SAs, in accordance with his findings. Absolute assurance is a complete assurance or guarantee that the financial statements are free from material misstatements; **reasonable assurance is a high level of assurance but not a complete guarantee**. So a management contention that the audit should give absolute assurance is **not correct**.

Understanding explain it, and place it in context • 1 question

- Quote the two limbs of the communication duty — communicate all accumulated misstatements on a timely basis, and request correction — before you explain the usefulness.

CSQ 3.2 • PYQ 2024-May [6] (c) • 3M • Pg 440

LEVEL I
Understanding

Easy

Application use the Standard - apply it to the facts • 2 questions

- State SA 450's requirement, apply it to the misstatement in the facts, and then deal separately with what happens if management refuses. The refusal limb is usually part (ii) and carries its own marks.
- A documentation question wants the three items named, nothing more. Do not pad it with the communication requirements.

TQ 3.1 • MTP 2025-Jul S1 [6] (a) • 5M • Pg 437

LEVEL II
Application

Medium

CSQ 3.1 • MTP 2024-Mar [1] (b) {C} • 4M • Pg 439

LEVEL II
Application

Medium

Topic 4: Written Representations (SA 580)

L2P5-C7-T04

Read first Read ICAI Study Material Chapter 7, Completion and Review — Written Representations (SA 580): objectives, from whom requested, date and periods covered, and the auditor's action where representations are not provided or are unreliable.

NOTES

The three objectives of the auditor under SA 580, "Written Representations": (1) to obtain written representations from management that it believes it has fulfilled its responsibility for the preparation of the financial statements and for the completeness of the information provided to the auditor; (2) to support other audit evidence relevant to the financial statements or specific assertions by means of written representations; and (3) to respond appropriately to written representations provided by management, or if management does not provide the representations requested. Written representations are **audit evidence**, but the answers are blunt about their rank: management representation is the last way of getting audit evidence when no other internal or external evidence is available, **it cannot be treated as a substitute for any other audit evidence**, and an auditor who blindly relies on it without caring to know whether other evidence is available will be held guilty of negligence of his professional duties.

Why a separate representation is needed even when all records have been given — a favourite scenario. Audit evidence that management has fulfilled its responsibilities is not sufficient without obtaining confirmation from management that it believes it has fulfilled those responsibilities, because the auditor **cannot judge solely on other audit evidence** whether management prepared and presented the financial statements and provided information on the basis of the agreed acknowledgement and understanding of its responsibilities. For example, the auditor could not conclude that management has given him all relevant information without **asking and receiving confirmation** that it has. So the Finance Manager who says the records are enough is **not correct**.

From whom, and when to ask for reconfirmation. Representations are requested from management with appropriate responsibilities for the financial statements and knowledge of the matters concerned — typically the **chief executive officer and chief financial officer** or equivalents; in some circumstances those charged with governance are also responsible. The auditor may ask management to **reconfirm its acknowledgement and understanding of those responsibilities**, which is particularly appropriate when (1) those who signed the terms of the audit engagement no longer have the relevant responsibilities; (2) **the terms of the audit engagement were prepared in a previous year**; (3) there is any indication that management misunderstands those responsibilities; or (4) **changes in circumstances make it appropriate to do so**. Management may make inquiries of **an actuary** for actuarially determined measurements, **staff engineers** for environmental liability measurements and **internal counsel** for provisions for legal claims. Where management adds **"to the best of its knowledge and belief"**, it is reasonable for the auditor to accept such wording if he is satisfied that the representations are made by those with appropriate responsibilities and knowledge.

Date and period — **two sentences that answer the whole question.** The date of the written representations shall be as near as practicable to, but not after, the date of the auditor's report on the financial statements, and the written representations shall be for all financial statements and period(s) referred to in the auditor's report. Because representations are necessary audit evidence, the auditor's opinion cannot be expressed and the report cannot be dated before the date of the

written representations. So a representation dated **29 June** with a report dated **30 June** is **appropriate**; one dated well before the report and not updated is not. Where the **management changed during the year** and the new team says it cannot cover the earlier period: this fact does not diminish their responsibility for the financial statements as a whole, so the requirement to request representations covering the whole of the relevant period(s) still applies, and on refusal the auditor should consider appropriate **modification in the audit report**.

If management does not provide a requested representation, the three steps, then the consequence: **(1) discuss the matter with management**; (2) re-evaluate the integrity of management and evaluate the effect this may have on the reliability of representations (oral or written) and audit evidence in general; and (3) take appropriate actions, including determining the possible effect on the opinion in accordance with SA 705. **The sharp rule:** where management does not provide the representations that it has fulfilled its responsibility for the preparation of the financial statements and for the completeness of the information provided, **the auditor shall disclaim an opinion**.

If representations are inconsistent with other audit evidence, the auditor shall **perform audit procedures to attempt to resolve the matter**; if it remains unresolved he shall reconsider the assessment of the competence, integrity, ethical values or diligence of management, or of its commitment to or enforcement of these, and determine the effect on the reliability of representations and audit evidence generally; and if he concludes that the written representations are not reliable, take appropriate actions, including determining the possible effect on the opinion under SA 705, having regard to the requirement of disclaimer of opinion.

What goes into the representation letter. Relating to the financial statements: that management has fulfilled its responsibilities as set out in the terms of the audit engagement for the preparation of the financial statements in accordance with the framework, and that they give a **true and fair view**; that significant assumptions used in making accounting estimates, including those measured at fair value, are reasonable; that related party relationships and transactions have been appropriately accounted for and disclosed (SA 550); that all subsequent events requiring adjustment or disclosure have been adjusted or disclosed (SA 560); and that the effects of uncorrected misstatements are immaterial, individually and in aggregate, with a list attached (SA 450). Other representations that supplement but do not form part of the responsibilities representation: **(a) that the selection and application of accounting policies are appropriate**; and **(b) that the following**, where relevant, have been recognised, measured, presented or disclosed in accordance with the framework — plans or intentions that may affect the carrying value or classification of assets and liabilities; liabilities, both actual and contingent; title to or control over assets, liens or encumbrances on assets and assets pledged as collateral; and aspects of laws, regulations and contractual agreements that may affect the financial statements, including non-compliance.

Understanding explain it, and place it in context · 6 questions

- State the date rule and the period rule as two separate sentences, each in the Standard's words. Students routinely give the date rule and forget that the representations must cover all periods in the report.

TQ 4.1 · PYQ 2021-Jan [2] (d) · 3M · Pg 440	LEVEL I Understanding	Easy
TQ 4.2 · PYQ 2021-Dec [3] (a) · 4M · Pg 442	LEVEL I Understanding	Medium
TQ 4.3 · RTP 2023-Nov [6] (a) · Pg 442	LEVEL I Understanding	Medium
TQ 4.4 · MTP 2025-Aug S2 [6] (c) · 4M · Pg 443	LEVEL I Understanding	Medium
TQ 4.5 · RTP 2026-Jan [16] · Pg 444	LEVEL I Understanding	Medium
CSQ 4.4 · MTP 2024-Nov [1] (a) {C} · 5M · Pg 447	LEVEL I Understanding	Medium

Application use the Standard - apply it to the facts · 8 questions

- Where management withholds a representation, work the three steps in order and only then name the consequence. Note the distinction the examiner is testing: withholding an ordinary representation leads to 'possible effect on the opinion under SA 705'; withholding the representation on management's own responsibilities leads to a disclaimer.
- On a change-of-management fact pattern, state the rule, then say plainly that the absence of the new management during the earlier period does not reduce their responsibility, then conclude that representations must cover the full period.

CSQ 4.1 · MTP 2023-Mar [5] (a) · 3M · Pg 445	LEVEL II Application	Easy
CSQ 4.2 · PYQ 2024-May [3] (b) · 4M · Pg 446	LEVEL II Application	Medium
CSQ 4.3 · RTP 2024-Sep [15] · Pg 447	LEVEL II Application	Medium
CSQ 4.5 · PYQ 2025-May [5] (b) · 5M · Pg 448	LEVEL II Application	Medium
CSQ 4.6 · PYQ 2026-Jan [2] (a) · 5M · Pg 449	LEVEL II Application	Medium
CSQ 4.7 · MTP 2026-Mar S1 [6] (a) · 5M · Pg 450	LEVEL II Application	Medium
CSQ 4.8 · MTP 2026-Apr S2 [6] (a) · 5M · Pg 452	LEVEL II Application	Medium
CSQ 4.9 · PYQ 2026-May [1] (c) {C} · 4M · Pg 454	LEVEL II Application	Medium

Topic 5: Significance of Communication with those Charged with Governance (SA 260)

L2P5-C7-T05

Read first Read ICAI Study Material Chapter 7, Completion and Review — communication with those charged with governance under SA 260, including who they are and what must be communicated.

NOTES

Who are “those charged with governance” — quote the definition: the person(s) or organisation(s) (for example, a corporate trustee) with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity, including overseeing the financial reporting process. For some entities they **may include management personnel**, for example executive members of a governance board or an **owner-manager**.

Governance structures vary, and the answer must say so. In some entities a **supervisory board** exists separate from the executive board; in others **both functions are performed by a single board**. In some, those charged with governance **hold positions that are an integral part of the entity's legal structure**, for example **company directors**. In most entities governance is the **collective responsibility of a governing body** such as a board of directors, a supervisory board, partners, proprietors, a committee of management, trustees or equivalent persons; in some **smaller entities one person** may be charged with governance, for example an owner-manager where there are no other owners, or a **sole trustee**.

Because of that diversity it is not possible to specify for all audits the persons with whom the auditor is to communicate particular matters, and the appropriate persons may **not be clearly identifiable from the legal framework** — for example in **family-owned entities and some not-for-profit organisations**. In such cases the auditor may need to discuss and agree with the engaging party the relevant persons with whom to communicate, and his understanding of the entity's governance structure and processes obtained in accordance with SA 315 is relevant. **The appropriate persons may vary depending on the matter to be communicated.**

The significant findings the auditor shall communicate — five heads, and the marks follow the heads: (1) the auditor's views about significant qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates and financial statement disclosures — and, when applicable, explaining why he considers a significant accounting practice that is acceptable under the applicable financial reporting framework not to be most appropriate to the particular circumstances of the entity; (2) **significant difficulties, if any, encountered during the audit**; (3) unless all of those charged with governance are involved in managing the entity — (a) significant matters arising during the audit that were discussed, or subject to correspondence, with management, and (b) written representations the auditor is requesting; (4) circumstances that affect the form and content of the auditor's report, if any; and (5) any other significant matters arising during the audit that, in the auditor's professional judgement, are relevant to the oversight

of the financial reporting process.

Independence — the extra communication for listed entities. In the case of a **listed** company the auditor must communicate: (1) a written statement that the engagement team, other relevant personnel of the firm, the firm itself and, where applicable, network firms have complied with relevant ethical requirements relating to independence; and (2)(i) all relationships and other matters between the firm, network firms and the entity that, in the auditor's professional judgement, may reasonably be thought to bear on independence, including the total fees charged during the period for audit services and non-audit services provided to the entity and its controlled components, classified into appropriate categories so that governance can evaluate the effect on independence, and (ii) the related safeguards applied to eliminate identified threats to independence or reduce them to an acceptable level.

Two things to keep straight. Head (3) applies only where not all of those charged with governance are involved in managing the entity — that proviso is a mark. And the **independence communication is a listed-entity requirement**; do not import it into an answer about an unlisted company unless the question says so.

Understanding explain it, and place it in context · 2 questions

- Define those charged with governance in the Standard's words first, then explain the variation in governance structures with the examples — supervisory board, single board, owner-manager, sole trustee.

TQ 5.1 · MTP 2025-Aug S2 [3] (b) · 5M · Pg 455

LEVEL I
Understanding

Medium

CSQ 5.2 · PYQ 2026-May [5] (c) · 4M · Pg 457

LEVEL I
Understanding

Medium

Application use the Standard - apply it to the facts · 1 question

- Where the facts give a listed company and an audit committee, answer under the independence head: the written confirmation of compliance, then relationships and fees by category, then safeguards.
- Where the facts mention difficulty in getting information and a questionable but acceptable accounting practice, tie each fact to the head it falls under before listing the rest.

CSQ 5.1 · PYQ 2025-Jan [5] (b) · 5M · Pg 456

LEVEL II
Application

Medium

Topic 6: Why Communication of Significant Deficiencies in Internal Control is Necessary? (SA 265)

L2P5-C7-T06

Read first Read ICAI Study Material Chapter 7, Completion and Review — communicating

deficiencies in internal control to those charged with governance and management under SA 265.

NOTES

The two definitions, and they are asked verbatim. Under SA 265, “Communicating Deficiencies in Internal Control to Those Charged with Governance and Management” — a **deficiency in internal control** exists when (1) a control is designed, implemented or operated in such a manner that it is unable to prevent, or to detect and correct, misstatements in the financial statements on a timely basis; or (2) a control that is necessary to prevent, or to detect and correct, misstatements in the financial statements on a timely basis is absent. A **significant deficiency in internal control** is a deficiency, or a combination of deficiencies, in internal control that, in the auditor's professional judgement, is of sufficient importance to merit the attention of those charged with governance. Add the sentence the examiner rewards: the significance does not depend solely on whether a misstatement has actually occurred; it also depends on the likelihood that a misstatement could occur and on the potential magnitude of the misstatement, so significant deficiencies may exist even where the auditor has identified no misstatements.

The auditor's objective and his three duties. The objective is to communicate appropriately to those charged with governance and management the deficiencies in internal control identified during the audit that, in the auditor's **professional judgement**, are of sufficient importance to merit their attention. The duties: (1) determine whether, on the basis of the audit work performed, one or more deficiencies in internal control have been identified; (2) determine whether, individually or in combination, they constitute significant deficiencies; and (3) communicate significant deficiencies in writing to those charged with governance on a timely basis.

Matters to consider in deciding whether a deficiency is “significant” — eight items: (1) the likelihood of the deficiencies leading to material misstatements in the financial statements in the future; (2) **the susceptibility to loss or fraud of the related asset or liability**; (3) the subjectivity and complexity of determining estimated amounts, such as fair value accounting estimates; (4) **the financial statement amounts exposed to the deficiencies**; (5) the volume of activity that has occurred or could occur in the account balance or class of transactions exposed to the deficiency; (6) **the importance of the controls to the financial reporting process** — general monitoring controls such as oversight of management, controls over the prevention and detection of fraud, controls over the selection and application of significant accounting policies, controls over significant transactions with related parties, controls over significant transactions outside the entity's normal course of business, and controls over the period-end financial reporting process such as controls over non-recurring journal entries; (7) the cause and frequency of the exceptions detected as a result of the deficiencies; and (8) the interaction of the deficiency with other deficiencies in internal control.

Indicators of significant deficiencies — a separate list, do not confuse it with the one above: (1) **evidence of ineffective aspects of the control environment** — indications that significant transactions in which management is financially interested are not being appropriately scrutinised

by TCWG, identification of **management fraud, whether or not material**, that was not prevented by internal control, and management's failure to implement remedial action on significant deficiencies previously communicated; (2) **absence of a risk assessment process** where one would ordinarily be expected; (3) **evidence of an ineffective entity risk assessment process**, such as failure to identify a risk of material misstatement the auditor would expect it to have identified; (4) **evidence of an ineffective response to identified significant risks**, for example absence of controls over such a risk; (5) misstatements detected by the auditor's procedures that were not prevented, or detected and corrected, by internal control; (6) disclosure of a material misstatement due to error or fraud as prior period items in the current year's Statement of Profit and Loss; and (7) evidence of management's inability to oversee the preparation of the financial statements.

The recurring case scenario, and the trap. A one-line communication — “physical verification of inventories is not being conducted at regular intervals”, or “controls over significant transactions with related parties are weak” — is **not proper**. The auditor must communicate the significant deficiency **giving its description**, but also **explain the potential effects** and give sufficient information to enable those charged with governance and management to understand the context of the communication. The answer should spell out the potential effect on the facts — that the deficiency **can lead to misstatement of inventories impacting profits**, or to **misstatement of related party transactions** — highlight the importance of the control and state that **responsibility should be fixed on the concerned person(s) for adhering to it**.

Two points students lose marks on. The communication of significant deficiencies to those charged with governance must be **in writing and on a timely basis** — say both. And a deficiency is not automatically significant: it becomes significant only on the auditor's **professional judgement** that it merits the attention of those charged with governance.

Understanding explain it, and place it in context · 3 questions

- Give the deficiency definition in its two limbs, then the significant deficiency definition, then the sentence that a significant deficiency can exist even where no misstatement was found.

TQ 6.3 · RTP 2025-May [15] · Pg 462	LEVEL I Understanding	Medium
TQ 6.4 · PYQ 2025-Sep [2] (a) · 5M · Pg 462	LEVEL I Understanding	Medium
TQ 6.5 · MTP 2025-Nov S1 [3] (b) · 5M · Pg 463	LEVEL I Understanding	Medium

Application use the Standard - apply it to the facts · 3 questions

- Where the question quotes the auditor's actual one-line communication, say it is not proper, give the rule about description plus potential effects plus sufficient information, and then write out the potential effect on those particular facts. An answer that only states the rule loses the application marks.

TQ 6.1 · PYQ 2020-Nov [3] (b) · 5M · Pg 459	LEVEL II Application	Medium
TQ 6.2 · PYQ 2021-Jan [2] (a) · 5M · Pg 460	LEVEL II Application	Medium
CSQ 6.1 · PYQ 2024-Sep [6] (Or) (a) · 4M · Pg 464	LEVEL II Application	Medium

CHAPTER 8

Audit Report

12 Topics · 74 Classified Questions · Importance: B

ICAI SKILL PROFILE ICAI band for this paper: Level I 40-60% · Level II 40-60% — this chapter reads **theory-heavy**

Level I — Comprehension & Knowledge **60.7%** 182 of 300 marks

Level II — Analysis & Application **39.3%** 118 of 300 marks

Above the paper's Level I ceiling: 61% of this chapter's marks are Comprehension and Knowledge, against ICAI's 40-60% for the paper. Reading carries more of the preparation here than it does elsewhere; do not prepare this chapter by working sums alone.

Topic 1: Forming an Opinion and Reporting on Financial Statements (SA 700)

L2P5-C8-T01

Read first Read ICAI Study Material Chapter 8, Audit Report — forming an opinion and reporting on financial statements under SA 700 (Revised).

NOTES

The six specific evaluations the auditor must make while forming the opinion — learn them as a list, because the question is set as one: whether (a) the financial statements adequately disclose the significant accounting policies selected and applied; (b) the accounting policies selected and applied are consistent with the applicable financial reporting framework and are appropriate; (c) **the accounting estimates made by management are reasonable**; (d) the information presented in the financial statements is relevant, reliable, comparable and understandable; (e) the financial statements provide adequate disclosures to enable the intended users to understand the effect of material transactions and events on the information conveyed; and (f) the terminology used in the financial statements, including the title of each financial statement, is appropriate.

The extra limb for a fair presentation framework. Where the financial statements are prepared in accordance with a **fair presentation framework**, the evaluation shall also include an evaluation of whether the financial statements achieve fair presentation, which shall include consideration of (a) **the overall presentation, structure and content of the financial statements** and (b) whether the financial statements, including the related notes, represent the underlying transactions and events in a manner that achieves fair presentation. The auditor shall also evaluate whether the financial statements **adequately refer to or describe the applicable financial reporting framework**.

Qualitative aspects and management bias. The evaluation of whether the financial statements are prepared in accordance with the framework shall include consideration of the qualitative aspects of the entity's accounting practices, including indicators of possible bias in management's judgments. SA 260 (Revised) contains the discussion of qualitative aspects of accounting practices;

the auditor may conclude that lack of neutrality together with uncorrected misstatements causes the financial statements to be materially misstated. **Indicators of a lack of neutrality:** (a) the selective correction of misstatements brought to management's attention during the audit — for example, correcting misstatements that increase reported earnings but not those that decrease them; and **(b) possible management bias in the making of accounting estimates**, which SA 540 addresses. Note the qualification: indicators of possible management bias do not themselves constitute misstatements for the purpose of concluding on individual estimates, but they may affect the auditor's evaluation of whether the financial statements as a whole are free from material misstatement.

Why SA 700 is drafted the way it is. Its requirements are aimed at an appropriate balance between the need for consistency and comparability in auditor reporting globally and the need to increase the value of auditor reporting by making the information more relevant to users. It promotes consistency but recognises the need for flexibility to accommodate the particular circumstances of individual jurisdictions; consistency promotes credibility in the global marketplace by making more readily identifiable those audits conducted in accordance with globally recognised standards and helps promote the user's understanding and identify unusual circumstances when they occur.

Understanding explain it, and place it in context • 1 question

- When the question adds 'fair presentation framework', do not stop at the six — the extra evaluation and its two limbs are what distinguishes a full answer.

TQ 1.2 • RTP 2021-May [25] • Pg 472

LEVEL I
Understanding

Medium

Application use the Standard - apply it to the facts • 2 questions

- The ask is the **specific evaluations** the auditor makes in forming the opinion. Name them as a numbered list — marks follow the number of evaluations stated.
- Do not drift into the contents of the report. The question stops at forming the opinion.

TQ 1.1 • PYQ 2018-Nov [5] (a) • 5M • Pg 471

LEVEL II
Application

Medium

TQ 1.4 • MTP 2026-Mar S1 [5] (a) • 5M • Pg 474

LEVEL II
Application

Hard

Analysis break it down and take the parts separately • 1 question

- On the bias question, give each indicator with the example attached, then the qualification that an indicator is not itself a misstatement. The qualification is the analysis mark.

TQ 1.3 • MTP 2018-Mar [5] (a) • 5M • Pg 472

LEVEL II

Hard

Topic 2: Form of Opinion

L2P5-C8-T02

Read first Read ICAI Study Material Chapter 8, Audit Report — the form of opinion, and what an unqualified (unmodified) opinion conveys.

NOTES

The rule in one line: an unqualified opinion should be expressed when the auditor concludes that the financial statements give a true and fair view in accordance with the financial reporting framework used for their preparation and presentation. Where the auditor is fully satisfied with the entity's systems and procedures and has no reservation, this is the opinion to give.

What an unqualified opinion says implicitly — this is the part students omit: that any changes in the accounting principles or in the method of their application, and the effects thereof, have been properly determined and disclosed in the financial statements.

What an unqualified opinion also indicates: (a) that the financial statements have been prepared using the generally accepted accounting principles, which have been consistently applied; (b) that the financial statements comply with relevant statutory requirements and regulations; and (c) that there is adequate disclosure of all material matters relevant to the proper presentation of the financial information, subject to statutory requirements where applicable.

Keep the vocabulary straight. An **unqualified** or **unmodified** opinion is the clean opinion. It is not the same as an unmodified opinion carrying an **Emphasis of Matter** paragraph or a **Material Uncertainty Related to Going Concern** section — those leave the opinion unmodified but add a section to the report; and it is the opposite of the three **modified** opinions under SA 705.

Understanding explain it, and place it in context · 1 question

- State the conclusion that triggers the opinion first — 'true and fair view in accordance with the framework' — then the implicit and express indications. An answer that only says 'clean report' earns almost nothing.

TQ 2.1 · MTP 2020-May [2] (d) · 3M · Pg 475

LEVEL I
Understanding

Easy

Topic 3: Auditor's Report

L2P5-C8-T03

Read first Read ICAI Study Material Chapter 8, Audit Report — the contents and structure of the auditor's report: the Opinion section, the Basis for Opinion section, Responsibilities of Management, and the wording of an unmodified opinion.

NOTES

The Opinion section comes first. The first section of the auditor's report shall include the auditor's opinion, and shall have the heading "Opinion". That section shall also **(1) identify the entity whose financial statements have been audited; (2) state that the financial statements have been audited; (3) identify the title of each statement comprising the financial statements; (4) refer to the notes, including the summary of significant accounting policies; and (5) specify the date of, or period covered by, each financial statement.**

Basis for Opinion — placement is a mark in itself. The report shall include a section **directly following the Opinion section**, with the heading "**Basis for Opinion**", that **(1) states that the audit was conducted in accordance with Standards on Auditing; (2) refers to the section of the auditor's report that describes the auditor's responsibilities under the SAs; (3) includes a statement that the auditor is independent of the entity in accordance with the relevant ethical requirements relating to the audit and has fulfilled his other ethical responsibilities in accordance with those requirements; and (4) states whether the auditor believes that the audit evidence obtained is sufficient and appropriate to provide a basis for the opinion.** Its purpose is to explain the foundation on which the opinion has been expressed.

When the opinion is modified, this section changes. In addition to the elements required by SA 700 (Revised), the auditor shall amend the heading "Basis for Opinion" to "Basis for Qualified Opinion", "Basis for Adverse Opinion" or "Basis for Disclaimer of Opinion", as appropriate, and within that section include a description of the matter giving rise to the modification.

Responsibilities of Management for the Financial Statements. The report shall include a section with that heading. **SA 200** explains the **premise** on which an audit under the SAs is conducted: management and, where appropriate, those charged with governance, **accept responsibility for the preparation of the financial statements** and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error. The section shall describe management's responsibility for (1) preparing the financial statements in accordance with the applicable financial reporting framework, and for such internal control as above — noting that because of the possible effects of fraud on other aspects of the audit, materiality does not apply to management's acknowledgement regarding its responsibility for internal control to prevent and detect fraud; and (2) assessing the entity's ability to continue as a going concern and whether the use of the going concern basis of accounting is appropriate, as well as disclosing, if applicable, matters relating to going concern, the explanation including **a description of when the use of the going concern basis is appropriate.** The ICAI illustrative report also describes management's responsibility as including **preventing and detecting frauds and other irregularities; selection and application of appropriate accounting policies; making judgements and estimates that are reasonable and prudent; and design, implementation and maintenance of adequate internal financial controls operating effectively for ensuring the accuracy and completeness of the accounting records relevant to the preparation of financial statements that give a true and fair view and are free from material**

misstatement.

What SA 210 requires the auditor to agree with management — often asked as the second half of the same question: responsibility (1) for the preparation of the financial statements in accordance with the applicable financial reporting framework; **(2) for such internal control as management considers necessary**; and (3) to provide the auditor with — access to all information such as records, documentation and other matters; additional information that the auditor may request for the purpose of the audit; and unrestricted access to persons within the entity from whom the auditor determines it necessary to obtain audit evidence.

The wording of an unmodified opinion — and the wording that is forbidden. Unless otherwise required by law or regulation, the opinion shall use one of two phrases, which are **regarded as being equivalent**: “In our opinion, the accompanying financial statements present fairly, in all material respects, ... in accordance with [the applicable financial reporting framework]” or “In our opinion, the accompanying financial statements give a true and fair view of ... in accordance with [the applicable financial reporting framework]”. **Inappropriate phrases**: when an unmodified opinion is expressed it is not appropriate to use phrases such as “with the foregoing explanation” or “subject to”, because they **suggest a conditional opinion or a weakening or modification of the opinion**.

UDIN. The **18-digit alphanumeric, system-generated number** below the auditor's signature and membership number is the **Unique Document Identification Number**. ICAI introduced it because financial documents and certificates attested by third persons misrepresenting themselves as CA members were misleading authorities and stakeholders, and ICAI received complaints of **CAs' signatures being forged by non-CAs**. A Chartered Accountant **holding a full-time Certificate of Practice** registers on the UDIN portal and generates the number; the auditor must mention the UDIN **along with his membership number** while signing, and it is required **for audit reports and certificates** — not for audit reports alone.

Remembering reproduce what you have learnt · 1 question

- Learn the five points of the Opinion section and the four points of the Basis for Opinion section as separate lists. Questions ask for one or the other, not both.

CSQ 3.2 · PYQ 2026-May [3] (b) · 5M · Pg 481

LEVEL I
Remembering

Medium

Understanding explain it, and place it in context · 4 questions

- On 'Basis for Opinion', answer the placement question explicitly — 'a separate section directly following the Opinion section' — before listing the contents. Placement is a stated part of the question and carries its own mark.

TQ 3.1 · RTP 2020-May [25] · Pg 476

LEVEL I
Understanding

Medium

TQ 3.2 · PYQ 2021-Jan [5] (b) · 4M · Pg 476	LEVEL I Understanding	Medium
TQ 3.3 · RTP 2023-May [24] · Pg 477	LEVEL I Understanding	Medium
TQ 3.4 · PYQ 2023-Nov [5] (b) · 4M · Pg 479	LEVEL I Understanding	Medium

Application use the Standard - apply it to the facts · 2 questions

- Where the question is about a modified opinion, state the amended heading by name and say that the matter giving rise to the modification is described within that section.

TQ 3.5 · PYQ 2024-Sep [4] (c) · 3M · Pg 480	LEVEL II Application	Easy
CSQ 3.1 · RTP 2025-Jan [17] · Pg 481	LEVEL II Application	Medium

Topic 4: Auditor's Report Prescribed by Law or Regulation

L2P5-C8-T04

Read first Read ICAI Study Material Chapter 8, Audit Report — the auditor's report prescribed by law or regulation, that is the other matters to be reported under Section 143(3)(j) read with Rule 11 of the Companies (Audit and Auditors) Rules, 2014.

NOTES

The rule in one line: where the auditor's report is prescribed by law or regulation, the content is set by that law, and for a company that means Section 143(3)(j) of the Companies Act, 2013 read with Rule 11 of the Companies (Audit and Auditors) Rules, 2014. The answer is a **list question — marks come from coverage, not depth** — so work through Rule 11 in its own order.

Take the first three together: whether the company has disclosed the impact, if any, of pending litigations on its financial position in its financial statements; whether the company has made provision, as required under any law or accounting standards, for material foreseeable losses, if any, on long-term contracts including derivative contracts; and whether there has been any delay in transferring amounts required to be transferred to the Investor Education and Protection Fund.

Then the funds representations — three limbs, and they must all be stated: the management representation that no funds have been advanced or loaned or invested by the company to or in any person or entity, including foreign entities ("Intermediaries"), with the understanding that the Intermediary shall lend or invest in other persons or entities identified by or on behalf of the company ("Ultimate Beneficiaries") or provide any guarantee, security or the like on their behalf; the management representation that no funds have been received by the company from any person or entity, including foreign entities ("Funding Parties"), with the understanding that the company shall lend or invest in persons or entities identified by or on behalf of the Funding Party

("Ultimate Beneficiaries") or provide any guarantee, security or the like on their behalf; and the auditor's own statement that, based on audit procedures considered reasonable and appropriate in the circumstances, nothing has come to his notice causing him to believe that the representations contain any material misstatement.

Then dividend: whether the dividend declared or paid during the year by the company is in compliance with Section 123 of the Companies Act, 2013.

Do not omit the audit trail clause. Whether the company has used accounting software for maintaining its books of account having a feature of recording audit trail (edit log) facility; whether it has been operated throughout the year for all transactions recorded in the software; **whether the audit trail feature has not been tampered with**; and whether the audit trail has been preserved by the company as per statutory requirements for record retention. It is **the most recently added limb and the one most often missed** — an answer without it is incomplete.

Understanding explain it, and place it in context · 1 question

- Where the facts turn on management's representation about funds advanced or received, answer the **Rule 11 reporting requirement** directly and say what the auditor must state in the report.
- Say what the auditor does before relying on the representation — it is a representation, not evidence, and the audit procedures still have to be performed.

CSQ 4.1 · PYQ 2026-Sep [3] (a) · 5M · Pg 482

LEVEL I
Understanding

Medium

Topic 5: Modifications to The Opinion in the Independent Auditor's Report (SA 705)

L2P5-C8-T05

Read first Read ICAI Study Material Chapter 8, Audit Report — modifications to the opinion in the independent auditor's report under SA 705 (Revised): the three types of modified opinion and the effect on the form and content of the report.

NOTES

When a modification is required, and the objective. SA 705, "Modifications to the Opinion in the Independent Auditor's Report", deals with the auditor's responsibility to issue an appropriate report where, in forming an opinion under SA 700 (Revised), he concludes that a modification is necessary, and with **how the form and content of the report is affected**. The auditor shall modify the opinion where (1) he concludes, based on the audit evidence obtained, that the financial statements as a whole are not free from material misstatement; or (2) he is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement. The **objective is to express clearly an appropriately modified**

opinion in those circumstances.

The two variables that decide which modification applies — this is the whole of the topic: **(a) the nature of the matter giving rise to the modification**, that is whether the financial statements **are materially misstated** or, in the case of an inability to obtain sufficient appropriate audit evidence, **may be materially misstated**; and **(b) the auditor's judgement about the pervasiveness of the effects or possible effects on the financial statements**. Run them as a grid: financial statements materially misstated — material but not pervasive → Qualified opinion; material and pervasive → Adverse opinion. Inability to obtain sufficient appropriate audit evidence — material but not pervasive → Qualified opinion; material and pervasive → Disclaimer of opinion. There are **three types of modified opinion: qualified, adverse and disclaimer**.

Say each one in the Standard's own words. Qualified opinion: the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are material but not pervasive; **or** he is unable to obtain sufficient appropriate audit evidence on which to base the opinion, but concludes that the possible effects of undetected misstatements, if any, could be material but not pervasive. **Adverse opinion:** he has obtained sufficient appropriate audit evidence and concludes that misstatements, individually or in the aggregate, are both material and pervasive. **Disclaimer of opinion:** he is unable to obtain sufficient appropriate audit evidence and concludes that the possible effects of undetected misstatements, if any, could be both material and pervasive; and also **in extremely rare circumstances involving multiple uncertainties**, where, notwithstanding having obtained sufficient appropriate audit evidence regarding each of the individual uncertainties, it is not possible to form an opinion because of the potential interaction of the uncertainties and their possible cumulative effect. When the opinion is modified, the heading of the Opinion section becomes “Qualified Opinion”, “Adverse Opinion” or “Disclaimer of Opinion” as appropriate.

Management-imposed scope limitation — follow the steps in order, they are the marks. If, **after accepting the engagement**, the auditor becomes aware that management has imposed a limitation on the scope that is likely to result in a qualified opinion or a disclaimer, he shall **request that management remove the limitation**. If management **refuses**, he shall communicate the matter to those charged with governance, unless all of them are involved in managing the entity, and **determine whether it is possible to perform alternative procedures** to obtain sufficient appropriate evidence. If he is still unable to obtain the evidence: **(1) material but not pervasive → qualify the opinion**; **(2) material and pervasive**, so that a qualification would be inadequate to communicate the gravity of the situation → (a) withdraw from the audit, where practicable and possible under applicable law or regulation, or (b) if withdrawal before issuing the report is not practicable or possible, disclaim an opinion. If he withdraws, before withdrawing he shall communicate to those charged with governance any matters regarding misstatements identified during the audit that would have given rise to a modification of the opinion.

What changes in the report when you disclaim. The heading of the basis section becomes “**Basis for Disclaimer of Opinion**” and **the matter giving rise to the modification is described within it**. The report shall **not** include the following elements otherwise required by SA 700 (Revised): a

reference to the section of the auditor's report that describes the auditor's responsibilities, and the statement about whether the audit evidence obtained is sufficient and appropriate to provide a basis for the opinion. The description of the auditor's responsibilities is **amended to include only**: (1) a statement that the auditor's responsibility is to conduct an audit of the entity's financial statements in accordance with Standards on Auditing and to issue an auditor's report; (2) a statement that, because of the matters described in the Basis for Disclaimer of Opinion section, the auditor was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion; and (3) the statement about auditor independence and other ethical responsibilities required by SA 700. And, unless required by law or regulation, when the auditor disclaims an opinion the report shall not include a Key Audit Matters section in accordance with SA 701.

Applying it to facts — the pattern the Scanner repeats. Where the auditor cannot attend the inventory count, cannot get addresses for external confirmations, cannot verify revenue and cannot get bills for expenses, the inability **affects many aspects of the financial statements**, so the possible effects are **both material and pervasive** and a qualification **would be inadequate to communicate the gravity of the situation** — withdraw where practicable, otherwise **disclaim**. Where books are moved to a new ERP, correct data cannot be extracted and is not available manually either, and the effects could be material and pervasive — **disclaim**. Where consolidated financial statements have not been prepared at all although **Section 129(3)** requires them, the statements **are** materially misstated and the misstatement is **pervasive** — **adverse opinion**, and the opinion paragraph says the financial statements **do not give a true and fair view**. Where a **material uncertainty related to going concern is not adequately disclosed**, express a **qualified or adverse opinion as appropriate** and say in the Basis section that a material uncertainty exists ... and that the financial statements do not adequately disclose this matter.

The distinction that decides the marks. **Misstatement** questions can only produce **qualified or adverse**; **inability to obtain evidence** questions can only produce **qualified or disclaimer**. The classic wrong answer is a disclaimer where the auditor has the evidence and knows the statements are wrong — that is an adverse opinion — or an adverse opinion where he simply could not get the evidence — that is a disclaimer. Name the nature of the matter and the pervasiveness expressly before you name the opinion.

Understanding explain it, and place it in context • 4 questions

- Define pervasive effects in contrast to material ones by using the Standard's own phrase: that a qualification 'would be inadequate to communicate the gravity of the situation'.

TQ 5.3 • RTP 2025-Sep [17] • Pg 487

LEVEL I
Understanding

Medium

TQ 5.4 • MTP 2025-Dec S2 [4] (c) • 4M • Pg 488

LEVEL I
Understanding

Medium

TQ 5.5 • MTP 2026-Apr S2 [5] (a) • DESC • 5M • Pg 488

LEVEL I
Understanding

Medium

CSQ 5.3 · RTP 2021-Nov [25] · Pg 492

LEVEL I
Understanding**Medium****Application** use the Standard - apply it to the facts · 6 questions

- Answer in three moves: is this a misstatement or an inability to obtain evidence; is the effect material but not pervasive, or material and pervasive; therefore which opinion. An answer that states the opinion without those two findings loses the application marks.
- On a management-imposed limitation, work through request removal → communicate to TCWG → alternative procedures → qualify or withdraw/disclaim. The steps before the opinion carry as many marks as the opinion itself.

TQ 5.2 · PYQ 2023-May [5] (c) · 3M · Pg 486

LEVEL II
Application**Easy**

CSQ 5.2 · PYQ 2021-Jul [5] (d) · 3M · Pg 490

LEVEL II
Application**Easy**

TQ 5.1 · MTP 2022-Mar [5] (c) · 4M · Pg 484

LEVEL II
Application**Medium**

CSQ 5.1 · PYQ 2019-May [2] (b) · 4M · Pg 489

LEVEL II
Application**Medium**

CSQ 5.4 · MTP 2024-Mar [3] (b) · 4M · Pg 493

LEVEL II
Application**Medium**

CSQ 5.5 · PYQ 2025-Jan [3] (c) · 4M · Pg 494

LEVEL II
Application**Medium**

Topic 6: Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report (SA 706)

L2P5-C8-T06

Read first Read ICAI Study Material Chapter 8, Audit Report — Emphasis of Matter paragraphs and Other Matter paragraphs in the independent auditor's report under SA 706 (Revised).

NOTES

Definition, and it is asked verbatim: an **Emphasis of Matter paragraph** is a paragraph included in the auditor's report that refers to a matter appropriately presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements. Note the two words that do all the work — the matter is **already presented or disclosed** in the financial statements, and it is **fundamental** to users' understanding.

When it may be included — the two conditions, both of which must hold: (1) the auditor would not be required to modify the opinion in accordance with SA 705 (Revised) as a result of the matter; and (2) when SA 701 applies, the matter has not been determined to be a key audit matter

to be communicated in the auditor's report. An Emphasis of Matter is therefore never a substitute for a modification and never a substitute for a key audit matter.

How it is included — three steps, and each is a mark: (1) include the paragraph within a separate section of the auditor's report with an appropriate heading that includes the term "Emphasis of Matter"; (2) include in the paragraph a clear reference to the matter being emphasised and to where the relevant disclosures that fully describe it can be found in the financial statements — the paragraph shall refer only to information presented or disclosed in the financial statements; and (3) indicate that the auditor's opinion is not modified in respect of the matter emphasised. A model drafting from the answers: "Emphasis of Matter — [heading]. We draw attention to Note (Y) of the financial statements, which describes ... Our opinion is not modified in respect of this matter."

Examples of circumstances where an Emphasis of Matter paragraph may be necessary: (1) an uncertainty relating to the future outcome of exceptional litigation or regulatory action; (2) a significant subsequent event that occurs between the date of the financial statements and the date of the auditor's report; (3) early application, where permitted, of a new accounting standard that has a material effect on the financial statements; and (4) a major catastrophe that has had, or continues to have, a significant effect on the entity's financial position. So a properly disclosed post-year-end fire, or a pending appeal against a regulator's demand that the company has disclosed, is an Emphasis of Matter case — the disclosure is complete and no adjustment is needed, but users should be alerted.

Other Matter paragraph — the contrast that decides which paragraph you use. An Other Matter paragraph is an additional paragraph in the auditor's report that draws attention to a matter not presented or disclosed in the financial statements, but which is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report. So: the matter is in the financial statements → Emphasis of Matter; the matter is not in the financial statements but concerns the audit or the report → Other Matter. That is why SA 710 puts the statements about a **predecessor auditor** and about **unaudited corresponding figures** into an Other Matter paragraph — they say something about the audit, not about the accounts.

The trap. An Emphasis of Matter paragraph **does not modify the opinion**, and you must say so in the paragraph itself. If the matter is not properly disclosed, or the auditor disagrees with the accounting, the answer is **SA 705**, not SA 706. The classic wrong answer is an Emphasis of Matter used to patch over a matter that in truth requires a qualification.

Understanding explain it, and place it in context · 2 questions

- Give the definition, then the two conditions, then the three steps. The condition that the matter would not require a modification under SA 705 is the one most often left out.

CSQ 6.3 · PYQ 2026-Jan [3] (a) · 5M · Pg 499

LEVEL I
Understanding

Medium

Application use the Standard - apply it to the facts · 2 questions

- On a fact pattern, first say that the matter is properly disclosed and needs no adjustment, which is why no modification arises; then name the paragraph; then give the three steps; then draft the paragraph itself. A drafted paragraph earns marks a description does not.

CSQ 6.1 · PYQ 2022-May [6] (a) · 4M · Pg 496

LEVEL II
Application

Medium

CSQ 6.2 · PYQ 2025-Jan [4] (c) · 4M · Pg 497

LEVEL II
Application

Medium

Topic 7: Communicating Key Audit Matters in the Independent Auditor's Report (SA 701)

L2P5-C8-T07

Read first Read ICAI Study Material Chapter 8, Audit Report — communicating key audit matters in the independent auditor's report under SA 701.

NOTES

Definition: Key Audit Matters are those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period. They are **selected from matters communicated with those charged with governance** — that source is part of the definition and is a mark.

How they are determined — a two-stage filter. From the matters communicated with those charged with governance, the auditor determines those matters that required significant auditor attention in performing the audit, taking into account (1) areas of higher assessed risk of material misstatement, or significant risks identified in accordance with SA 315; (2) significant auditor judgements relating to areas in the financial statements that involved significant management judgement, including accounting estimates that have been identified as having high estimation uncertainty; and (3) the effect on the audit of significant events or transactions that occurred during the period. Out of those matters, the ones of most significance in the audit of the current period are the key audit matters.

Purpose. The objective is to enhance the communicative value of the auditor's report by providing greater transparency about the audit that was performed. Communicating key audit matters provides additional information to intended users to assist them in understanding those matters that, in the auditor's professional judgement, were of most significance in the audit of the current period, and may also assist users in understanding the entity and the areas of significant management judgement in the audited financial statements.

What communicating key audit matters is NOT — four limbs, and this is the most-set part of the topic. It is not (a) a substitute for disclosures in the financial statements that the applicable financial reporting framework requires management to make, or that are otherwise necessary to achieve fair presentation; (b) a substitute for the auditor expressing a modified opinion when required by the circumstances of a specific audit engagement in accordance with SA 705 (Revised); (c) a substitute for reporting in accordance with SA 570 when a material uncertainty exists relating to events or conditions that may cast significant doubt on an entity's ability to continue as a going concern; or (d) **a separate opinion on individual matters**.

The context sentence, and the link with a disclaimer. Key audit matters are communicated in the context of the auditor having formed an opinion on the financial statements as a whole — they never stand apart from the opinion. And unless required by law or regulation, when the auditor disclaims an opinion on the financial statements, the auditor's report shall not include a Key Audit Matters section.

Keep the three apart. A **key audit matter** is a matter of most significance in the audit, drawn from what was communicated to TCWG; an **Emphasis of Matter** draws attention to something already disclosed in the financial statements and is used only where the matter is not a key audit matter; a **modification under SA 705** is the response where the statements are wrong or the evidence is missing. The classic wrong answer is to describe a key audit matter as a qualification or as a separate opinion — it is neither.

Application use the Standard - apply it to the facts • 4 questions

- The ask is **how key audit matters are determined**, so give the selection process: matters communicated to those charged with governance, then those of most significance in the audit.
- Name the three factors the Standard directs attention to, and say that a matter giving rise to a modified opinion is never reported as a key audit matter.

TQ 7.2 • PYQ 2020-Nov [5] (c) • 3M • Pg 500	LEVEL II Application	Easy
TQ 7.3 • PYQ 2023-Nov [5] (d) • 3M • Pg 501	LEVEL II Application	Easy
TQ 7.4 • PYQ 2025-May [3] (b) • 5M • Pg 502	LEVEL II Application	Medium
CSQ 7.1 • PYQ 2025-Sep [2] (b) • 5M • Pg 502	LEVEL II Application	Hard

Analysis break it down and take the parts separately • 1 question

- Where the question says the student is confused between a modification and a key audit matter, answer by contrast: state the purpose of key audit matters, then say expressly that they do not replace a modified opinion, a going concern report under SA 570, or a required disclosure.

Topic 8: Standard on Auditing 710, Comparative Information- “Corresponding Figures and Comparative Financial Statements”

L2P5-C8-T08

Read first Read ICAI Study Material Chapter 8, Audit Report — SA 710, Comparative Information: corresponding figures and comparative financial statements.

NOTES

Definition and the two approaches. Comparative information means the amounts and disclosures included in the financial statements in respect of one or more prior periods in accordance with the applicable financial reporting framework. The nature of the comparative information depends on the requirements of the framework, and there are two broad approaches to the auditor's reporting responsibilities: corresponding figures and comparative financial statements. The approach to be adopted is often specified by law or regulation but may also be specified in the terms of engagement.

The essential reporting difference — one line each, and it is the answer to a three-mark question: (a) for corresponding figures, the auditor's opinion on the financial statements refers to the current period only; (b) for comparative financial statements, the auditor's opinion refers to each period for which financial statements are presented.

Audit procedures on comparative information. The auditor shall determine whether the financial statements include the comparative information required by the applicable financial reporting framework and whether it is appropriately classified, and for that purpose shall evaluate whether (a) the comparative information agrees with the amounts and other disclosures presented in the prior period; and (b) the accounting policies reflected in the comparative information are consistent with those applied in the current period or, if there have been changes, whether those changes have been properly accounted for and adequately presented and disclosed.

Corresponding figures — the opinion shall not refer to them, except in three circumstances. **(1) Prior period report was modified and the matter is unresolved:** where the auditor's report on the prior period, as previously issued, included a qualified opinion, a disclaimer of opinion or an adverse opinion and the matter giving rise to the modification is unresolved, the auditor **shall modify his opinion on the current period's financial statements**, and in the **Basis for Modification** paragraph shall either (a) refer to both the current period's figures and the corresponding figures in the description of the matter, where the effects or possible effects on the current period's figures are material, or (b) in other cases, explain that the audit opinion has been modified because of the effects or possible effects of the unresolved matter on the comparability of the current period's figures and the corresponding figures. **(2) Material misstatement in prior period financial statements on which an unmodified opinion was issued:** the auditor shall verify whether

the misstatement has been dealt with as required under the applicable financial reporting framework and, if not, express a qualified opinion or an adverse opinion on the current period's financial statements. **(3) Prior period financial statements not audited:** the auditor shall **state in an Other Matter paragraph that the corresponding figures are unaudited** — and that statement does not relieve him of the requirement to obtain sufficient appropriate audit evidence that the opening balances do not contain misstatements that materially affect the current period's financial statements.

Prior period audited by a predecessor auditor. Where the auditor is permitted by law or regulation to refer to the predecessor's report and decides to do so, he shall, in addition to expressing an opinion on the current period's financial statements, state in an Other Matter paragraph: (1) that the financial statements of the prior period were audited by a predecessor auditor; (2) the type of opinion expressed by the predecessor auditor and, if the opinion was modified, the reasons therefor; and **(3) the date of that report**, unless the predecessor's report on the prior period's financial statements is revised with the financial statements. **Meaning of an Other Matter paragraph, in case the question asks:** an additional paragraph in the auditor's report that draws attention to a matter not presented or disclosed in the financial statements but which the auditor believes is important for users to understand the audit, the auditor's responsibilities or the auditor's report.

Where the two approaches meet in one question. An unresolved prior period **adverse opinion** makes the auditor modify the **current** period's opinion and explain it in the Basis for Modification paragraph; and where **comparative financial statements** are presented, the opinion must refer to each period for which financial statements are presented and on which an audit opinion is expressed. Both points are wanted — the modification and the multi-period opinion — plus the predecessor auditor's Other Matter paragraph if the prior period was audited by someone else.

Remembering reproduce what you have learnt • 2 questions

- The three exceptional circumstances are a numbered list. Name all three before expanding any; the third — prior period unaudited — is the one usually forgotten.

TQ 8.2 • PYQ 2023-Nov [4] (d) • 3M • Pg 505

LEVEL I
Remembering

Easy

CSQ 8.3 • PYQ 2026-May [6] (b) • 5M • Pg 508

LEVEL I
Remembering

Medium

Application use the Standard - apply it to the facts • 3 questions

- When the prior period was audited by a predecessor, give the three contents of the Other Matter paragraph. When the prior period opinion was modified and the matter is unresolved, give the Basis for Modification treatment and its two alternatives. Read which of the two the facts actually raise — several questions raise both.

TQ 8.1 · PYQ 2019-Nov [5] (a) · 4M · Pg 504	LEVEL II Application	Medium
CSQ 8.1 · PYQ 2022-Nov [5] (a) · 4M · Pg 506	LEVEL II Application	Medium
CSQ 8.2 · PYQ 2025-Jan [6] (b) · 5M · Pg 507	LEVEL II Application	Medium

Topic 9: Audit of Branch Office Accounts

L2P5-C8-T09

Read first Read ICAI Study Material Chapter 8, Audit Report — audit of branch office accounts under the Companies Act, 2013 and the use of the work of another auditor under SA 600.

NOTES

Who audits a branch — Section 143(8). The accounts of a branch office shall be audited either by **the auditor of the company**; or by any other person qualified for appointment as an auditor of the company and appointed under Section 139; or, where the branch is situated outside India, by a person qualified to act as an auditor of the accounts of the branch in accordance with the laws of that country.

The company auditor's right of access — Section 143(1), and this is the fact pattern the examiner sets. The auditor of a company shall, at all times, have a right of access to the books of account and vouchers of the company, whether kept at the registered office or at any other place, and is entitled to require from the officers of the company such information and explanation as he may consider necessary for the performance of his duties. That right is **not limited to the books and records at the registered office or head office**; in a company with branches it **extends to branch records if the auditor considers it necessary**, read with Section 143(8). The appointment of a separate branch auditor does not take away the company auditor's right of access to the books and records of the branch. So where management refuses to let the company auditor visit a branch on the ground that a branch auditor has been appointed, **management is not entitled to refuse that access**.

SA 600 — the need for coordination. Where the branch is audited by a person other than the company's auditor (the **principal auditor**), there must be **a clear understanding of the role of each of them** in relation to the audit of the branch and of the company as a whole, and **a proper rapport between the two auditors for an effective audit**. The Standard requires that the principal auditor should advise the other auditor of the use that is to be made of the other auditor's work and report, and make sufficient arrangements for coordination of their efforts at the planning stage; that he should inform the other auditor of matters requiring special consideration, procedures for the identification of inter-component transactions that may require disclosure, and the time-table for completion of the audit; and that he should advise the other auditor of the significant accounting, auditing and reporting requirements and obtain representation as to

compliance with them.

The procedures the principal auditor performs. He should perform procedures to obtain sufficient appropriate audit evidence that the work of the other auditor is adequate for the principal auditor's purposes in the context of the specific assignment. He might **discuss with the other auditor the audit procedures applied**, or review a written summary of the other auditor's procedures and findings, which may be in the form of a completed questionnaire or checklist. He **may also wish to visit the other auditor**. The nature, timing and extent of these procedures depend on the circumstances of the engagement and the principal auditor's knowledge of the professional competence of the other auditor, which may have been enhanced by review of the other auditor's previous audit work.

Visiting the component — the qualification that earns the last mark. In certain situations the statute governing the entity may confer a right on the principal auditor to visit a component and examine its books of account and other records if he thinks it necessary. Where another auditor has been appointed for the component, the principal auditor would normally be entitled to rely upon the work of that auditor, unless there are special circumstances making it essential for him to visit the component and examine its books of account and other records.

Remembering reproduce what you have learnt • 1 question

- Section 143(8) is a three-limb list — company auditor, another qualified person appointed under Section 139, and a person qualified under foreign law for a foreign branch. Give all three.

CSQ 9.2 • PYQ 2024-May [4] (b) • 4M • Pg 513

LEVEL I
Remembering

Medium

Understanding explain it, and place it in context • 2 questions

- Say expressly that the appointment of a branch auditor does not displace the company auditor's right of access. That sentence is the pivot of every branch-visit answer.

CSQ 9.1 • PYQ 2020-Nov [5] (d) • 3M • Pg 511

LEVEL I
Understanding

Easy

TQ 9.1 • RTP 2026-May [17] • Pg 509

LEVEL I
Understanding

Hard

Topic 10: Joint Audit

L2P5-C8-T10

Read first Read ICAI Study Material Chapter 8, Audit Report — joint audit under SA 299, including the joint audit plan, division of work and the responsibilities of joint auditors.

NOTES

What joint audit is, and the advantages. Joint audit implies pooling together the resources and expertise of more than one firm of auditors to render an expert job in a given time period which may be difficult to accomplish acting individually; it essentially involves sharing of the total work, and this by itself is a great advantage. The specific advantages are: **sharing of expertise; advantage of mutual consultation; lower workload; better quality of performance; improved service to the client;** in the case of multi-national companies, the work can be spread using the expertise of local firms which are better placed to deal with detailed work and with local laws and regulations; **lower staff development costs; lower costs to carry out the work; and a sense of healthy competition towards better performance.**

The joint audit plan — before the audit begins, the joint auditors should discuss and develop one, and in doing so should: **(1) identify division of audit areas and common audit areas; (2) ascertain the reporting objectives of the engagement;** (3) consider and communicate among all joint auditors the factors that are significant in directing the engagement team's efforts; (4) consider the results of preliminary engagement activities, or similar engagements performed earlier; and (5) ascertain the nature, timing and extent of resources necessary to accomplish the engagement.

Individual responsibility. In respect of audit work divided among the joint auditors, each joint auditor shall be responsible only for the work allocated to such joint auditor, including proper execution of the audit procedures. That is the general rule; everything in the next bullet is the exception to it, and the exception is what is examined.

Jointly and severally responsible for — six items, and the marks follow the count: (1) the audit work which is not divided among the joint auditors and is carried out by all of them; (2) decisions taken by all the joint auditors under audit planning in respect of common audit areas; (3) matters which are brought to the notice of the joint auditors by any one of them and on which there is an agreement among the joint auditors; (4) examining that the financial statements of the entity comply with the requirements of the relevant statutes; (5) presentation and disclosure of the financial statements as required by the applicable financial reporting framework; and (6) ensuring that the audit report complies with the requirements of the relevant statutes, the applicable Standards on Auditing and other relevant pronouncements issued by ICAI.

Communication between joint auditors, and the report. Where a joint auditor comes across matters relevant to the areas of responsibility of other joint auditors and which deserve their attention, or which require disclosure or require discussion with, or application of judgement by, other joint auditors, he shall communicate the same to all the other joint auditors in writing prior to the completion of the audit. **The joint auditors are required to issue a common audit report;** however, where they are in disagreement with regard to the opinion or any matters to be covered by the audit report, they shall express their opinion in a separate audit report, and the audit report(s) so issued shall make a reference to each other's audit report(s).

Remembering reproduce what you have learnt · 1 question

- When asked for 'any five advantages', give five from the list and stop. When asked for the areas of joint and several responsibility, give all six.

TQ 10.1 · PYQ 2015-Nov [4] (a) · 6M · Pg 514

LEVEL I
Remembering

Hard

Understanding explain it, and place it in context · 2 questions

- Open with the rule that each joint auditor is responsible only for the work allocated to him, then set out the joint and several list as the exception. That structure is what the marks are laid out against.

TQ 10.2 · PYQ 2019-Nov [4] (b) · 4M · Pg 515

LEVEL I
Understanding

Medium

TQ 10.3 · PYQ 2025-May [5] (a) · 5M · Pg 516

LEVEL I
Understanding

Medium

Topic 11: Reporting Requirement Under the Companies Act, 2013

L2P5-C8-T11

Read first Read ICAI Study Material Chapter 8, Audit Report — reporting requirements under the Companies Act, 2013: the auditor's report under Section 143(2), the inquiries under Section 143(1), and the other matters under Section 143(3)(j) read with Rule 11.

NOTES

Section 143(2) — to whom and on what. The auditor shall make a report to the members of the company on the accounts examined by him and on every financial statement which is required by or under this Act to be laid before the company in general meeting, and the report shall, after taking into account the provisions of this Act, the accounting and auditing standards and matters required to be included in the audit report under this Act or any rules made thereunder or under any order made under this section, state whether to the best of his information and knowledge the said accounts and financial statements give a true and fair view of the state of the company's affairs as at the end of its financial year and profit or loss and cash flow for the year, and such other matters as may be prescribed.

Section 143(1) — the six matters of inquiry, and the crucial qualification. The auditor shall inquire: (a) whether loans and advances made by the company on the basis of security have been properly secured and whether the terms on which they have been made are prejudicial to the interests of the company or its members; (b) whether transactions of the company which are represented merely by book entries are prejudicial to the interests of the company; (c) where the company is not an investment company or a banking company, whether so much of the assets of the company as consist of shares, debentures and other securities have been sold at a price less than that at which they were purchased; **(d) whether loans and advances made by the company**

have been shown as deposits; (e) whether personal expenses have been charged to revenue account; and (f) where it is stated in the books and documents that shares have been allotted for cash, whether cash has actually been received, and if not, whether the position as stated in the account books and the balance sheet is correct, regular and not misleading. **The qualification:** since the law requires only an inquiry, the auditor is not required to report on these matters unless he has some special comment to make on any of them; if he is satisfied as a result of his inquiries, he has no further duty to report that he is so satisfied, and he is **required to make only inquiries, not to investigate.**

Applying Section 143(1) to facts. On **unsecured loans and advances** under clause (a), the auditor **may enter an adverse comment** but cannot doubt the true and fair view by reference to that fact alone so long as the loans are properly described and presented in terms of **Part I of Schedule III**; but if the terms are prejudicial to the interests of the company or its members, he should qualify his report. On **trade receivables and payables adjusted inter se**, this amounts to **merely book entries** under clause (b), to be inquired into by reference to the effects of the book entries, unsupported by transactions, on the legitimate interests of the company, the auditor exercising **his judgement based on certain objective standards**. On **personal expenses** under clause (e), charging them to revenue on the basis of the company's contractual obligations or in accordance with accepted business practice is perfectly normal and legitimate and calls for no special comment; but where personal expenses **not covered by contractual obligations or accepted business practice** are charged to revenue and **the amounts are material, he should qualify his report.**

Section 143(3)(j) with Rule 11 — the other matters on which the auditor's views and comments are required: (1) whether the company has disclosed the impact, if any, of pending litigations on its financial position in its financial statements; (2) whether the company has made provision, as required under any law or accounting standards, for material foreseeable losses, if any, on long-term contracts including derivative contracts; (3) whether there has been any delay in transferring amounts required to be transferred to the Investor Education and Protection Fund; (4) the management representations on funds — that no funds have been advanced, loaned or invested by the company to or in any person or entity, including foreign entities ("Intermediaries"), with the understanding that the Intermediary shall lend or invest in other persons or entities identified by or on behalf of the company ("Ultimate Beneficiaries") or provide any guarantee, security or the like on their behalf; that no funds have been received by the company from any person or entity, including foreign entities ("Funding Parties"), with a corresponding understanding; and that, based on audit procedures considered reasonable and appropriate in the circumstances, nothing has come to the auditor's notice causing him to believe that these representations contain any material misstatement; (5) whether the dividend declared or paid during the year is in compliance with Section 123 of the Companies Act, 2013; and (6) Rule 11(g) — whether the company, in respect of financial years commencing on or after 1st April 2023, has used accounting software for maintaining its books of account having a feature of recording audit trail (edit log) facility, whether the same has been operated throughout the year for all transactions recorded in the software, whether the audit trail feature has not been tampered with, and whether the audit trail has been

preserved by the company as per statutory requirements for record retention.

Non-provision for an anticipated liability. Under **AS 29** a provision is recognised when (a) the enterprise has a present obligation as a result of a past event, (b) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and (c) a reliable estimate can be made of the amount; if these conditions are not met, no provision is recognised. Where the legal team anticipates that a tax demand will mature and no provision has been made, the auditor should discuss the matter with management, and if management does not agree, modify the report in accordance with SA 705. The ICAI Council has also expressed the view that non-provision for tax where a liability is anticipated would amount to contravention of Sections 128 and 129 of the Companies Act, 2013, so the auditor should qualify his report, bringing out the manner in which the accounts do not disclose a true and fair view.

CSR disclosure under Schedule III — where a company has spent on CSR under Section 135, the financial statements must disclose (a) the amount required to be spent by the company during the year; (b) the amount of expenditure incurred; (c) the shortfall at the end of the year; (d) the total of previous years' shortfall; (e) the reason for shortfall; (f) the nature of CSR activities; (g) details of related party transactions, for example contribution to a trust controlled by the company in relation to CSR expenditure, as per the relevant Accounting Standard; and (h) where a provision is made with respect to a liability incurred by entering into a contractual obligation, the movements in the provision during the year, shown separately.

Understanding explain it, and place it in context • 3 questions

- On Section 143(1), always add the sentence that the auditor need not report unless he has a special comment, and that he inquires rather than investigates. It is a mark on its own.

TQ 11.2 • PYQ 2021-Dec [5] (d) • 3M • Pg 518

LEVEL I
Understanding

Easy

CSQ 11.3 • MTP 2024-Mar [1] (c) {C} • 3M • Pg 526

LEVEL I
Understanding

Easy

TQ 11.5 • MTP 2025-Jul S1 [4] (a) • 5M • Pg 522

LEVEL I
Understanding

Medium

Application use the Standard - apply it to the facts • 5 questions

- Take each fact in the question under its own clause of Section 143(1) — unsecured loans under (a), inter se adjustments under (b), personal expenses under (e) — and say for each whether it calls for a comment, a qualification, or nothing.

TQ 11.4 • PYQ 2023-Nov [2] (d) • 3M • Pg 521

LEVEL II
Application

Easy

TQ 11.1 • RTP 2019-Nov [23] • Pg 517

LEVEL II
Application

Medium

TQ 11.3 · MTP 2022-Mar [5] (b) · 4M · Pg 519	LEVEL II Application	Medium
CSQ 11.1 · PYQ 2019-Nov [2] (b) · 5M · Pg 523	LEVEL II Application	Medium
CSQ 11.2 · PYQ 2021-Jul [1] (b) {C} · 5M · Pg 524	LEVEL II Application	Medium

Topic 12: Reporting Under the Companies Auditor's Report Order, 2020 (CARO, 2020)

L2P5-C8-T12

Read first Read ICAI Study Material Chapter 8, Audit Report — reporting under the Companies (Auditor's Report) Order, 2020 (CARO, 2020): its applicability and the clauses of Paragraph 3.

NOTES

Applicability, and the exemptions — a question in itself. CARO, 2020 applies to every company, including a foreign company as defined in clause (42) of Section 2 of the Companies Act, 2013, except: (1) a banking company as defined in clause (c) of Section 5 of the Banking Regulation Act, 1949; (2) **an insurance company as defined under the Insurance Act, 1938;** (3) **a company licensed to operate under Section 8 of the Companies Act;** (4) a One Person Company as defined in clause (62) of Section 2 and a small company as defined in clause (85) of Section 2; and (5) a private limited company, not being a subsidiary or holding company of a public company, having a paid up capital and reserves and surplus not more than one crore rupees as on the balance sheet date, which does not have total borrowings exceeding one crore rupees from any bank or financial institution at any point of time during the financial year, and which does not have total revenue as disclosed in Schedule III (including revenue from discontinuing operations) exceeding ten crore rupees during the financial year. All three limits of the private company exemption must be satisfied — breach any one and CARO applies. Work the numbers on the facts: capital and reserves are taken **net of the year's losses**, borrowings from a bank and a financial institution are **added together**, and turnover **includes revenue from discontinuing operations**.

Clause (i) — Property, Plant and Equipment and intangible assets. Report (a) whether the company is maintaining proper records showing full particulars, including quantitative details and situation, of Property, Plant and Equipment, and whether it is maintaining proper records showing full particulars of intangible assets; (b) whether the Property, Plant and Equipment have been physically verified by the management at reasonable intervals, whether any material discrepancies were noticed and, if so, whether they have been properly dealt with in the books of account; (c) whether the title deeds of all immovable properties (other than properties where the company is the lessee and the lease agreements are duly executed in favour of the lessee) disclosed in the financial statements are held in the name of the company, and if not, the details in the prescribed format; (d) whether the company has revalued its Property, Plant and Equipment (including Right of Use assets) or intangible assets or both during the year and, if so, whether the revaluation is

based on the valuation by a Registered Valuer, specifying the amount of change if the change is 10% or more in the aggregate of the net carrying value of each class; and (e) whether any proceedings have been initiated or are pending against the company for holding any benami property under the Benami Transactions (Prohibition) Act, 1988 and the rules made thereunder, and if so, whether the company has appropriately disclosed the details in its financial statements.

Clause (ii) — inventory and working capital limits. (a) Whether physical verification of inventory has been conducted at reasonable intervals by the management and whether, in the opinion of the auditor, the coverage and procedure of such verification is appropriate; whether any discrepancies of 10% or more in the aggregate for each class of inventory were noticed and, if so, whether they have been properly dealt with in the books of account. (b) Whether at any point of time during the year the company has been sanctioned working capital limits in excess of five crore rupees, in aggregate, from banks or financial institutions on the basis of security of current assets; whether the quarterly returns or statements filed by the company with such banks or financial institutions are in agreement with the books of account, and if not, give details. Note the application point: **an ERP system, however sophisticated, does not replace physical verification** — where the company has stopped verifying physically, the auditor must **report the non-conduct of physical verification** under clause 3(ii)(a).

Clauses (iii), (v) and (ix) — money lent and money borrowed. Clause (iii), loans granted, including to related parties — six sub-clauses: (a) the aggregate amount of loans granted during the year and the balance outstanding at the balance sheet date, separately for subsidiaries, joint ventures and associates and for parties other than subsidiaries, joint ventures and associates; (b) whether the terms and conditions of the grant of such loans are not prejudicial to the company's interest; (c) whether the schedule of repayment of principal and payment of interest has been stipulated and whether the repayments or receipts are regular; (d) if any amount is overdue for more than 90 days, whether reasonable steps have been taken by the company for recovery; (e) whether any loan falling due during the year has been renewed or extended, or fresh loans granted to settle the overdue of existing loans; and (f) whether the company has granted any loans or advances in the nature of loans either repayable on demand or without specifying any terms or period of repayment, and if so, the aggregate amount of such loans, the percentage thereof to the total loans granted during the year, and the aggregate amount of loans granted to Promoters and Related Parties as defined in clause (76) of Section 2. **Clause (v) — deposits:** whether the company has complied with the directives issued by the Reserve Bank of India and the provisions of Sections 73 to 76 or any other relevant provisions of the Act and the rules framed thereunder, stating the nature of contraventions if there is non-compliance, and whether any order passed by the Company Law Board, National Company Law Tribunal, RBI or any Court or Tribunal has been complied with. **Clause (ix) — borrowings, six limbs:** (a) whether the company has defaulted in repayment of loans or other borrowings or in the payment of interest thereon to any lender, and if so, the period and amount of default in the prescribed format, lender-wise for defaults to banks, financial institutions and Government; (b) whether the company is a declared wilful defaulter by any bank or financial institution or other lender; (c) whether term loans were applied for the purpose for which they were obtained, and if not, the amount so diverted and the purpose for

which it is used; (d) whether funds raised on short term basis have been utilised for long term purposes, and if so, the nature and amount; (e) whether the company has taken any funds from any entity or person on account of or to meet the obligations of its subsidiaries, associates or joint ventures, with details and amounts; and (f) whether the company has raised loans during the year on the pledge of securities held in its subsidiaries, joint ventures or associate companies, with details, and whether it has defaulted in repayment of such loans.

Clause (vii) — statutory dues, and the “dispute” trap. (a) Whether the company is regular in depositing undisputed statutory dues including Goods and Services Tax, provident fund, employees' state insurance, income tax, sales tax, service tax, duty of customs, duty of excise, value added tax, cess and any other statutory dues to the appropriate authorities, and if not, the extent of the arrears outstanding as on the last day of the financial year for a period of more than six months from the date they became payable shall be indicated. (b) Where such dues have not been deposited on account of any dispute, the amounts involved and the forum where the dispute is pending shall be mentioned — and a mere representation to the concerned Department shall not be treated as a dispute. So where a company has only **filed an objection letter** with the GST authorities and no forum is seized of the matter, the dues are **undisputed** and, being outstanding for more than six months, are reported under **clause (vii)(a)**, not (vii)(b).

Clause (x) — the recurring “funds used for another purpose” scenario. (a) Whether moneys raised by way of initial public offer or further public offer (including debt instruments) during the year were applied for the purposes for which they were raised; if not, the details together with delays or default and subsequent rectification, if any, shall be reported. (b) Whether the company has made any preferential allotment or private placement of shares or convertible debentures (fully, partially or optionally convertible) during the year and, if so, whether the requirements of Section 42 and Section 62 of the Companies Act, 2013 have been complied with and the funds raised have been used for the purposes for which they were raised; if not, details in respect of the amount involved and nature of non-compliance. Where **fully convertible debentures** were issued for expansion and diversification but the money was used to **repay long-term loans**, the funds have not been used for the purpose for which they were raised, so the auditor reports under **clause (x) (b)** the **amount involved and the nature of and reason for the non-compliance**.

The remaining clauses the questions keep returning to. (xi) **Fraud:** whether any fraud by the company or any fraud on the company has been noticed or reported during the year, and if so, the nature and the amount involved; whether any report under Section 143(12) has been filed by the auditors in Form ADT-4 as prescribed under Rule 13 of the Companies (Audit and Auditors) Rules, 2014 with the Central Government; and whether the auditor has considered whistle-blower complaints, if any, received during the year — noting that only frauds noticed or reported during the year are covered, not suspected frauds, and that the auditor may apply the **principles of materiality in the Standards on Auditing**. (xii) **Nidhi company: whether it has complied with the Net Owned Funds to Deposits ratio of 1:20;** whether it is maintaining 10% unencumbered term deposits as specified in the Nidhi Rules, 2014; and whether there has been any default in payment of interest on deposits or repayment thereof for any period, with details. (xiii) **Related parties:**

whether all transactions with related parties are in compliance with Sections 177 and 188 where applicable, and whether the details have been disclosed in the financial statements as required by the applicable accounting standards. **(xiv) Internal audit:** whether the company has an internal audit system commensurate with the size and nature of its business, and whether the reports of the internal auditors for the period under audit were considered by the statutory auditor. **(xv) Non-cash transactions:** whether the company has entered into any non-cash transactions with its directors or persons connected with them, and if so, whether the provisions of Section 192 have been complied with. **Resignation of the statutory auditors:** whether there have been any resignations of the statutory auditors during the year and, if so, whether the auditor has taken into consideration the issues, objections or concerns raised by the outgoing auditors. **Cash losses:** whether the company has incurred cash losses in the financial year and in the immediately preceding financial year, and if so, the amount of cash losses — the clause requires the immediately preceding year too, so say so even where the facts give only the current year.

Remembering reproduce what you have learnt • 11 questions

- Name the clause number as well as its contents — 'Clause (vii)(a) of Paragraph 3 of CARO, 2020' — in every answer. The clause reference itself carries a mark.
- The five exemptions from CARO, 2020 are a list question; learn the private company exemption with all three of its limits and figures.

TQ 12.7 • PYQ 2024-May [5] (d) • 3M • Pg 533	LEVEL I Remembering	Easy
CSQ 12.7 • PYQ 2024-Sep [1] (d) {C} • 3M • Pg 542	LEVEL I Remembering	Easy
TQ 12.1 • PYQ 2018-May [4] (b) • 4M • Pg 527	LEVEL I Remembering	Medium
TQ 12.5 • PYQ 2021-Dec [4] (b) • 4M • Pg 531	LEVEL I Remembering	Medium
TQ 12.6 • RTP 2023-Nov [23] • Pg 532	LEVEL I Remembering	Medium
TQ 12.8 • MTP 2024-Jul [3] (a) • 5M • Pg 533	LEVEL I Remembering	Medium
TQ 12.10 • PYQ 2025-May [2] (c) • 4M • Pg 535	LEVEL I Remembering	Medium
CSQ 12.3 • PYQ 2022-Nov [6] (a) • 4M • Pg 538	LEVEL I Remembering	Medium
CSQ 12.4 • PYQ 2023-May [4] (b) • 4M • Pg 539	LEVEL I Remembering	Medium
CSQ 12.8 • MTP 2024-Nov [3] (c) • 4M • Pg 543	LEVEL I Remembering	Medium
CSQ 12.10 • MTP 2026-Mar S1 [4] (c) • 4M • Pg 544	LEVEL I	Medium

Remembering

Understanding explain it, and place it in context • 9 questions

- Answer by **clause**. Name the CARO clause, then state what the auditor must report under it, in the Order's own words as far as you can.
- Where the facts describe a situation, say first whether the clause applies to that company at all — several clauses are restricted by class or by threshold.

TQ 12.2 • PYQ 2019-May [5] (d) • 3M • Pg 528	LEVEL I Understanding	Easy
TQ 12.4 • PYQ 2020-Nov [4] (c) • 3M • Pg 530	LEVEL I Understanding	Easy
TQ 12.3 • PYQ 2019-Nov [5] (b) • 4M • Pg 529	LEVEL I Understanding	Medium
TQ 12.9 • RTP 2024-Sep [17] • Pg 534	LEVEL I Understanding	Medium
TQ 12.11 • MTP 2025-Jul S1 [6] (c) • 4M • Pg 536	LEVEL I Understanding	Medium
CSQ 12.6 • MTP 2024-Mar [1] (a) {C} • 4M • Pg 541	LEVEL I Understanding	Medium
CSQ 12.9 • PYQ 2026-Jan [2] (c) • 4M • Pg 543	LEVEL I Understanding	Medium
CSQ 12.11 • PYQ 2026-May [2] (c) • 4M • Pg 545	LEVEL I Understanding	Medium
CSQ 12.12 • PYQ 2026-Sep [5] (c) • 4M • Pg 546	LEVEL I Understanding	Medium

Application use the Standard - apply it to the facts • 3 questions

- On an applicability question, test each of the three private company limits against the figures given and show the arithmetic — capital and reserves net of losses, borrowings added together, turnover including discontinuing operations — then conclude. Breaching any one limit makes CARO applicable.
- Where the question gives facts under more than one clause, deal with them as separate numbered parts, each opening with its clause reference. Running them together loses the coverage marks.

CSQ 12.1 • PYQ 2018-Nov [4] (b) • 4M • Pg 536	LEVEL II Application	Medium
CSQ 12.2 • PYQ 2022-May [2] (a) • 4M • Pg 537	LEVEL II Application	Medium
CSQ 12.5 • PYQ 2023-Nov [3] (a) • 4M • Pg 540	LEVEL II Application	Medium

CHAPTER 9

Special Features of Audit of Different Types of Entities

14 Topics · 66 Classified Questions · Importance: B

ICAI SKILL PROFILE ICAI band for this paper: Level I 40-60% · Level II 40-60% — this chapter reads **theory-heavy**

Level I — Comprehension & Knowledge **61.4%** 156 of 254 marks

Level II — Analysis & Application **38.6%** 98 of 254 marks

Above the paper's Level I ceiling: 61% of this chapter's marks are Comprehension and Knowledge, against ICAI's 40-60% for the paper. Reading carries more of the preparation here than it does elsewhere; do not prepare this chapter by working sums alone.

Topic 1: Government Audit

L2P5-C9-T01

Read first Read ICAI Study Material Chapter 9, Special Features of Audit of Different Types of Entities — Government Audit: its definition and objectives, the powers of the C&AG, expenditure audit, audit of receipts, audit of stores and inventories, and the C&AG's role under the Companies Act, 2013.

NOTES

The definition, learn it whole — it carries a mark on its own: Government Audit is the objective, systematic, professional and independent examination of financial, administrative and other operations of a public entity, made subsequently to their execution, for the purpose of evaluating and verifying them, presenting a report containing explanatory comments on audit findings together with conclusions and recommendations for future action by the responsible officials and, in the case of examination of financial statements, expressing the appropriate professional opinion regarding the fairness of the presentation. **The four objectives** the answers head and number are: **(1) Accounting for Public Funds** — it is a mechanism for public accounting of government funds; **(2) Appraisal of Government Policies** — public accounting of the operational, management, programme and policy aspects of public administration and the accountability of the officials administering them; **(3) Corrective Actions** — audit observations based on factual data highlight the lapses of the lower hierarchy and help supervisory officers take corrective measures; **(4) Administrative Accountability** — a combination of ensuring accountability of administration to the legislature and functioning as an aid to administration. In India the function is discharged by the independent statutory authority of the Comptroller and Auditor General through the agency of the Indian Audit and Accounts Department.

The five basic standards for Expenditure Audit — the single most repeated list in this chapter. The

basic standards are set to ensure that there is provision of funds authorised by competent authority fixing the limits within which expenditure can be incurred. They are: **(1) Audit against Rules and Orders** — that the expenditure conforms to the relevant provisions of the statutory enactment and is in accordance with the financial rules and regulations framed by the competent authority; **(2) Audit of Sanctions** — that each item of expenditure is covered by a sanction, **either general or special**, accorded by the competent authority authorising it; **(3) Audit against Provision of Funds** — that there is a provision of funds out of which the expenditure can be incurred and **the amount does not exceed the appropriations made**; **(4) Propriety Audit** — that the expenditure is incurred with due regard to **broad and general principles of financial propriety**; **(5) Performance Audit** — that the programmes, schemes and projects where large financial expenditure has been incurred are **run economically and are yielding the results expected of them**. The examiner sets this as a fact pattern: payments without approval of the competent authority go to **audit of sanctions**; a project with no assessment of benefits to **performance audit**; funds drawn where no budgetary provision was made to **audit against provision of funds**; expenditure ignoring prescribed financial regulations to **audit against rules and orders**; unnecessary spending to **propriety audit**. Name the audit, then give the standard it enforces.

Audit against Rules and Orders — the three categories and the four checks. The rules and orders against which regularity audit is conducted fall mainly under: (1) rules and orders regulating the powers to incur and sanction expenditure from the Consolidated Fund of India or of a State (and the Contingency Fund); (2) rules and orders dealing with the mode of presentation of claims against government, withdrawing moneys from the Consolidated Fund, Contingency Fund and Public Accounts, and the financial rules prescribing the detailed procedure for government servants dealing with government transactions; (3) rules and orders regulating the conditions of service, pay and allowances, and pensions of government servants. **The sentence the examiner wants stated:** it is the function of the executive government to frame rules, regulations and orders; the job of audit is to see that they are applied properly by the subordinate authorities, and it is not the function of audit to prescribe what those rules shall be. But audit does examine the rules themselves to see that (a) they are not inconsistent with any provisions of the Constitution or any laws made thereunder; (b) they are consistent with the essential requirements of audit and accounts as determined by the C&AG; (c) they do not come in conflict with the orders of, or rules made by, any higher authority; and (d) in case they have not been separately approved by competent authority, the issuing authority possesses the necessary rule-making power. Audit of expenditure against regularity is **quasi-judicial work** involving interpretation of the Constitution, statutes, rules and orders — but **the final power of interpretation does not vest with the C&AG**.

Propriety audit and its four exceptions. Propriety audit looks beyond the rules: the auditor aims to bring out cases of improper, avoidable or infructuous expenditure even though the expenditure has been incurred in conformity with the existing rules and regulations, and audit aims to secure a reasonably high standard of public financial morality by looking into the wisdom, faithfulness and economy of transactions. **The rule tested by the exception:** public moneys should not be utilised for the benefit of a particular person or section of the community **unless** — (1) the amount of expenditure involved is insignificant; or (2) a claim for the amount could be enforced in a Court of

law; or (3) the expenditure is in pursuance of a recognised policy or custom; and (4) the amount of allowances, such as travelling allowances, granted to meet expenditure of a particular type should be so regulated that the allowances are not, on the whole, sources of profit to the recipients. A question that asks for the exceptions wants these four, not a description of propriety audit.

Performance audit — the three limbs and the five-step procedure. The scope of audit has been extended to cover efficiency, economy and effectiveness audit, or performance audit, or full scope audit. **Efficiency audit** looks into whether the schemes and projects are executed and their operations conducted economically and whether they are yielding the results expected of them — the relationship between goods and services produced and the resources used to produce them.

Economy audit looks into whether the government has acquired the **financial, human and physical resources** in an economical manner and whether the sanctioning and spending authorities have observed economy. **Effectiveness audit** is an appraisal of the performance of programmes, schemes and projects **with reference to the overall targeted objectives** as well as the efficiency of the means adopted for attaining them. Efficiency-cum-performance audit is an objective examination of the financial and operational performance of an organisation, programme, authority or function, oriented towards identifying opportunities for greater economy and effectiveness. The procedure for conducting a performance audit covers (1) identification of topic, (2) preliminary study, (3) planning, (4) execution of audit, and (5) reporting.

Audit of receipts — newer than expenditure audit, and asked in its own right. Such an audit provides for checking: (1) whether all revenues or other debts due to government have been correctly assessed, realised and credited to the government account by the designated authorities; (2) whether adequate regulations and procedures have been framed by the department to secure an effective check on assessment, collection and proper allocation of cases; (3) whether such regulations and procedures are actually being carried out; (4) whether adequate checks are imposed to ensure prompt detection and investigation of irregularities, double refunds, fraudulent or forged refund vouchers or other loss of revenue through fraud, wilful omission or negligence to levy or collect taxes or to issue refunds; and (5) review of systems and procedures to see that internal procedures adequately secure correct and regular accounting of demands, collection and refunds and pursuit of dues up to final settlement, and to suggest improvement. **The basic principle:** it is **more important to look at the general than at the particular**, though individual cases of assessment, demand, collection and refund are important within the area of test check; and a review of the judicial decisions taken by tax authorities is done to judge the effectiveness of the assessment procedure. Add that the extent and quantum of audit are determined by the C&AG and are neither negotiable nor questioned, structured by test check, random sampling, general review and in-depth study of specified areas; that the institutional mechanism provides primary check by the auditor, test check by the supervisor and control and direction by the group leader; and that audit is conducted both centrally, where accounts and original vouchers are kept, and locally, where the drawing and disbursing functions are performed.

Four more blocks the answers use — keep them apart. (a) Powers of the C&AG: to inspect any office of accounts under the control of the Union or a State Government including offices

responsible for the creation of initial or subsidiary accounts; to require that any accounts, books, papers and other documents relevant to the transactions under audit be sent to specified places; to **put such questions or make such observations as he considers necessary** to the person in charge and call for information needed for any account or report he must prepare; and to dispense with any part of the detailed audit of any accounts or class of transactions and apply such limited checks as he may determine. **(b) Audit of stores and inventories** has been developed as a part of expenditure audit, with objectives: that the regulations governing **purchase, receipt, issue, custody, sale and inventory-taking** are properly designed and effectively implemented; to bring deficiencies in quantities held or weaknesses in internal control to the government's attention; to verify that purchases are **duly sanctioned, made economically and in compliance with the purchase rules**; that **prices paid are reasonable** and in accordance with contractual terms, with certificates of quality and quantity issued by the inspecting and receiving units, uneconomical purchases and losses from defective or inferior stores being specifically reported; and to check receipts, issues and balances for accuracy with reference to **prescribed norms for inventory holding levels, excess or idle inventory being specifically reported**, with periodic physical verification and examination of inventory valuation so that **value accounts reconcile with physical accounts**. **(c) Under the Companies Act, 2013: section 143(5)** — in the case of a Government company, or any other company owned or controlled directly or indirectly by the Central Government or by any State Government or partly by both, the C&AG appoints the auditor under section 139(5) and directs the manner in which the accounts are to be audited, and the auditor submits a copy of his report to the C&AG including the directions issued, the action taken and its impact on the accounts. **Section 143(6)** — the C&AG may **by order cause a test audit** to be conducted, **section 19A of the C&AG's (Duties, Powers and Conditions of Service) Act, 1971** applying to that report; his directions broadly cover **the system of book-keeping and accounts, internal control etc.**; and he has a **right to comment upon or supplement the audit report** submitted by the statutory auditors. **(d) The trap: section 134(3)** obliges the board to explain every reservation, adverse remark or disclaimer in the auditor's report and the secretarial audit report — there is no similar provision for the C&AG's comments, so the board is not bound to give information or explanation on them. **Also state plainly:** government audit is neither equipped nor intended to function as an investigating agency pursuing every irregularity or misdemeanour to its logical end.

Remembering reproduce what you have learnt · 1 question

- List the five basic standards of expenditure audit by name before you explain any one of them. Marks follow the number of heads named.
- The four objectives of government audit and the four powers of the C&AG are separate lists. A question on one is not answered by the other.

Understanding explain it, and place it in context · 10 questions

- Quote the definition of government audit in full — 'objective, systematic, professional and independent examination ... made subsequently to their execution' is the clause the examiner looks for.
- When asked about audit against rules and orders, give the three categories of rules AND the four things audit examines, and end with the sentence that audit does not prescribe what the rules shall be.

TQ 1.3 · PYQ 2019-May [6] (d) · 3M · Pg 553	LEVEL I Understanding	Easy
CSQ 1.2 · MTP 2024-Mar [2] (d) · 3M · Pg 563	LEVEL I Understanding	Easy
TQ 1.1 · RTP 2018-May [27] (a) · Pg 551	LEVEL I Understanding	Medium
TQ 1.2 · PYQ 2018-Nov [6] (d) · 5M · Pg 552	LEVEL I Understanding	Medium
TQ 1.4 · PYQ 2020-Nov [6] (Or) (ii) · 4M · Pg 553	LEVEL I Understanding	Medium
TQ 1.6 · RTP 2021-May [28] (b) · Pg 557	LEVEL I Understanding	Medium
TQ 1.7 · PYQ 2021-Jul [6] (Or) (a) · 4M · Pg 557	LEVEL I Understanding	Medium
TQ 1.9 · MTP 2024-Mar [6] (b) · 4M · Pg 559	LEVEL I Understanding	Medium
TQ 1.10 · RTP 2025-May [17] · Pg 559	LEVEL I Understanding	Medium
CSQ 1.3 · PYQ 2025-Sep [6] (b) · 5M · Pg 563	LEVEL I Understanding	Medium

Application use the Standard - apply it to the facts · 3 questions

- The observations-to-audit-type question is a mapping exercise: take each observation in turn, name the type of audit, then state the standard that type enforces. An answer that names the audit without the standard loses half the mark for each item.
- On a Government company scenario, cite section 143(5) for appointment and direction and section 143(6) for test audit and supplementary comment, then answer the board's duty under section 134(3) separately.

TQ 1.11 · PYQ 2020-Nov [6] (d) · 3M · Pg 561	LEVEL II Application	Medium
CSQ 1.1 · PYQ 2023-May [6] (b) · 4M · Pg 562	LEVEL II Application	Medium
CSQ 1.4 · MTP 2025-Nov S1 [3] (c) · 4M · Pg 565	LEVEL II Application	Medium

Analysis break it down and take the parts separately · 1 question

- Where the facts list procedural deficiencies in a receipts audit — double refunds, weak checks on assessment, no review of judicial decisions — tie each deficiency to the numbered check it fails, then state that the extent of audit is fixed by the C&AG and is not negotiable.

TQ 1.5 · RTP 2020-Nov [28] (a) · Pg 555

LEVEL II
Analysis

Medium

Topic 2: Audit of Local Bodies

L2P5-C9-T02

Read first Read ICAI Study Material Chapter 9, Special Features of Audit of Different Types of Entities — Audit of Local Bodies: the meaning of a municipality, the objectives of the audit, sources of revenue and revenue grants, heads of expenditure, and the audit programme.

NOTES

Who appoints, and it is the first line of the answer: the external control of municipal expenditure is exercised by the State Governments through the appointment of auditors to examine municipal accounts. The Local Fund Audit Wing of the State Government is generally in charge of the audit of municipal accounts, but the municipal corporations of Delhi, Mumbai and a few others have powers to appoint their own auditors for regular external audit. Begin an audit-programme answer by having the auditor **ensure his appointment**.

The five objectives of audit of local bodies — a five-item list, so name all five: (1) reporting on the fairness of the content and presentation of financial statements; (2) reporting upon the strengths and weaknesses of systems of financial control; (3) reporting on the adherence to legal and/or administrative requirements; (4) reporting upon whether value is being fully received on money spent; and (5) detection and prevention of error, fraud and misuse of resources. When the question is put as 'what will be your reporting areas', it is asking for this same list.

Definition of a municipality — short, and it is asked verbatim: a municipality can be defined as a unit of local self-government in an urban area. **Local self-government** means the administration of a locality — a village, a town, a city or any other area smaller than a State — by a body representing the local inhabitants, possessing fairly large autonomy, raising at least a part of its revenue through local taxation and spending its income on services which are regarded as local and therefore distinct from State and Central services. Expenditure of municipalities and corporations is broadly classified under six heads: (1) general administration and revenue collection, (2) public health, (3) public safety, (4) education, (5) public works, and (6) others such as interest payments.

Revenue and grants. Property taxes and octroi are the major sources of revenue of municipal authorities; other municipal taxes are professional tax, non-mechanised vehicles tax, taxes on advertisements, taxes on animals and boats, tolls and show-tax. Local bodies also receive grants

from the State administration, and **the revenue grants are of three categories: (1) General purpose grants** — primarily intended to **substantially bridge the gap between the needs and resources of the local bodies**; **(2) Specific purpose grants** — grants **tied to the provision of certain services or performance of certain tasks**; **(3) Statutory and compensatory grants** — given under various enactments as compensation on account of loss of any revenue on taking over a tax by the State Government from the local government.

The audit programme for local bodies runs in six heads, and the last four repeat the government expenditure standards: **(1) Appointment** — ensure the appointment, the Local Fund Audit Wing being generally in charge; **(2) Auditor's concerns** — report on fairness of contents and presentation, strengths and weaknesses of the system of financial control, adherence to legal and administrative requirements and whether value is fully received on money spent, the objective being **to detect errors and fraud and misuse of resources**; **(3) Rules and regulations** — that the expenditure conforms to the relevant provisions of law and the financial rules and regulations framed by the competent authority; **(4) Authorisations** — that all sanctions, **either special or general**, have been accorded by the competent authority; **(5) Provisioning** — that there is a provision of funds, the expenditure is incurred from that provision and it has been authorised by the competent authority; **(6) Performance** — that schemes, programmes and projects carrying large expenditure are **running economically and getting the expected results**.

Remembering reproduce what you have learnt · 1 question

- The ask is the **objectives of local body audit**. Name them as a list before explaining any; marks follow the number of objectives stated.
- Keep them distinct from the objectives of government audit generally — the examiner sets both, and the lists differ.

TQ 2.1 · PYQ 2015-May [6] (c) · 4M · Pg 566

LEVEL I
Remembering

Medium

Understanding explain it, and place it in context · 1 question

- Give the definition of municipality first and the definition of local self-government second — both are short and both are marked.
- Keep the five objectives and the six heads of expenditure apart; a question on one is not served by the other.

TQ 2.2 · PYQ 2020-Nov [6] (c) · 3M · Pg 567

LEVEL I
Understanding

Easy

Application use the Standard - apply it to the facts · 1 question

- For an audit-programme question, use the six numbered heads with their titles. The titles themselves — Appointment, Auditor's Concerns, Rules and Regulations, Authorisations, Provisioning, Performance — are what the examiner ticks.

CSQ 2.1 · MTP 2023-Sep [6] (b) · 4M · Pg 568

LEVEL II
Application

Medium

Analysis break it down and take the parts separately · 1 question

- Where the question asks how expenditure is verified, answer by **category of expenditure**, and name what the auditor checks in each.
- Say against what the expenditure is tested — the budget grant, the sanction, and the rules governing that class of spending.

TQ 2.3 · PYQ 2022-Nov [6] (c) · 3M · Pg 568

LEVEL II
Analysis

Medium

Topic 3: Audit of Non Governmental Organisations (NGO's)

L2P5-C9-T03

Read first Read ICAI Study Material Chapter 9, Special Features of Audit of Different Types of Entities — Audit of Non-Governmental Organisations: planning the audit, the audit programme for assets, liabilities, income and expenditure, corpus and revolving funds, and verification of receipts of income.

NOTES

Planning an NGO audit — the answers list ten points, and four are usually enough only if the question says so: (1) knowledge of the NGO's work, its mission and vision, areas of operations and the environment in which it operates; (2) updating knowledge of relevant statutes, especially recent amendments, circulars and judicial decisions — the Foreign Contribution (Regulation) Act, 2010, **the** Societies Registration Act, 1860, **the** Income Tax Act, 1961 and the Rules under them; (3) reviewing the legal form of the organisation and its Memorandum of Association, Articles of Association, Rules and Regulations; (4) reviewing the organisation chart, the financial and administrative manuals, project and programme guidelines, funding agencies' requirements and formats and budgetary policies; (5) examination of minutes of the Board, Managing Committee, Governing Body and Management and their committees to ascertain the impact of decisions on the financial records; (6) study of the accounting system, procedures, internal controls and internal checks and verification of their applicability; (7) setting of materiality levels for audit purposes; (8) the nature and timing of reports or other communications; (9) the involvement of experts and their reports; (10) review of the previous year's audit report.

The audit programme runs in sequential order over all assets, liabilities, income and expenditure so that no material item is omitted. **Corpus fund** — vouch contributions and grants towards corpus **with special reference to the letters from the donors**, and check interest income with the Investment Register and physical investments in hand. **Reserves** — vouch transfers from projects and programmes with donors' letters and board resolutions, and check transfer of the **gross value**

of an asset sold from capital reserve to general reserve. **Ear-marked funds** — check the requirements of donor institutions, the board resolution and the rules and regulations of the schemes. **Project/agency balances** — vouch disbursements and expenditure as per the agreements with donors. **Loans** — vouch with loan agreements and counterfoils of receipts issued. **Fixed assets** — vouch acquisitions, sale or disposal including depreciation and the authorisations, check donors' letters and agreements for the grant, and in the case of immovable property check title. **Investments** — check the Investment Register and the investments physically, **ensuring that investments are in the name of the NGO**, and verify further investments and disinvestments for approval by the appropriate authority. **Cash in hand** — physically verify cash and imprest balances at the close of the year and tally with the books. **Bank balance** — check the bank reconciliation statements and ascertain details of old outstanding and unadjusted amounts. **Inventory** — verify inventory in hand and **obtain a certificate from the management for quantities and valuation.** **Programme and project expenses** — verify the agreement with the donor to ascertain the conditions and, where contracts are involved, ensure **income tax is deducted, deposited and returns filed.** **Establishment expenses** — verify that provident fund, life insurance premium, employees' state insurance and their administrative charges are deducted, contributed and deposited within the prescribed time.

Two definitions the examiner asks side by side. Donations and grants in the nature of promoter's contribution are **capital receipts and are shown as liabilities in the balance sheet of the NGO.**

Corpus contribution: a contribution made towards the capital or the corpus of an NGO; the donors are generally required to specify whether the donation or grant shall form part of the corpus. **Revolving fund:** the objective of a contribution or grant towards a revolving fund is to rotate the amount by giving temporary loans from the fund to other NGOs or beneficiaries for their projects and then recover the loan so as to give temporary loans again, and so on; interest earned from a beneficiary on such temporary loans may be either added back to the fund or credited to the Income and Expenditure Account, depending on the restrictions laid down by the authority providing the contribution or by the NGO's own rules.

Verification of income of an NGO — five heads, each with its own record: (a) **Contributions and grants for projects and programmes** — examine agreements with donors and grant letters, and verify that all foreign contribution receipts are deposited in the foreign contribution bank account as notified under the Foreign Contribution (Regulation) Act, 2010; (b) **Receipts from fund-raising programmes** — review the internal control system in detail, ascertain the persons responsible for collection and the mode of receipt, and ensure **collections are counted and deposited in the bank on a daily basis;** (c) **Membership fees** — verify with the Membership Register and ensure proper classification between entrance fees, annual fees and life membership fees, reconciling with the fees expected during the year; (d) **Subscriptions** — check with the subscription register and receipts issued, reconcile subscription income with the printing and dispatch of the corresponding magazines, circulars or periodicals, and verify receipts against the subscription rate schedule; (e) **Interest and dividends** — verify received and receivable against the investments held during the year.

Where the NGO collects donations and passes them on, the programme has two halves and both are marked. **Receipt of donations: internal control system** — division of responsibilities for authorised collection, custody of receipt books and safe custody of money; **custody of receipt books** — a system for issue of receipt books, unused books returned and physically verified including the number of books and the sequence of numbering; **receipt of cheques** — carbon copy for the duplicate receipt, signed by a responsible official, with date of cheque, bank's name, date and amount clearly stated; **bank reconciliation** — reconcile cash deposits not only by date and amount but **with reference to the receipt book**; **cash receipts** — vouch the register of cash donations more extensively and, where donors' addresses are available, cross-check by asking the entity to **post thank-you letters mentioning amount, date and receipt number**; and foreign contributions receive special attention for compliance with applicable laws. **Remittance to other NGOs: mode of sending remittance** — all remittances through **account payee cheques**, demand drafts scrutinised with reference to the recipient; **confirming receipt** — all remittances supported by receipts and acknowledgements; **identity** — the recipient NGO is a genuine entity, verify address and **80G registration number**; **direct confirmation procedure** — send confirmation letters to entities paid; **donation utilisation** — used for relief and not for any other purpose; and **the system for selecting the NGOs** to whom donations were sent.

Remembering reproduce what you have learnt · 1 question

- For an NGO the answer must name the **registration and the statute** the facts point to, and only then the audit points.
- Where receipts are of a particular kind — corpus, grant, foreign contribution — say which rules attach to that kind. The foreign contribution point is the one most often missed.

CSQ 3.1 · PYQ 2023-Nov [6] (Or) (a) · 4M · Pg 571

LEVEL I
Remembering

Medium

Understanding explain it, and place it in context · 3 questions

- Corpus contribution and revolving fund are two-mark definitions. Give the purpose of each and, for the revolving fund, the treatment of interest — that sentence is the second mark.

TQ 3.1 · MTP 2021-Mar [6] (c) · 3M · Pg 570

LEVEL I
Understanding

Easy

CSQ 3.2 · PYQ 2024-May [6] (Or) (a) · 4M · Pg 572

LEVEL I
Understanding

Medium

CSQ 3.4 · PYQ 2026-Jan [5] (b) · 5M · Pg 574

LEVEL I
Understanding

Medium

Application use the Standard - apply it to the facts · 1 question

- Where the facts mention foreign contributions, say the FCRA, 2010 point explicitly — foreign contribution receipts must go into the notified foreign contribution bank account. Facts that name foreign money and an answer that never names the Act lose the mark.
- A 'draft an audit programme' question wants headings and the record checked against each. Write the head in bold, then the document — Corpus Fund/donor letters, Investments/Investment Register, Inventory/management certificate.

CSQ 3.3 · RTP 2025-Jan [18] · Pg 573

LEVEL II
Application

Medium

Topic 4: Audit of Sole Trader

L2P5-C9-T04

CONCEPT BASE — no exam question asked yet · essential for full preparation

Read first Read ICAI Study Material Chapter 9, Special Features of Audit of Different Types of Entities — Audit of a Sole Trader.

NOTES

No question has been printed on this topic in the Scanner — no past paper, RTP, MTP or model question. It is carried here as a concept-base topic, so read the Study Material's own treatment of the sole trader before the exam rather than relying on notes.

What does transfer from the pack: the neighbouring answers on the audit of a firm open with the **letter of appointment** point — the auditor confirms that the letter of appointment **clearly states the nature and scope of the audit contemplated and the limitation, if any, under which the auditor shall have to function**. That is the discipline of a non-company audit generally: where the audit is not mandated by a statute that fixes its scope, the scope comes from the engagement, and the auditor gets it in writing before he starts.

Do not import lists from the other entities. The special points for a partnership, an LLP, a co-operative society or a trust each belong to their own entity and their own statute. If a sole-trader question does appear, answer it from the Study Material's own text; do not substitute the partnership list.

Topic 5: Audit of Firm

L2P5-C9-T05

Read first Read ICAI Study Material Chapter 9, Special Features of Audit of Different Types of Entities — Audit of a Firm: the special points in the audit of a partnership, the advantages of that audit,

and the books, returns and audit of a Limited Liability Partnership.

NOTES

The seven special points in the audit of a partnership firm, in the order the answers give them: **(1) Letter of Appointment** — confirm that the letter, **signed by a partner duly authorised**, clearly states the nature and scope of the audit contemplated by the partners, especially the limitation, if any, under which the auditor shall have to function; **(2) Partnership Documents** — study the minute book, if any, recording policy decisions, specially minutes relating to authorisation of extraordinary and capital expenditure, raising of loans, purchase of assets and extraordinary contracts; **(3) Objects of Partnership** — verify that the business the partnership is engaged in is **authorised by the partnership agreement** or by any extension or modification agreed to subsequently; **(4) Books of Account** — examine whether they appear reasonable and are adequate **in relation to the nature of the business**; **(5) Mutual Interest** — verify that **the interest of no partner has suffered prejudicially** by an activity the partnership was not authorised to engage in, or by any violation of a provision of the agreement; **(6) Provision for Taxes** — confirm that provision for the firm's tax payable has been made before arriving at the amount of profit divisible among the partners; **(7) Division of Profits** — verify that profits and losses have been divided **in the agreed profit-sharing ratio**.

The six advantages of auditing a partnership's accounts — the examiner asks for exactly six: **(1) Disputes** — audited accounts are a convenient and reliable means of settling accounts between the partners, so the possibility of a dispute is mitigated, and it is usually provided that accounts once signed are **binding unless some manifest error is brought to light within a specified period**; **(2) Dissolution** — on the **retirement or death of a partner**, audited accounts accepted by the partners are reliable evidence for computing the amount due in respect of **share of capital, profits and goodwill**; **(3) Taxation** — audited accounts are generally accepted by the Income Tax Department as the basis for computing the assessable income of the partners; **(4) Reliable** — relied upon by **banks when advancing loans** and by **prospective purchasers of the business** as evidence of profitability and financial position; **(5) Admission** — helpful in negotiations to admit a person as a partner, especially when available for a number of past years; **(6) Control** — an effective safeguard against **undue advantage being taken by a working partner**, especially where some partners are not actively associated with the working of the firm.

LLP returns, and the two periods are the marks: an LLP must file an annual return in Form 11 with the ROC within 60 days of closure of the financial year, and that return is available for public inspection on payment of the prescribed fees to the Registrar; and it must submit a Statement of Account and Solvency in Form 8, filed within thirty days from the end of six months of the financial year to which it relates. Do not swap the form numbers or the periods.

LLP books of account — four items: an LLP is under an obligation to **maintain annual accounts reflecting a true and fair view of its state of affairs**, and its books must contain (1) particulars of all sums of money received and expended and the matters in respect of which the receipt and

expenditure take place; (2) a record of the assets and liabilities of the LLP; (3) statements of costs of goods purchased, inventories, work-in-progress, finished goods and costs of goods sold; (4) any other particulars which the partners may decide.

The auditor's duty on an LLP audit runs in four heads, and the third is a list of eleven: **(1)**

Engagement letter — obtain **clear and definite instructions in writing** regarding the scope of the work; **(2) Minutes book** — if maintained, refer to it for resolutions passed in relation to the accounts; **(3) LLP agreement** — read it and take note of (a) the nature of the business; (b) the amount of capital contributed by each partner; (c) interest payable on additional capital contributed; (d) the duration of the partnership; (e) drawings permitted to partners; (f) salaries, commission and other remuneration payable to partners; (g) borrowing powers of the LLP; (h) rights and duties of the partners; (i) the method of settlement of accounts among partners at the time of admission, retirement or otherwise; (j) any loans advanced by the partners to the LLP; (k) the profit-sharing ratio; **(4) Reporting** — report on **whether the records of the LLP appear to be correct and reliable, whether all information and explanations necessary for the audit were obtained**, and whether any restriction was imposed on the auditor in the performance of the audit work.

Remembering reproduce what you have learnt · 3 questions

- Form 11 within 60 days of closure of the financial year; Form 8 within thirty days from the end of six months. Both the form and the period are marked, so give them as a pair.

TQ 5.3 · PYQ 2022-Nov [6] (d) · 3M · Pg 577

LEVEL I
Remembering

Easy

TQ 5.4 · RTP 2023-Nov [28] (b) · Pg 577

LEVEL I
Remembering

Medium

TQ 5.5 · PYQ 2025-Sep [5] (c) · 4M · Pg 578

LEVEL I
Remembering

Medium

Understanding explain it, and place it in context · 2 questions

- The special points in a partnership audit and the advantages of that audit are two different lists. Read the verb in the question — 'points to consider' or 'advantages' — before you start writing.

TQ 5.1 · PYQ 2019-Nov [6] (d) · 3M · Pg 575

LEVEL I
Understanding

Easy

TQ 5.2 · PYQ 2021-Jul [6] (c) · 3M · Pg 576

LEVEL I
Understanding

Easy

Topic 6: Audit of Charitable Institution

L2P5-C9-T06

Read first Read ICAI Study Material Chapter 9, Special Features of Audit of Different Types of

Entities — Audit of a Charitable Institution: verification of subscriptions and donations, including digital receipts, and the audit of expenditure items.

NOTES

Subscriptions and donations — start with the change in rates, then the receipt trail. (1) Ascertain the changes, if any, made in the amount of annual or life membership subscription during the year. **(2) Where official receipts are issued: (a) confirm that adequate control is imposed over unused receipt books; (b) obtain all receipt books covering the period under review;** (c) test check the counterfoils with the cash book, cancelled receipts being specially looked into; (d) obtain the printed list of subscriptions and donations and agree them with the total collections shown in the accounts; (e) examine the system of internal check regarding moneys received from box collections, flag days etc., check the amount received from representatives with the correspondence and the official receipts issued, and pay special attention to the control exercised over collections and the steps taken to ensure that all collections made have been accounted for; (f) verify the total subscriptions and donations received with any figures published in reports issued by the charity.

Online and digital receipts — new material, and new material is what gets set. (a) Verify subscriptions and donations received through UPI, internet banking, credit cards, debit cards, payment gateways and other electronic payment modes by reconciling the collections with **bank statements, payment gateway settlement reports and the books of account**, examining and explaining any unreconciled differences. **(b) Where collected through the institution's website or online donation portal**, verify that all successful transactions have been completely recorded and that pending settlements, failed transactions, refunds and chargebacks have been duly authorised and correctly accounted for. (c) Examine whether transaction charges, payment gateway fees or bank charges deducted from online collections have been correctly accounted for and appropriately disclosed. **(d) Where an integrated donor management system or accounting software is used**, verify that **adequate interface controls exist** to ensure complete and accurate transfer of digital receipt data **without unauthorised alteration or omission**. **(e) Review the access controls** over the online donation and subscription systems so that only authorised personnel can modify donor records, cancel receipts or process refunds, and **adequate audit trails are maintained**.

Audit of expenditure items — five heads, and the first carries the point about benefit to trustees: **(1) vouch payment of grants, verifying that the grants have been paid** only for a charitable purpose falling within the purview of the objects for which the charitable institution has been set up **and that** no trustee, director or member of the Managing Committee has benefited therefrom either directly or indirectly; (2) verify the schedules of securities held and the inventories of properties, movable and immovable, by **inspecting the securities and title deeds** and by **physical verification of the movable properties on a test basis**; (3) check payments along with supporting documents for salary and other expenses, verifying that all payments have been made after proper sanction by the appropriate authority; (4) ascertain that **any funds contributed for a special**

purpose have been utilised for that purpose; (5) verify cash and bank balances and payments.

The recurring test across the charitable entities — trace the money to its stated purpose. Whether the receipt is a subscription, a donation, a legacy or a grant, the question asked is the same: was it received completely, and was it applied to the purpose for which it was given? Say that sentence and then run the specific procedure; an answer that only lists vouching steps without the purpose test reads incomplete.

Understanding explain it, and place it in context · 1 question

- Separate receipts from expenditure in your answer. A question on 'audit of expenditure items' wants the five heads ending with cash and bank balances; a question on subscriptions and donations wants the receipt-book trail plus the digital points.

CSQ 6.1 · PYQ 2021-Dec [6] (d) · 3M · Pg 579

LEVEL I
Understanding

Easy

Application use the Standard - apply it to the facts · 1 question

- Where the facts mention online or UPI donations, add the digital block — reconciliation with gateway settlement reports, gateway fees, interface controls and access controls. These are the newest points and they score.

CSQ 6.2 · PYQ 2023-May [6] (d) · 3M · Pg 581

LEVEL II
Application

Easy

Topic 7: Audit of Educational Institutions (School, College or Universities)

L2P5-C9-T07

Read first Read ICAI Study Material Chapter 9, Special Features of Audit of Different Types of Entities — Audit of Educational Institutions: verification of fees from students, other receipts, grants and donations, and assets and liabilities.

NOTES

Fees from students — the seven steps, and they are the most asked item in this topic: (1) check names entered in the Students Fee Register for each month or term with the respective Class Registers showing names of students on the rolls, test the amount of fees charged, and verify that a system of internal check operates which ensures that demands against students are properly raised; (2) check fees received by comparing counterfoils of receipts granted with entries in the Cash Book and trace the collections in the Fee Register; (3) **total up the various columns of the Fees Register for each month or term** to see that **fees paid in advance have been carried forward** and that arrears that are irrecoverable have been written off under the sanction of an appropriate authority; (4) check admission fees with admission slips signed by the head of the institution and

confirm that the amount has been credited to a Capital Fund, unless the Managing Committee has taken a decision to the contrary; (5) see that free studentships and concessions have been granted by a person authorised to do so, having regard to the Rules prepared by the Managing Committee; (6) confirm that fines for late payment or absence have been either collected or remitted under proper authority; (7) confirm that hostel dues were recovered before students' accounts were closed and their deposits of caution money refunded.

Other receipts, grants and donations — four steps: (1) verify rental income from landed property with the rent rolls; (2) vouch income from endowments and legacies, as well as interest and dividends from investments, and inspect the securities in respect of the investments held; (3) verify any government or local authority grant with the memo of grant; (4) if any expense has been disallowed for the purpose of the grant, ascertain the reason for it.

Assets and liabilities — five points, and two of them are classification traps: (1) report any old heavy arrears on account of fees, dormitory rents etc. to the Managing Committee; (2) confirm that caution money and other deposits paid by students on admission have been shown as a liability in the balance sheet and not transferred to revenue, unless they are not refundable; (3) see that the investments representing endowment funds for prizes are kept separate and that any income in excess of the prizes has been accumulated and invested along with the corpus; (4) ascertain that the system of ordering inspection on receipt and issue of provisions, foodstuffs, clothing and other equipment is efficient and that all bills are duly authorised and passed before payment; (5) verify the inventories of furniture, stationery, clothing, provisions and all equipment by reference to the Inventory Register or the corresponding inventories of the previous year, the values applied to various items being test checked.

The two classification points the examiner keeps returning to. Admission fees go to a Capital Fund unless the Managing Committee has decided otherwise, and caution money and deposits are a liability, not revenue, unless they are not refundable. The classic wrong answer treats both as income of the year. Say the rule and then say the exception in the same breath — each carries its own mark.

Understanding explain it, and place it in context • 3 questions

- Fees, other receipts and assets-and-liabilities are three distinct lists. Answer only the one the question names.

TQ 7.2 • PYQ 2021-Jul [6] (b) • 4M • Pg 583

LEVEL I
Understanding

Medium

TQ 7.3 • PYQ 2023-Nov [6] (a) • 4M • Pg 583

LEVEL I
Understanding

Medium

TQ 7.1 • MTP 2021-Mar [6] (b) • 3M • Pg 582

LEVEL I
Understanding

Hard

Application use the Standard - apply it to the facts · 1 question

- Where an investor wants the revenue figures confirmed before buying into a school, the answer is the seven-step fee verification — not a general discussion of revenue. Set out the steps in order and finish with hostel dues and caution money.

CSQ 7.1 · PYQ 2025-Jan [6] (a) · 5M · Pg 584

LEVEL II
Application

Medium

Topic 8: Audit of Hospital

L2P5-C9-T08

Read first Read ICAI Study Material Chapter 9, Special Features of Audit of Different Types of Entities — Audit of a Hospital: the special points in auditing a hospital's receipts, expenditure, stores, investments and inventories, including digital collections.

NOTES

The thirteen special points, in the order the answers run them: (1) **Register of Patients** — vouch the register with copies of bills issued to them, and **verify bills for a selected period with the patients' attendance record** to see that bills have been correctly prepared and issued to all patients from whom an amount was recoverable according to the rules of the hospital; (2) **Collection of Cash** — check cash collections as entered in the Cash Book with the receipts, counterfoils and other evidence — copies of patients' bills, counterfoils of dividend and other interest warrants, copies of rent bills; (3) **Legacies and Donations** — ascertain that those received **for a specific purpose have been applied in the manner agreed upon**; (4) **Reconciliation of Subscriptions** — trace all collections of subscriptions and donations from the Cash Book to the respective Registers and reconcile the total subscriptions due with the amount collected and that still outstanding; (5) **Authorisation and Sanctions** — vouch all purchases and expenses and verify that capital expenditure was incurred only with the prior sanction of the Trustees or the Managing Committee and that **appointments and increments to staff have been duly authorised**; (6) **Grants and TDS** — verify that grants from Government or a local authority have been duly accounted for and that **refund in respect of taxes deducted at source has been claimed**; (7) **Budgets** — compare the totals of the various items of expenditure and income **with the amounts budgeted for them** and **report the significant variations to the Trustees or the Managing Committee**; (8) **Internal Check** — examine the internal check on **receipt and issue of stores — medicines, linen, apparatus, clothing, instruments** — so that purchases are properly recorded in the Inventory Register and **issues are made only against proper authorisation**; (9) **Income from Investments, Rent etc.** — see, with reference to the **Property and Investment Register**, that all income receivable by way of rent, dividends and interest has been collected; (10) **Depreciation** — see that it has been **written off against all the assets at the appropriate rates**; (11) **Registers** — inspect the **bonds, share scrips and title deeds of properties** and compare their particulars with the Property and Investment Registers; (12) **Inventories** — obtain inventories, especially of stocks and stores, as at the end of

the year, **check a percentage of the items physically** and compare their total values with the respective ledger balances; **(13) Management Representation and Certificate** — obtain a proper management representation and certificate in respect of the various aspects covered during the audit.

Digital collections — the newest block, and it sits inside point (2): where amounts are received through **UPI, credit cards, debit cards, internet banking and payment gateways**, the auditor should (a) reconcile daily collections as per the Hospital Management Information System (HMIS) or billing software with settlement reports received from banks and payment gateway service providers; (b) verify that all digital receipts have been credited to the hospital's bank accounts and investigate pending settlements, failed transactions or unreconciled differences; (c) examine deductions made by banks or payment gateways towards Merchant Discount Rate (MDR), convenience charges or other transaction fees and see that they are correctly accounted for; (d) verify that refunds made to patients through digital modes have been duly authorised, supported by appropriate documentation and correctly recorded; (e) ensure that cancelled bills, reversed transactions and chargebacks have been properly approved and reconciled with the original billing records; (f) review the period-end reconciliation so that payments received before the balance sheet date but credited by banks or gateways after the year-end have been appropriately accounted for; (g) where HMIS, billing software and accounting system are integrated, examine whether interface controls ensure complete and accurate transfer of billing and collection data without unauthorised alteration.

Map the fact pattern to the point — that is how this topic is set. Bills not issued to patients recorded in the register goes to **Register of Patients**; donations for a dialysis unit spent on general administration goes to **Legacies and Donations** — applied in the manner agreed upon; missing documentation for a government health scheme grant goes to **Grants and TDS**; a large stock of medicines with no records or controls over issue goes to **Internal Check and Inventories**; unexplained deviations between budgeted and actual salaries and maintenance goes to **Budgets** — and the answer must add that the variations are **reported to the Trustees or the Managing Committee**.

Where the question is about developing the audit programme rather than the hospital's transactions, the answer changes entirely. Then the five heads are: **(1) a written audit programme** setting forth the procedures needed to implement the audit plan; **(2) audit objectives and instructions to assistants** — the programme may contain the audit objectives for each area and should have sufficient detail to serve as a set of instructions to the assistants and as a means to control the proper execution of the work; **(3) reliance on internal controls** — having an understanding of the accounting system and related internal controls, the auditor may wish to rely on certain internal controls in determining the nature, timing and extent of required procedures, but may decide not to rely on them when there are other more efficient ways of obtaining sufficient appropriate audit evidence, also considering the timing of procedures, coordination of client assistance, availability of assistants and the involvement of other auditors or experts; **(4) timing of performance of audit procedures** — the auditor normally has flexibility, but in some

cases has no discretion, for example when observing the taking of inventories by client personnel or verifying securities and cash balances at the year-end; **(5) audit planning** — planning **ideally commences at the conclusion of the previous year's audit** and the programme **should be reconsidered for modification as the audit progresses**, based on the review of internal control, the preliminary evaluation and the results of compliance and substantive procedures.

Understanding explain it, and place it in context • 2 questions

- Read whether the question asks about the audit programme or about the hospital's transactions. The written-programme answer and the thirteen-point answer are not interchangeable.

TQ 8.1 • PYQ 2021-Jul [4] (b) • 4M • Pg 585

LEVEL I
Understanding

Medium

CSQ 8.1 • MTP 2026-Apr S2 [3] (c) • 4M • Pg 590

LEVEL I
Understanding

Medium

Application use the Standard - apply it to the facts • 1 question

- Where the question gives five observations, answer observation by observation: name the head, state the procedure, state what the auditor does about it. Do not write the thirteen points as an undifferentiated list and hope the marker matches them up.
- Add the digital-collection sub-points wherever the facts mention online or card payments — MDR, settlement reports, chargebacks and interface controls are fresh material.

TQ 8.2 • PYQ 2019-Nov [6] (Or) (b) • 4M • Pg 587

LEVEL II
Application

Medium

Topic 9: Audit of Club

L2P5-C9-T09

Read first Read ICAI Study Material Chapter 9, Special Features of Audit of Different Types of Entities — Audit of a Club: verification of entrance fees, subscriptions including online collections, members' dues in arrear, and the club's own trading margins.

NOTES

The six special steps for the receipts of a club: (1) vouch the receipt on account of entrance fees with members' applications, the counterfoils issued to them, and by reference to the minutes of the Managing Committee; (2) vouch members' subscriptions with the counterfoils of receipts issued to them, trace receipts for a selected period to the Register of Members, and reconcile the amount of total subscriptions due with the amount collected and that outstanding; (3) ensure that arrears of subscriptions for the previous year have been correctly brought over and that arrears for the year under audit and subscriptions received in advance have been correctly adjusted; (4) check

the totals of the various columns of the Register of Members and tally them across; (5) see the Register of Members to ascertain the members' dues which are in arrear, enquire whether necessary steps have been taken for their recovery, and the amount considered irrecoverable should be mentioned in the Audit Report; (6) verify the internal check as regards members being charged with the price of foodstuffs and drinks provided to them and their guests, as well as with the fees chargeable for the special services rendered, such as billiards, tennis etc.

Online and digital subscription collection — the newest material in this topic: (i) vouch subscriptions received through UPI, internet banking, credit cards, debit cards, payment gateways and other electronic modes with bank statements, payment gateway settlement reports and the Register of Members; (ii) reconcile the subscriptions recorded in the Club Management System or membership software with the books of account and bank credits, investigating differences from pending settlements, failed transactions, refunds or chargebacks; (iii) verify that transaction charges deducted by banks or payment gateway service providers have been correctly accounted for and appropriately classified; (iv) where subscriptions are collected through an online membership portal or mobile application, ensure that all successful transactions have been credited to the respective members' accounts and that receipts have been generated for every collection; (v) examine whether adequate interface controls exist between the Club Management System, the online payment platform and the accounting system; (vi) review the controls over user access so that only authorised personnel can modify members' subscription records, reverse transactions or process refunds, and adequate audit trails are maintained.

Two short items the examiner sets as sub-parts. Irrecoverable member dues: check that the dues have been properly written off or provided against, and that the write-off is supported by approval of the managing committee or other competent authority under the club's rules. **Margins earned by the club:** vouch the purchases and sales of the club's supplies and compare the margin earned with the margin of earlier periods and with the club's own norms, investigating variations.

Cut-off deserves a separate line. A stay or a function that straddles the period end **must be apportioned**, and **advances received against future bookings are liabilities, not revenue**. This point repeats where the club has an attached hotel and it is worth stating explicitly whichever stream the question names.

Remembering reproduce what you have learnt · 1 question

- Give the **special points for a club** and nothing borrowed from another entity. Subscriptions, entrance fees, members' dues and facility receipts are the club's own heads.
- Where the question gives a receipts figure, say what it triggers before listing the points.

Application use the Standard - apply it to the facts · 1 question

- The arrears point has a reporting tail: amounts considered irrecoverable are to be mentioned in the audit report. An answer that stops at 'enquire into recovery' leaves that mark on the table.
- Where the club sells food, drink or special services, bring in the internal check on charging members and their guests, and compare margins with earlier periods.

CSQ 9.2 · PYQ 2026-Sep [5] (b) · 2M · Pg 596

LEVEL II
Application

Easy

Topic 10: Audit of Cinema

L2P5-C9-T10

Read first Read ICAI Study Material Chapter 9, Special Features of Audit of Different Types of Entities — Audit of a Cinema: verification of receipts from the sale of tickets, advertisement and restaurant income, and the controls over online booking and POS systems.

NOTES

The eleven classic steps for receipts from the sale of tickets, in order: (1) verify that entrance to the cinema hall during a show is only through printed tickets; (2) verify that the tickets are serially numbered and bound into books, and where bookings are made online, verify the system for online booking; (3) verify that the number of tickets issued for each show and each class is different, though the numbers of the same class for the show on the same day, each week, run serially; **(4) verify that for advance booking a separate series of tickets is issued;** (5) verify that the inventory of tickets is kept in the custody of a responsible official; (6) confirm that at the end of the show a statement of tickets sold is prepared and the cash collected is agreed with it; (7) verify that a record is kept of the 'free passes' and that these are issued under proper authority; (8) reconcile the amount of tax collected with the total number of tickets issued for each class, and vouch and verify the tax returns filed each month; (9) vouch the entries in the Cash Book in respect of cash collected on sale of tickets for different shows by reference to the Daily Statements which have been test checked against the record of tickets issued; (10) verify the charges collected for advertisement slides and shorts by reference to the Register of Slides and Shorts Exhibited kept at the cinema and the agreements entered into with advertisers; (11) enquire into the arrangement for collection of the share in the restaurant income — either a fixed sum or a fixed percentage of the taking may be receivable annually — and where the restaurant is run by the cinema itself, check its accounts, covering sale of various items of foodstuffs and purchase of foodstuffs, cold drinks etc., as in the case of a club.

The first five points are the internal control mechanism. When the question asks about verifying the internal control mechanism rather than the receipts, the answer is points (1) to (5) — printed tickets only, serially numbered and bound, different numbers for each show and class with the same class running serially week by week, a separate series for advance booking, and inventory of

tickets in the custody of a responsible official — followed by the digital block below.

The digital additions, which are new and therefore likely: (a) **controls over online ticket booking platforms** — evaluate the controls over tickets booked through the cinema's **website, mobile application and third-party booking platforms**, verify that ticket sales are **completely and accurately captured** in the accounting system from these platforms, verify **revenue sharing arrangements with online booking platforms**, and review cybersecurity and backup controls over the ticketing database and customer transaction records; (b) **reconciliation of digital collections** — reconcile ticket sales recorded in the booking system with collections received through **payment gateways, UPI, debit and credit cards, net banking and wallets**, verify settlement reports and identify **pending settlements, chargebacks or refunds**; (c) **QR code or barcode based admission controls** — review the controls over scanning at entry gates so that **each ticket is validated only once** and reports of scanned tickets are reconciled with tickets sold, investigating **duplicate scans, cancelled tickets or manual overrides**; (d) **convenience fees, promotional discounts and loyalty programmes** — examine the accounting treatment of convenience fees, booking charges, promotional discounts, cashback offers, coupon redemptions and loyalty reward points, and ensure revenue is recognised appropriately after considering contractual arrangements with third-party booking platforms; (e) **automated reports from ERP and POS systems** — where ticketing, food and beverage sales and accounting are integrated, verify the reliability of system-generated reports by testing **IT controls, interface controls and automated reconciliations**.

Learn the POS definition — it is short and definition-friendly: a **Point of Sale (POS) System** is a computerised system used for processing ticket sales and food and beverage transactions, generating invoices, accepting digital payments, updating inventory and producing sales reports.

Remembering reproduce what you have learnt • 1 question

- The ticket-numbering rule is the one students garble. Different numbers for each show and each class; the same class on the same day each week runs serially; advance booking has a separate series.

TQ 10.1 • MTP 2020-May [6] (b) • 4M • Pg 596

LEVEL I
Remembering

Medium

Application use the Standard - apply it to the facts • 1 question

- Read whether the question asks for receipts from sale of tickets or for the internal control mechanism. The internal control answer is the first five points plus the digital block; the receipts answer runs all eleven, ending with advertisement and restaurant income.

CSQ 10.1 • PYQ 2025-May [6] (b) • 5M • Pg 599

LEVEL II
Application

Medium

Topic 11: Audit of Hire Purchase and Leasing

L2P5-C9-T11

Read first Read ICAI Study Material Chapter 9, Special Features of Audit of Different Types of Entities — Audit of Hire Purchase and Leasing: the types of lease, examination of the lease agreement, verification of hire purchase transactions, and the accounting treatment and tax benefits of each kind of lease.

NOTES

Two types of lease, and the finance lease is defined by its attributes. As per **AS 19 / Ind AS 17**, lease agreements are of two types — **finance lease** and **operating lease**. An arrangement qualifies as a **finance lease** where: the lease agreement transfers ownership of the asset to the lessee at the end of the lease term; (1) the lessee has the option to purchase the asset at a price expected to be sufficiently lower than the fair value at the date the option becomes exercisable, for it to be reasonably certain at the inception of the lease that the option will be exercised; (2) the lease term is for the major part of the economic life of the asset even if title is not transferred; (3) at the inception of the lease, the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset; and (4) the leased assets are of such a specialised nature that only the lessee can use them without major modifications. An **operating lease** is an arrangement that does not transfer substantially all the risks and rewards incidental to ownership — in other words, **a lease arrangement other than a finance lease**. The pack records that AS 19 continues to apply to entities not following Ind AS, that Ind AS 17 has been replaced by Ind AS 116, and that under Ind AS 116 the finance/operating classification is retained only for lessor accounting, a lessee recognising a right-of-use asset and a lease liability for all leases other than short-term and low-value leases.

Accounting treatment and tax benefits from the lessee's side — the distinction the examiner returns to again and again. **Operating lease: generally treated like a renting arrangement** — lease payments are treated as operating expenses and the asset does not appear as an asset in the lessee's balance sheet; for tax, the lease payment is considered like an expense just as in the case of renting, and no depreciation can be claimed by the lessee. **Finance lease: treated like a loan arrangement** — asset ownership is considered to be that of the lessee and the asset appears on the lessee's balance sheet; for tax, the lessee can claim both interest and depreciation, as it is treated like a loan. The classic wrong answer says a lease is a lease — but the whole mark lies in which one it is and what that does to the balance sheet and to the deduction.

Applying the classification to facts — run the four tests in order and say which one is satisfied. Where a plant is taken for **11 years, approximately the estimated economic life of the asset**, it is a finance lease as per AS 19, since the lease term is for a major part of the economic life of the asset even if title is not transferred; the option to take ownership at the end rests with the lessee and **title may or may not be eventually transferred**. Where the facts give two leases side by side, compare the term with the life and say who bears insurance and maintenance: a **5-year lease on**

equipment with a 10-year economic life, with insurance and major maintenance borne by the lessor and alternative use available, is an **operating lease** — the pack's reasoning is that the lease term covers less than 75% of the asset's economic life, so it does not transfer most of the risks and rewards of ownership; an **8-year lease on specialised equipment with an 8-year economic life, with insurance and major maintenance borne by the lessee** and no alternative use, is a **finance lease** — the lessee uses the asset for almost its entire useful life and bears the risks and rewards of ownership. Then give the accounting treatment and the tax benefit for each separately.

The lease agreement — four points to note, and they come up in both a general and a finance-lease framing: (1) the description of the lessor, the lessee, the equipment and the location where the equipment is to be installed, including whether the agreement stipulates that the equipment shall not be removed from the described location except for repairs and whether the lessor requires **plates or markings to be attached to the equipment** for identification; (2) the amount and tenure of the lease, dates of payment, late charges, deposits or advances; (3) whether the equipment shall be returned to the lessor on termination of the agreement and whether the related cost shall be borne by the lessee; (4) whether the agreement prohibits the lessee from subletting the equipment and authorises the lessor to do so.

Hire purchase — the agreement must be in writing, and the five particulars are the marks. The auditor examines that **the hire purchase agreement is in writing and is signed by all parties**, and that it **specifies clearly**: (i) the hire-purchase price of the goods to which the agreement relates; (ii) the cash price of the goods, that is to say, the price at which the goods may be purchased by the hirer for cash; (iii) the date on which the agreement shall be deemed to have commenced; (iv) the number of instalments by which the hire-purchase price is to be paid, the amount of each instalment, the date or the mode of determining the date upon which it is payable, and the person to whom and the place where it is payable; and (v) the goods to which the agreement relates, in a manner sufficient to identify them. He must also **ensure that payments are being received regularly as per the agreement**.

Cut-off arrangement is set alongside this topic, so know it. Accounting is a continuous process because the business never comes to a halt, so transactions of one period must be separated from those in the ensuing period and the arrangement made for this purpose is technically known as the cut-off arrangement. It **essentially forms part of the internal control system of the organisation**, and because accounts other than sales, purchases and inventory are not usually affected by the continuity of the business, **it is generally applied only to sales, purchases and inventory**. The auditor satisfies himself by examination and test checks that goods purchased, property in which has already passed to the client, have in fact been included in the inventories and the liability provided for in case of credit purchase, and that goods sold have been excluded from the inventories and credit taken for the sales, the concerned party being debited where the value is receivable. He may examine a sample of documents evidencing the movement of inventory into and out of stores, including documents pertaining to the period shortly before and after the cut-off date.

Remembering reproduce what you have learnt · 2 questions

- The ask is a **definition and classification of leases**. Name each type and give the test that puts a lease in it, citing the Standard the answer cites.
- Where the question asks for the points in a lease or hire purchase agreement, answer with the agreement's particulars, not with audit procedures.

TQ 11.1 · PYQ 2019-May [6] (b) · 4M · Pg 601

LEVEL I
Remembering**Medium**

TQ 11.2 · MTP 2023-Sep [6] (c) · 4M · Pg 602

LEVEL I
Remembering**Medium****Understanding** explain it, and place it in context · 1 question

- Give the four finance-lease attributes as a list, then define an operating lease as everything else. An answer that only describes an operating lease has not earned the classification mark.

TQ 11.4 · RTP 2024-May [21] · Pg 604

LEVEL I
Understanding**Medium****Application** use the Standard - apply it to the facts · 3 questions

- Classify first, then treat. State which attribute the facts satisfy — lease term versus economic life, who bears insurance and maintenance — before you touch accounting or tax.
- Where two leases are given, answer them one at a time under separate headings with their own conclusion. A merged answer loses the comparison marks.

CSQ 11.1 · PYQ 2024-May [6] (d) · 3M · Pg 605

LEVEL II
Application**Easy**

CSQ 11.2 · PYQ 2024-Sep [6] (d) · 3M · Pg 606

LEVEL II
Application**Easy**

TQ 11.3 · RTP 2023-Nov [20] · Pg 603

LEVEL II
Application**Medium****Analysis** break it down and take the parts separately · 1 question

- Ownership status, accounting treatment and tax benefit are three separate asks in one question. Head them separately; the marker is looking for three answers, not one paragraph.

CSQ 11.3 · PYQ 2026-May [5] (b) · 5M · Pg 606

LEVEL II
Analysis**Medium****Topic 12: Audit of Hotels**

L2P5-C9-T12

Read first Read ICAI Study Material Chapter 9, Special Features of Audit of Different Types of

Entities — Audit of Hotels: internal control and pilferage, verification of revenue and taxes, food and beverage inventories, online bookings and OTA reconciliation, and room and hall revenue.

NOTES

Pilfering is the organising idea of this topic, so open with it. Pilfering is one of the greatest problems in any hotel and the importance of internal control cannot be undermined. It is the responsibility of management to introduce controls which will minimise the leakage as far as possible. Evidence of their success is provided by the preparation of regular — perhaps weekly — trading accounts for each sales point and a detailed scrutiny of the resulting profit percentages, with any deviation from the anticipated form being investigated. The auditor should obtain these regular trading accounts for the period under review, examine them and obtain explanations for any apparent deviations. He should verify a few restaurant bills by reference to K.O.T.s (Kitchen Order Tickets) or basic records, which enables him to ensure that **controls regarding the revenue cycle are in order**. He should also satisfy himself that all taxes collected from occupants on food and occupation have been paid over to the proper authorities within the prescribed time and that **the returns filed reconcile with the revenue recorded in the books**, so as to avoid **interest, penalty and other legal and financial exposure**. Hotels collect principally Goods and Services Tax (GST), together with any State or local levies on occupancy that may apply.

What happens when internal control breaks down — the examiner wants this consequence spelled out. If the internal control in a hotel is weak or perhaps breaks down, then a very serious problem exists for the auditor. Because of **the transient nature of many of his clients' records** — short stays, cash dealings, multiple service points — the auditor must rely to a very large extent on the gross margin shown by the accounts. **The scope of his audit tests will necessarily be increased**, and in the event of a material margin discrepancy being unexplained, he will have to consider qualifying his audit report. An answer that stops at 'increase the tests' and never reaches the qualification has left the last mark behind.

Inventories — portable, saleable, and therefore controlled by documentation and by lock. The inventories in any hotel are both readily portable and saleable, particularly the food and beverage inventories. **All movements and transfers of such inventories should be properly documented** to enable control over each individual stores area and sales point, and the auditor should carry out tests to ensure that all such documentation is accurately processed. Areas where large quantities of inventory are held should be kept locked, the key being retained by the departmental manager; **the key should be released only to trusted personnel** and unauthorised persons should not be permitted in the stores areas except under constant supervision, with **any movement of goods in or out of the stores checked**. Many hotels use specialised professional valuers to take and value the inventories on a continuous basis throughout the year, and such a valuation is then almost invariably used as the basis of the balance sheet inventory figure at the year end. Although the valuers are independent of the audit client, **the auditor must satisfy himself that the amounts included are reasonable** — by considering attending the physical inventory taking and carrying out certain pricing and calculation tests, the extent of which could well be limited since the figures will

have been prepared independently of the hotel.

Online bookings and OTAs — new material, four sub-points, learn them as a set: (i)

Completeness of booking revenue — verify that all confirmed bookings received through the hotel's website, mobile application and third-party platforms are **automatically recorded in the Property Management System (PMS)** and completely accounted for, reconciling **reservation reports, PMS records and revenue recognised**; **(ii) Reconciliation with Online Travel Agencies (OTAs)** — reconcile amounts receivable from OTAs with the statements received from them and examine deductions towards **commission, promotional discounts, cancellation charges and taxes** against the contractual terms; **(iii) Advance receipts and deferred revenue** — verify advances against future reservations with **booking confirmations and bank records**, ensure they are recognised as revenue only when the accommodation or related services have actually been provided, and that unearned revenue outstanding at the balance sheet date has been appropriately disclosed; **(iv) Cancellations, refunds and no-show charges** — examine the system of recording them, ensure refunds are **duly authorised, correctly processed and supported by appropriate documentation**. Definition worth a mark: no-show charges are charges recovered by a hotel when a guest makes a confirmed reservation but fails to arrive and does not cancel the booking.

Room sales and hall bookings, where the question names them as separate items. For **room sales**, verify the occupancy from the room register or the property management system against the bills raised, and test that the tariff applied agrees to the approved tariff card, including the treatment of discounts and complimentary stays, which should be authorised. For **hall bookings**, examine the booking register and the agreements or confirmations with customers, trace advances received to the bookings, and check that revenue is recognised for the period in which the facility was actually provided. Cut-off deserves a separate line for both streams: a stay or a function that straddles the period end must be apportioned, and advances against future bookings are liabilities, not revenue.

Understanding explain it, and place it in context · 4 questions

- Name K.O.T.s in full — Kitchen Order Tickets — and say what checking a bill against one proves: that the revenue cycle controls are in order.

TQ 12.1 · MQ · Pg 608	LEVEL I Understanding	Medium
TQ 12.2 · RTP 2022-May [28] (a) · Pg 610	LEVEL I Understanding	Medium
TQ 12.3 · MTP 2022-Sep [5] (c) (ii) · 4M · Pg 611	LEVEL I Understanding	Medium
TQ 12.4 · RTP 2022-Nov [28] (a) · Pg 612	LEVEL I Understanding	Medium

Application use the Standard - apply it to the facts · 1 question

- Where the facts show weak controls, run the chain: reliance on gross margin, increased scope of tests, and a qualified report if a material margin discrepancy stays unexplained.
- Where the facts mention OTAs or online bookings, use the four sub-points and define no-show charges. That definition is the newest line in the topic.

CSQ 12.1 · PYQ 2026-Sep [5] (b) (iii) · 3M · Pg 613

LEVEL II
Application

Easy

Topic 13: Audit of Co-Operative Societies

L2P5-C9-T13

Read first Read ICAI Study Material Chapter 9, Special Features of Audit of Different Types of Entities — Audit of Co-operative Societies: qualifications and appointment of auditors, restrictions on shareholding, borrowing and investment under the Central Act, books and registers, the special features of co-operative audit, inspection and special audit under the Multi-State Co-operative Societies Act, 2002.

NOTES

Who may audit — and this is where the two statutes part company. Under **section 72 of the Multi-State Co-operative Societies Act, 2002**, only a person who is a Chartered Accountant within the meaning of the Chartered Accountants Act, 1949 can be appointed as auditor of a Multi-State co-operative society, and the following are **not eligible**: (1) a body corporate; (2) an officer or employee of the Multi-State co-operative society; (3) a person who is a member of, or who is in the employment of, an officer or employee of the society; (4) a person who is indebted to the society, or who has given any guarantee or provided any security in connection with the indebtedness of any third person to the society, for an amount exceeding one thousand rupees. If an auditor becomes subject to any of these disqualifications after his appointment, he shall be deemed to have vacated his office. But for an ordinary society, apart from a Chartered Accountant, some of the State Co-operative Acts have permitted persons holding a government diploma in co-operative accounts or in co-operation and accountancy, and also a person who has served as an auditor in the co-operative department of a government, to act as an auditor; and under section 17 of the Co-operative Societies Act, 1912 the audit is to be conducted by the Registrar of Co-operative Societies or by a person authorised by him, that auditor conducting the audit on behalf of the Registrar and submitting his report to him as also to the society. **The trap:** a non-Chartered Accountant who has served in the co-operative department of a government **can validly be the statutory auditor of an ordinary co-operative society** — but a Chartered Accountant who is a senior manager of a Multi-State society is an officer of it and cannot be its auditor under section 72.

Appointment of auditors under section 70 of the Multi-State Co-operative Societies Act, 2002 — the periods are the marks. The first auditor or auditors shall be appointed by the board within one

month of the date of registration of the society, and shall hold office until the conclusion of the first annual general meeting; if the board fails to exercise this power, the society in general meeting may appoint the first auditor or auditors. The subsequent auditor or auditors are appointed by the society at each annual general meeting, and hold office from the conclusion of that meeting until the conclusion of the next annual general meeting.

Three restrictions under the Central Act, each with its own number. Section 5 — shareholding:

where the liability of a member is limited, no member of a society other than a registered society can hold such portion of the share capital of the society as would exceed a maximum of twenty per cent of the total number of shares, or a value of shareholding of ₹1,000. So on a society of 1,000 shares of ₹10 each, a member may hold **a maximum of 100 shares**, and a holding of 200 shares is in breach. **Section 30 — borrowing:** a registered society shall accept loans and deposits from persons who are not members subject to the restrictions and limits of the bye-laws of the society — **so the auditor must examine the bye-laws**, and where the bye-laws contain no restriction, a loan from a non-member is permissible. **Section 32 — investment of funds:** a society may invest its funds in (i) a Central or State Co-operative Bank; (ii) any securities specified in section 20 of the Indian Trusts Act, 1882; (iii) the shares, securities, bonds or debentures of any other society with limited liability; (iv) any co-operative bank other than a Central or State Co-operative Bank, as approved by the Registrar on specified terms and conditions; (v) any other moneys permitted by the Central or State Government. Blue-chip mutual funds are not on that list, so investing idle funds in them is not permissible however handsome the return — which is why the auditor qualifies his opinion. A profitable breach is still a breach; say so.

Three features of co-operative audit the examiner asks by name. Audit classification of society:

after a judgement of the overall performance of the society, the auditor has to award a class to the society, **based on the criteria specified by the Registrar**; if the management is not satisfied with the award of audit class, it can appeal to the Registrar, and the Registrar may direct a review of the audit classification, so the auditor must be very careful in making the decision. **Discussion of the draft audit report with the managing committee:** on conclusion of the audit, the auditor should ask the Secretary of the society to convene a managing committee meeting to discuss the draft audit report; the audit report should never be finalised without discussion with the managing committee; minor irregularities may be got settled and rectified, and matters of policy should be discussed in detail. **Special report to the Registrar:** where the auditor notices serious irregularities in the working of the society he may report these special matters to the Registrar, who on receipt of such a special report may take necessary action against the society. A special report may become necessary in the case of: (1) personal profiteering by members of the managing committee; (2) detection of fraud; (3) specific examples of mismanagement, including decisions of management against co-operative principles; (4) in the case of urban co-operative banks, disproportionate advances to vested interest groups; (5) reckless advancing without judging the creditworthiness of the party.

Inspection under section 79 of the Multi-State Co-operative Societies Act, 2002 — who can ask, how much notice, and how long for the report. **When:** the Central Registrar may act on a request

from (a) a federal co-operative to which a Multi-State co-operative society is affiliated, or a creditor; or (b) not less than one-third of the members of the board; or (c) not less than one-fifth of the total number of members of the society. **How: by general or special order in writing,** inspect, or direct any person authorised by him by order in writing, to make an inspection into the constitution, working and financial condition of the society. **Opportunity of being heard:** no inspection shall be made unless a notice of not less than fifteen days has been given to the society. **Powers:** the Central Registrar or his authorised person shall at all times have access to all books, accounts, papers, vouchers, securities, stock and other property of the society, may in the event of serious irregularities discovered during inspection take them into custody, has power to **verify the cash balance** and, subject to the general or special order of the Central Registrar, to call a meeting of the society where such general meeting is in his opinion necessary; and every officer or member shall furnish such information with regard to the working of the society as may be required. **Inspection report:** a copy shall be communicated to the society within a period of three months from the date of completion of the inspection.

Special audit under section 77 — the shareholding gate first, then the three grounds. The Central Government shall order a special audit only if that Government or the State Government, either by itself or both together, hold fifty-one per cent or more of the paid-up share capital in the Multi-State co-operative society. It may then direct a special audit where it is of the opinion (a) that the affairs of the society are not being managed in accordance with self-help and mutual aid and co-operative principles, or prudent commercial practices, or with sound business principles; or (b) that the society is being managed in a manner likely to cause serious injury or damage to the interests of the trade, industry or business to which it pertains; or (c) that the financial position of the society is such as to endanger its solvency; and may appoint a Chartered Accountant or such other qualified person as may be prescribed to conduct such audit. Map the facts to the clauses: unsecured advances to related parties and ignored internal audit reports go to **(a)** — deviation from prudent commercial practices; complaints of market distortion go to **(b)**; abnormal borrowing, cash-flow mismatch and short-term funds used for long-term projects go to **(c)** — solvency.

Books and registers — the main books are not enough for a large society. In Maharashtra, co-operative societies must maintain books of account in terms of the Registrar's instructions covering (1) all sums of money received and expended by the society and the matters in respect of which receipts and expenditure take place; (2) all sales and purchases of goods by the society; (3) assets and liabilities of the society. The statutory or mandatory provisions provide a directive but they are not conclusive — the society is at liberty to maintain such additional records as it thinks more useful for clarity and detailed explanation. In a large co-operative organisation, different subsidiary books and registers shall be maintained and the daily summary totals transferred to the main Cash Book: (a) daily cash sales summary register; (b) a register of collection from debtors, if credit sales are allowed by the bye-laws; (c) a register of recovery of loans from salaries and directly by receipts from members, in the case of a credit society; (d) loan disbursement register in the case of a credit society; (e) any other columnar subsidiaries depending upon the nature and functions of the society. So the contention that the Cash Book and General Ledger alone suffice is

incorrect.

Remembering reproduce what you have learnt • 1 question

- Tag each rule with its section: 72 qualification, 70 appointment, 5 shareholding, 30 borrowing, 32 investment, 77 special audit, 79 inspection, and section 17 of the 1912 Act for audit by the Registrar. The section number is a mark in itself.

TQ 13.4 • PYQ 2024-Sep [4] (d) • 3M • Pg 617

LEVEL I
Remembering

Easy

Understanding explain it, and place it in context • 3 questions

- Keep the Multi-State Co-operative Societies Act, 2002 and the Co-operative Societies Act, 1912 apart. Only a Chartered Accountant may audit a Multi-State society; the older Act and some State Acts allow others.

CSQ 13.2 • PYQ 2019-May [6] (c) • 3M • Pg 619

LEVEL I
Understanding

Easy

TQ 13.1 • PYQ 2018-Nov [6] (b) • 5M • Pg 614

LEVEL I
Understanding

Medium

TQ 13.3 • RTP 2022-May [28] (b) • Pg 616

LEVEL I
Understanding

Medium

Application use the Standard - apply it to the facts • 5 questions

- On an eligibility question, state the rule from section 72, then list the disqualifications that bear on the facts, then conclude in one sentence that the appointment is or is not valid. The conclusion is separately marked.
- On a section 77 scenario, check the 51% shareholding gate first, then take each ground in turn and say which fact satisfies it, then conclude that invocation is justified.

CSQ 13.1 • PYQ 2018-May [6] (b) • 5M • Pg 617

LEVEL II
Application

Medium

CSQ 13.4 • MTP 2024-Dec S2 [3] (b) • 5M • Pg 620

LEVEL II
Application

Medium

CSQ 13.5 • PYQ 2025-Jan [5] (c) • 4M • Pg 621

LEVEL II
Application

Medium

CSQ 13.6 • MTP 2025-Nov S1 [5] (a) • 5M • Pg 622

LEVEL II
Application

Medium

CSQ 13.8 • PYQ 2026-May [6] (c) • 4M • Pg 625

LEVEL II
Application

Medium

Analysis break it down and take the parts separately • 3 questions

- Where several transactions are given — a shareholding, a loan from a non-member, an investment — take them one at a time under the relevant section and give each its own conclusion. A merged answer loses marks item by item.

TQ 13.2 • PYQ 2020-Nov [6] (b) (i) (1) • 4M • Pg 615	LEVEL II Analysis	Medium
CSQ 13.3 • PYQ 2023-May [5] (Or) (b) • 4M • Pg 620	LEVEL II Analysis	Medium
CSQ 13.7 • MTP 2026-Mar S1 [3] (c) • 4M • Pg 623	LEVEL II Analysis	Medium

Topic 14: Audit of Trusts & Societies

L2P5-C9-T14

CONCEPT BASE — no exam question asked yet • essential for full preparation

Read first Read ICAI Study Material Chapter 9, Special Features of Audit of Different Types of Entities — Audit of Trusts and Societies.

NOTES

No question has been printed on this topic in the Scanner — no past paper, RTP, MTP or model question. It is carried as a concept-base topic, so read the Study Material's own treatment of trusts and societies directly.

What the pack does put in your hands, from the neighbouring topics. The **Societies Registration Act, 1860** is named in the NGO planning answer as one of the statutes whose recent amendments, circulars and judicial decisions the auditor must keep current on, alongside the **Foreign Contribution (Regulation) Act, 2010** and the **Income Tax Act, 1961**; and the auditor is to review the legal form of the organisation and its Memorandum of Association, Articles of Association, Rules and Regulations. The charitable institution answers are set on a **Public Charitable Trust** and give the procedures for **subscriptions and donations** and for **expenditure**, including that grants are paid only for a charitable purpose falling within the objects for which the institution was set up and that no trustee, director or member of the Managing Committee has benefited directly or indirectly. The hospital answers add that capital expenditure requires the prior sanction of the Trustees or the Managing Committee and that **significant budget variations are reported to the Trustees**.

Do not invent a statute. If a trusts-and-societies question appears, build the answer on the trust deed or the rules and regulations of the society, the purpose test for the application of funds, and the sanction of the trustees — and quote a statute only where the Study Material names one for

this entity.

CHAPTER 10

Audit of Banks

10 Topics · 44 Classified Questions · Importance: C

ICAI SKILL PROFILE ICAI band for this paper: Level I 40-60% · Level II 40-60% — this chapter reads **problems first**

Level I — Comprehension & Knowledge **38.8%** 69 of 178 marks

Level II — Analysis & Application **61.2%** 109 of 178 marks

Below the paper's Level I floor: only 39% of this chapter's marks are Comprehension and Knowledge, against ICAI's 40-60% for the paper. There is little theory to fall back on — nearly every mark here is earned by working the problem, so preparation is practice, not reading.

Topic 1: Introduction

L2P5-C10-T01

Read first Read ICAI Study Material Chapter 10, Audit of Banks — the introduction: the types of banking institutions in India and the reports the Statutory Central Auditors furnish in addition to the main audit report.

NOTES

Six types of banking institution, and the examiner wants an example with each: (1) **Commercial banks** — the most widespread banking institutions in India, providing a number of products and services to the general public and other segments of the economy, their **two main functions being (a) accepting deposits and (b) granting advances**; (2) **Regional Rural Banks (RRBs)** — set up in rural areas in different states to cater to the basic banking and financial needs of the rural communities, for example Punjab Gramin Bank, Tripura Gramin Bank, Allahabad UP Gramin Bank, Andhra Pradesh Grameen Vikas Bank; (3) **Co-operative banks** — they function like commercial banks but are set up on the basis of co-operative principles and registered under the Co-operative Societies Act of the respective State or the Multi-State Co-operative Societies Act, usually catering to the **agricultural and rural sectors**, for example **The Gujarat State Co-operative Bank Ltd.**; (4) **Payments banks** — a new type of bank recently introduced by RBI, allowed to accept restricted deposits but they cannot issue loans and credit cards, though customers can open **current and savings accounts** and use **ATM-cum-debit cards, internet banking and mobile banking**, for example **Airtel Payments Bank, India Post Payments Bank, Paytm Payments Bank**; (5) **Development banks** — more commonly known as **term-lending institutions**, conceptualised to provide funds for infrastructural facilities important for the economic growth of the country, for example **IFCI, IDBI, SIDBI**; (6) **Small finance banks** — set up by RBI to make available basic financial and banking facilities to the unserved and unorganised sectors like small and marginal farmers and small and micro business units, for example **Equitas Small Finance Bank, AU Small Finance Bank**.

The eight reports a Statutory Central Auditor must furnish in addition to the main audit report — a list question, so name all eight: (1) a report on the adequacy and operating effectiveness of Internal Controls over Financial Reporting in the case of banks registered as companies under the Companies Act, **in terms of section 143(3)(i) of the Companies Act, 2013**, normally given as an **Annexure to the main audit report** as per the Guidance Note on Audit of Internal Financial Controls over Financial Reporting issued by the ICAI; **(2) the Long Form Audit Report (LFAR)**; **(3) a report on compliance with SLR requirements**; (4) a report on whether the treasury operations of the bank have been conducted in accordance with the instructions issued by the RBI from time to time; (5) a report on whether income recognition, asset classification and provisioning have been made as per the RBI guidelines issued from time to time; (6) a report on whether any serious irregularity was noticed in the working of the bank which requires immediate attention; (7) a report on the status of compliance with the implementation of the recommendations of the Ghosh Committee relating to frauds and malpractices and of the recommendations of the Jilani Committee on internal control and inspection/credit system; **(8) a report on instances of adverse credit-deposit ratio in the rural areas.**

Learn the two committee names together — they are the detail that separates a full answer from a partial one. Ghosh Committee — frauds and malpractices; Jilani Committee — internal control and inspection/credit system. They appear in a single item of the list, so an answer that gives one and not the other has given half an item.

The LFAR is a separate report, not part of the main audit report. It appears at two points in this chapter: as item (2) of the additional reports the Statutory Central Auditors furnish, and at the end of an operating-expenses answer, where any material weakness in internal controls or unexplained abnormal trends may require appropriate reporting in the audit report or Long Form Audit Report (LFAR), as applicable to banks. Where a question asks what you would do with an unresolved control weakness, that sentence is the closing line.

Understanding explain it, and place it in context · 2 questions

- Payments banks are defined by what they cannot do — no loans, no credit cards — as much as by what they can. Say both limbs.

TQ 1.1 · MTP 2021-Mar [6] (d) · 4M · Pg 630

LEVEL I
Understanding

Medium

TQ 1.2 · RTP 2021-May [26] · Pg 632

LEVEL I
Understanding

Medium

Topic 2: Bank Audit Approach

L2P5-C10-T02

Read first Read ICAI Study Material Chapter 10, Audit of Banks — the bank audit approach: the engagement team discussion at the planning stage and its advantages.

NOTES

The rule in one line: the discussion between the members of the engagement team and the audit engagement partner should be on the susceptibility of the bank's financial statements to material misstatement. That sentence opens the answer; the six points follow it.

The six points ordinarily included in the engagement team discussion: (1) errors that may be more likely to occur; (2) errors which have been identified in prior years; (3) methods by which fraud might be perpetrated by bank personnel or others within particular account balances and/or disclosures; (4) audit responses to Engagement Risk, Pervasive Risks and Specific Risks; (5) the need to maintain professional scepticism throughout the audit engagement; (6) the need to be alert for information or other conditions that indicate that a material misstatement may have occurred — for example, the bank's application of accounting policies in the given facts and circumstances.

The three advantages of holding that discussion at the planning stage — a separate question, with a separate answer: (1) specific emphasis is given to the susceptibility of the bank's financial statements to material misstatement due to fraud, which enables the engagement team to consider an appropriate response to fraud risks, including those related to engagement risk, pervasive risks and specific risks; (2) it enables the audit engagement partner to delegate the work to the experienced engagement team members and to determine the procedures to be followed when fraud is identified; (3) the audit engagement partner may review the need to involve specialists to address issues relating to fraud.

The trap here is answering the wrong question. 'Points ordinarily included in the discussion' calls for the six; 'advantages of the discussion' calls for the three. The three risks — **engagement risk, pervasive risks and specific risks** — appear in both, so quoting them does not by itself show which question you are answering. Read the verb before you write.

Understanding explain it, and place it in context · 2 questions

- Open with the susceptibility sentence. An answer that lists points without saying what the discussion is about loses the framing mark.
- Keep the six points and the three advantages in separate mental lists; the examiner has set both.

TQ 2.1 · PYQ 2019-Nov [6] (c) · 3M · Pg 633

LEVEL I
Understanding

Easy

TQ 2.2 · PYQ 2021-Jul [6] (d) · 3M · Pg 634

LEVEL I
Understanding

Easy

Topic 3: Appointment of Auditor

L2P5-C10-T03

CONCEPT BASE — no exam question asked yet · essential for full preparation

Read first Read ICAI Study Material Chapter 10, Audit of Banks — appointment of the auditor of a bank.

NOTES

No question has been printed on this topic in the Scanner — no past paper, RTP, MTP or model question. It is carried as a concept-base topic, so read the Study Material's own treatment of the appointment of bank auditors directly rather than working from notes.

What the pack does give you about the auditors themselves. It uses the term **Statutory Central Auditors (SCAs)** for the auditors of the bank as a whole and **statutory branch auditor** for those allotted branches, and it records that the SCAs must furnish **eight reports in addition to their main audit report**, beginning with the report on internal financial controls under **section 143(3)(i) of the Companies Act, 2013** for banks registered as companies, and including the **Long Form Audit Report**. Those two designations are the ones the case scenarios use, so use them correctly.

Do not import the appointment rules of another entity. The C&AG's appointment power under section 139(5) belongs to government companies and the Registrar's power belongs to co-operative societies; neither answers a question on bank auditors. If a question on appointment appears, answer it from the Study Material's own text.

Topic 4: Auditor's Report

L2P5-C10-T04

Read first Read ICAI Study Material Chapter 10, Audit of Banks — the auditor's report, and in particular reporting an account that has become 'out of order'.

NOTES

The definition you must reproduce before you touch the figures — an account should be treated as 'out of order' if: (1) the outstanding balance remains continuously in excess of the sanctioned limit or drawing power; or (2) the outstanding balance in the principal operating account is less than the sanctioned limit or drawing power, but there are no credits continuously for 90 days as on the date of the Balance Sheet; or (3) credits are there but are not enough to cover the interest debited during the same period. **Three limbs, and any one of them is enough.**

How the printed answer applies it — take the limbs in order and say which is attracted. On a cash credit facility of **₹1 crore** with drawing power of **₹80 lakh** and an outstanding balance of **₹75 lakh**, the balance is **within the drawing power, so the first limb is not attracted**. But where total credits into the account for the quarter are only ₹2.5 lakh against interest of ₹3.5 lakh debited, the credits are not sufficient to cover the interest debited and the third limb is attracted. Conclusion: the account is 'out of order', and the auditor should report the cash credit account as a non-

performing asset.

The conclusion is a separate mark, so write it as a separate sentence. Out of order first, NPA second. An answer that shows the arithmetic and stops has done the work without collecting the mark for the reporting consequence.

The classic wrong answer is to say the account is regular because the balance is within the sanctioned limit. The sanctioned limit is not the test on its own; the balance must also be within the **drawing power**, and even a balance within drawing power fails if **there are no credits for 90 days** or if **credits do not cover the interest debited**.

Application use the Standard - apply it to the facts · 1 question

- State the three-limb definition in full before applying it. The definition carries marks independently of the conclusion.
- Take the limbs in the order given, say expressly which are not attracted and which is, then conclude 'out of order' and then 'NPA'.

CSQ 4.1 · PYQ 2021-Jul [6] (a) · 4M · Pg 634

LEVEL II
Application

Medium

Topic 5: Conducting an Audit

L2P5-C10-T05

Read first Read ICAI Study Material Chapter 10, Audit of Banks — conducting an audit: the requirements of an effective risk management system in a bank and assessing the risk of fraud including money laundering under SA 240.

NOTES

An effective risk management system in a bank — five heads, each with a title the examiner ticks: (1) Oversight and involvement in the control process by those charged with governance — those charged with governance (the Board of Directors or Chief Executive Officer) should approve written risk management policies, and the policies should be consistent with the bank's business objectives and strategies, capital strength, management expertise, regulatory requirements and the types and amounts of risk it regards as acceptable; (2) **Identification, measurement and monitoring of risks** — risks that could significantly impact the achievement of the bank's goals should be **identified, measured and monitored against pre-approved limits and criteria**; (3) **Control activities** — appropriate controls to manage risks, including effective segregation of duties (particularly between front and back offices), accurate measurement and reporting of positions, verification and approval of transactions, reconciliation of positions and results, setting of limits, reporting and approval of exceptions, physical security and contingency planning; (4) **Monitoring activities** — the risk management models, methodologies and assumptions used to measure and

manage risk should be regularly assessed and updated, a function which **may be conducted by the independent risk management unit**; (5) **Reliable information systems** — banks require information systems that provide adequate financial, operational and compliance information on a timely and consistent basis, and those charged with governance and management need risk management information that is easily understood and that enables them to assess the changing nature of the bank's risk profile.

Fraud and money laundering — name the Standard and then the RBI guidelines. Under SA 240, 'The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements', the auditor's objective is to identify and assess the risks of material misstatement in the financial statements due to fraud, to obtain sufficient appropriate audit evidence on those identified misstatements and to respond appropriately. The attitude of professional scepticism should be maintained so as to recognise the possibility of misstatements due to fraud. Then add the banking layer: the RBI has framed specific guidelines dealing with prevention of money laundering and 'Know Your Customer (KYC)' norms, and has issued from time to time the 'Know Your Customer Guidelines – Anti Money Laundering Standards', requiring banks to establish policies, procedures and controls to deter and to recognise and report money laundering activities.

Segregation of front office from back office is the control the examiner looks for by name in the control activities head. A generic sentence about segregation of duties does not carry it; say front office and back office.

An answer on fraud risk in a bank that never leaves SA 240 is incomplete. The marks are split between the Standard's objective plus professional scepticism, and the RBI's KYC and anti-money-laundering guidelines. Give both halves.

Understanding explain it, and place it in context · 1 question

- Quote SA 240 by its full title. The number alone is worth less than the number with the title.

TQ 5.1 · PYQ 2019-May [6] (Or) (b) · 4M · Pg 635

LEVEL I
Understanding

Medium

Application use the Standard - apply it to the facts · 1 question

- Where the facts describe a manager designing controls, answer with the five heads and attach each to what the facts show; do not write a general essay on risk.

TQ 5.2 · PYQ 2021-Jan [3] (c) · 3M · Pg 637

LEVEL II
Application

Easy

Topic 6: Advances

L2P5-C10-T06

Read first Read ICAI Study Material Chapter 10, Audit of Banks — Advances: the nature of securities

and modes of creating them, funded loans, the RBI prudential norms on income recognition and asset classification, the provisioning table, and the special cases of agricultural, government guaranteed, staff and consortium advances.

NOTES

Securities — the two kinds, then the list. Primary security is the security offered by the borrower for bank finance, or the one against which credit has been extended by the bank; **it is the principal security for an advance.** Collateral security is an additional security, and security can be in any form — tangible or intangible asset, movable or immovable asset. The most common types accepted by banks are (a) personal security of guarantor; (b) goods, stocks, debtors and trade receivables; (c) gold ornaments and bullion; (d) immovable property; (e) plantations, for agricultural advances; (f) third party guarantees; (g) banker's general lien; (h) life insurance policies; (i) stock exchange securities and other instruments. **Two modes of creating security are asked by name.** Pledge involves bailment or delivery of goods by the borrower to the lending bank with the intention of creating a charge thereon as security for the advance; the legal ownership of the goods remains with the pledger while the lending banker gets certain defined interests in the goods, and **the pledge of goods constitutes a specific (or fixed) charge.** Set-off is a statutory right of a creditor to adjust, wholly or partly, the debit balance in the debtor's account against any credit balance lying in another account of the debtor; it lets a bank combine a deposit account and a loan account of the same person provided both accounts are in the same name and same right; for the purpose of set-off, all the branches of a bank are treated as one single entity; and **the right of set-off can be exercised in respect of time-barred debts also.** Funded loans are those loans where there is an actual transfer of funds from the bank to the borrower, comprising term loans; cash credits, overdrafts and demand loans; bills discounted and purchased; participation on risk sharing basis; and interest-bearing staff loans.

The provisioning table — the single most examined item in the chapter. Reproduce it as a table. **Substandard asset** — one which **has remained NPA for a period less than or equal to 12 months** — 15% of the outstanding. **Doubtful asset** — one which **has remained in the substandard category for a period of 12 months** — provided as **secured portion + unsecured portion: D1, doubtful up to 1 year — 25% + 100%; D2, doubtful 1 to 3 years — 40% + 100%; D3, doubtful more than 3 years — 100% + 100%.** **Loss asset** — one where loss has been identified by the bank or by internal or external auditors or by RBI inspection but the amount has not been written off wholly — 100%. The statement 'there is no difference in provisioning whether the debt is secured or unsecured' is wrong, and the reason is the point of the question: classification as NPA is based on the record of recovery, and the availability of security or the net worth of the borrower or guarantor is not to be taken into account for treating an advance as NPA or otherwise — **but security is very relevant to the amount of provision on a doubtful asset**, where the unsecured portion attracts 100% and the secured portion attracts the prescribed rate depending on how long the asset has been doubtful. Add that asset classification is borrower-wise and not facility-wise,

and all facilities including investments in securities would be termed as NPA.

Working the provisioning arithmetic — the examiner sets it as a table of accounts to correct. Take each account, split the outstanding into secured and unsecured, apply the rate for its category, and say whether the branch's provision is right or wrong and by how much. So: a **D1 account of ₹10 lakh, fully secured, needs 25% = ₹2.50 lakh, not ₹5 lakh**; a substandard account of ₹50 lakh needs 15% = ₹7.50 lakh, so ₹7.50 lakh provided is correct; a **D2 account of ₹30 lakh, fully secured, needs 40% = ₹12 lakh, not ₹30 lakh**; a **loss asset of ₹1 lakh needs 100% = ₹1 lakh, so the provision is correct**. Where the account is only partly secured, split it first: on a **D1 term loan with ₹50 lakh outstanding and security of ₹40 lakh, the unsecured portion is ₹10 lakh**, so the provision is 25% of ₹40 lakh = ₹10 lakh plus 100% of ₹10 lakh = ₹20 lakh, a required provision of ₹20 lakh, and a provision of ₹7.50 lakh is not proper.

Erosion in the value of security — two percentages, and they decide the classification, not just the provision. Where there are potential threats for recovery on account of erosion in the value of security or non-availability of security and the existence of other factors, it is not prudent that such accounts should go through the various stages of asset classification; in such cases of serious credit impairment the asset should be straightaway classified as doubtful or loss asset, as appropriate. **(a) Erosion of more than 50%** — where the realisable value of the security is less than 50% of the value assessed by the bank or accepted by the RBI inspection team at the time of the last inspection, the erosion is 'significant', and the asset is **classified as doubtful straightaway and provided for adequately**. **(b) Realisable value less than 10%** — where the realisable value of security as assessed by banks, approved valuers or the RBI is less than 10% of the outstanding in the borrowal account, the existence of the security should be ignored and the asset should be straightaway classified as a loss asset, to be **either written off or fully provided for**. Apply it: security worth **₹0.8 crore against ₹6 crore assessed at the last inspection** is significant erosion and the account goes **straight to doubtful**; security worth **₹0.4 crore against an outstanding of ₹5 crore**, or **₹6 lakh against ₹65 lakh**, is below 10% and the account goes **straight to loss asset with 100% provision** — classifying such an account merely as doubtful is not in accordance with RBI norms.

Four special categories, each with its own trigger. **Agricultural advances** are of two types — 'long duration' crops, being crops with a crop season longer than one year, and 'short duration' crops, being crops which are not long duration crops — and the crop season for each crop, meaning the period up to harvesting of the crops raised, is determined by the State Level Bankers' Committee in each State. A loan for short duration crops becomes NPA if the instalment of principal or interest remains overdue for two crop seasons; a loan for long duration crops becomes NPA if it remains overdue for one crop season. These norms apply to all direct agricultural advances as listed in the Master Circular on Lending to Priority Sectors, and to agricultural term loans according to the duration of the crops raised; for all other agricultural loans, NPA identification is on the same basis as non-agricultural advances, which at present is the 90 days delinquency norm. Where **natural calamities impair the repaying capacity**, banks may as a relief measure convert the short-term production loan into a term loan or reschedule the repayment period and sanction a fresh short-

term loan, subject to RBI guidelines. **Government guaranteed advances:** Central Government guaranteed advances, where the guarantee is not invoked or repudiated, are classified as Standard Assets but are regarded as NPA for income recognition purposes; the position is different for a State Government guarantee, where the advance is to be considered NPA if it remains overdue for more than 90 days, for both provisioning and income recognition. So where an advance is guaranteed equally by the Centre and a State and the instalment is overdue for more than six months, the 50% guaranteed by the Centre is not classified as NPA unless the guarantee is invoked and repudiated, while the 50% guaranteed by the State must be classified as NPA. **Advances to staff:** interest-bearing staff advances as a banker are part of the advances portfolio of the bank; for housing or similar loans to staff where interest is payable after recovery of principal, interest need not be considered overdue from the first quarter onwards, and such loans are classified as NPA only when there is a default in repayment of an instalment of principal or payment of interest on the respective due dates; staff advances made by a bank as an employer and not as a banker go under the sub-head 'Others' in the schedule of Other Assets. **Advances under consortium:** consortium advances mean advancing loans to a borrower by two or more banks jointly by forming a consortium, joint appraisal, control and monitoring facilitating exchange of valuable information, and **usually a bank with a higher share leads the consortium;** classification is **based on the record of recovery of the respective individual member banks,** and where remittances by the borrower are pooled with one bank, or the bank receiving remittances is not parting with the share of the other member banks, the account should be treated as not serviced in the books of the other member banks and therefore an NPA — so member banks must arrange to get their share of recovery transferred from the lead bank, or obtain express consent from the lead bank for the transfer.

Income recognition once an account turns NPA — the reversal rule, and it is asked on its own. If any advance, including bills purchased and discounted, becomes NPA as at the close of any year, the entire interest accrued and credited to the income account in past periods should be reversed or provided for if the same is not realised — **this applies to Government guaranteed accounts also.** In respect of NPAs, fees, commission and similar income that have accrued should cease to accrue in the current period and should be reversed or provided for with respect to past periods, if uncollected. Banks which have wrongly recognised income in the past should reverse the interest if it was recognised as income during the current year, or make a provision for an equivalent amount if it was recognised as income in the previous year(s). The auditor should also enquire if there are any large debits in the Interest Income account that have not been explained, and whether there are any communications from borrowers pointing out differences in interest charge and whether appropriate action has been taken. **On partial recoveries:** in the absence of a clear agreement between bank and borrower on appropriation of recoveries in NPAs — towards principal or interest due — banks must adopt an accounting policy and exercise the right of appropriation in a uniform and consistent manner; the appropriate policy is to recognise income as per AS 9, 'Revenue Recognition', when certainty attaches to realisation, **interest partly or fully realised in NPAs can be taken to income,** but it must be ensured that the credits towards interest are not out of fresh or additional credit facilities sanctioned to the borrower concerned.

Accounts regularised near the balance sheet date — the window-dressing test. The asset classification of borrower accounts where a solitary or a few credits are recorded before the balance sheet date should be handled with care and without scope for subjectivity, and where the account indicates inherent weakness on the basis of the data available, the account should be deemed as NPA. The auditor should check sample transactions immediately before the closing of the financial year and immediately after the closing of the financial year to understand the objective behind the transactions, whether they have any relation to each other in the borrower accounts, and whether any transactions are being reversed during the first few days after closing, which might show an arrangement to prevent the borrower account from slipping into the NPA category. So where a payment of **₹10 lakh on 29 March** is followed by a reversal of **₹8 lakh on 4 April**, the auditor must assess whether the pair was an attempt to prevent the slippage and, **if so, classify the account as an NPA in compliance with regulatory guidelines.**

Understanding explain it, and place it in context · 7 questions

- Security does not decide whether an advance is an NPA — the record of recovery does. Security decides how much provision a doubtful asset needs. Say both sentences; the mark is in the contrast.

TQ 6.4 · MTP 2021-Oct [2] (d) · 3M · Pg 640	LEVEL I Understanding	Easy
TQ 6.1 · PYQ 2018-May [6] (c) · 5M · Pg 637	LEVEL I Understanding	Medium
TQ 6.5 · MTP 2022-Mar [6] (c) · 4M · Pg 641	LEVEL I Understanding	Medium
TQ 6.6 · MTP 2023-Mar [6] (a) · 4M · Pg 641	LEVEL I Understanding	Medium
TQ 6.7 · MTP 2023-Mar [6] (b) · 4M · Pg 642	LEVEL I Understanding	Medium
CSQ 6.9 · RTP 2025-May [19] · Pg 653	LEVEL I Understanding	Medium
CSQ 6.11 · MTP 2026-Apr S2 [2] (b) · 5M · Pg 655	LEVEL I Understanding	Medium

Application use the Standard - apply it to the facts · 4 questions

- For a provisioning correction, set out the working: outstanding, less value of security, unsecured portion, then the rate on each portion, then the required provision against the provision made.
- For erosion in the value of security, test 50% against the last assessed value first and 10% against the outstanding second, and conclude 'straightaway doubtful' or 'straightaway loss asset' in those words.

CSQ 6.1 · PYQ 2018-Nov [6] (e) · 5M · Pg 643	LEVEL II Application	Medium
CSQ 6.2 · PYQ 2022-Nov [6] (b) · 4M · Pg 645	LEVEL II	Medium

	Application	
CSQ 6.8 • RTP 2025-May [18] • Pg 652	LEVEL II Application	Medium
TQ 6.2 • PYQ 2019-Nov [6] (a) • 4M • Pg 638	LEVEL II Application	Hard

Analysis break it down and take the parts separately • 8 questions

- Where several accounts are tabulated, take them one at a time with their own working and their own verdict. A single closing sentence covering all of them will not earn the per-account marks.
- On a split Central and State guarantee, divide the advance in the stated proportion and apply a different rule to each half before you state the amount to be classified as NPA.

CSQ 6.5 • PYQ 2024-Sep [3] (c) • 3M • Pg 648	LEVEL II Analysis	Easy
TQ 6.3 • PYQ 2021-Jan [6] (Or) (b) • 4M • Pg 640	LEVEL II Analysis	Medium
TQ 6.8 • PYQ 2024-May [6] (b) • 4M • Pg 643	LEVEL II Analysis	Medium
CSQ 6.3 • RTP 2024-May [22] • Pg 647	LEVEL II Analysis	Medium
CSQ 6.4 • MTP 2024-Jul [6] (a) • 5M • Pg 647	LEVEL II Analysis	Medium
CSQ 6.6 • MTP 2024-Nov [3] (a) • 5M • Pg 649	LEVEL II Analysis	Medium
CSQ 6.7 • RTP 2025-Jan [19] • Pg 650	LEVEL II Analysis	Medium
CSQ 6.10 • RTP 2025-Sep [19] • Pg 654	LEVEL II Analysis	Medium

Topic 7: Computation of Drawing Power

L2P5-C10-T07

Read first Read ICAI Study Material Chapter 10, Audit of Banks — Computation of Drawing Power: the meaning of drawing power and how it differs from the sanctioned limit, the bank's duties, the auditor's concerns, the computation itself and the requirement of stock audit.

NOTES

The two definitions, and the difference between them is asked directly. Drawing Power, generally referred to as 'DP', is an important concept for Cash Credit facilities availed from banks and financial institutions; it is the limit up to which a firm or company can withdraw from the working capital limit sanctioned. The Sanctioned Limit is the total exposure that a bank can take on a

particular client for facilities such as cash credit, overdraft, export packing credit and non-funded exposures, whereas Drawing Power refers to the amount calculated based on primary security less margin as on a particular date. So the sanctioned limit represents the overall approved limit, while DP represents the amount actually available for drawing based on the eligible primary security after considering the stipulated margin. All accounts should be kept within the drawing power and the sanctioned limit, and accounts which exceed either should be brought to the notice of the management regularly.

The four heads the answers use, and each has its own facts: (1) **Bank's duties** — banks should ensure that drawings in the working capital account are covered by the adequacy of the current assets; **drawing power is required to be arrived at based on the current stock statement**; and, considering the difficulties of large borrowers, stock statements relied upon by the bank for determining drawing power should not be older than three months, the outstanding in the account based on drawing power calculated from stock statements older than three months being deemed as irregular. (2) **Auditor's concern** — the stock statements, quarterly returns and other statements submitted by the borrower should be scrutinised in detail; the audited annual report submitted by the borrower should be scrutinised properly; and the monthly stock statement of the month for which the audited accounts are prepared should be compared and the reasons for deviations ascertained. (3) **Computation of DP** — ensure that the drawing power is calculated as per the guidelines formulated by the Board of Directors of the respective bank and agreed upon by the concerned statutory auditors, and that special consideration is given to proper reporting of sundry creditors for the purpose of calculating drawing power. (4) **Stock audit** — stock audit should be carried out by the bank for all accounts having funded exposure of more than ₹5 crores; auditors can also advise for stock audit in other cases if the situation warrants; branches should obtain the stock audit reports from the lead bank where the bank is not the leader of the consortium for working capital; and the report submitted by the stock auditors should be reviewed during the course of the audit, with special focus on the comments made on valuation of security and calculation of drawing power.

The computation itself — learn the order of the lines, because the marks are for the format. **Stock, less sundry creditors** (to arrive at **paid stock**), **less margin on stock**, gives **drawing power on stock (A)**. **Debtors, less debtors older than three months, which are ineligible, less margin on debtors**, gives **drawing power on debtors (B)**. **Total drawing power is A + B**, and where the total exceeds the sanctioned limit, the drawing power is restricted to the sanctioned limit. The worked answer: stock ₹50,000 less creditors ₹15,000 = paid stock ₹35,000, less margin at 20% ₹7,000 = ₹28,000; debtors ₹45,000 less ₹5,000 outstanding beyond three months = ₹40,000, less margin at 50% ₹20,000 = ₹20,000; **total DP ₹48,000, restricted to the sanctioned limit of ₹45,000**.

Two eligibility filters the examiner buries in the facts. Damaged stock is not eligible for DP — so stock of ₹5 crore including ₹1 crore of goods completely damaged in floods is taken at ₹4 crore before deducting trade creditors. **Book debts beyond the eligible ageing are excluded** — so debtors of ₹3 crore including ₹50 lakh outstanding for six months are taken at ₹2.50 crore where the sanction limits eligibility to 90 days. On those facts, with margins of **25% on stocks and 40% on**

eligible book debts: ₹4 crore less creditors ₹2 crore = paid stock ₹2 crore, less margin ₹0.50 crore = ₹1.50 crore; **₹2.50 crore less margin ₹1 crore = ₹1.50 crore; total DP ₹3 crore against a sanctioned limit of ₹4 crore.** Close with what the figure signifies to the borrower: the company can utilise funds only to the tune of ₹3 crore against the sanctioned cash credit limit of ₹4 crore.

The classic wrong answer is that the account is regular because the outstanding is within the sanctioned limit. Where the sanctioned limit is ₹12 crore, drawing power ₹9 crore and the outstanding ₹10 crore, the balance is within the limit but **exceeds the drawing power**, and an outstanding balance in excess of drawing power for a continuous period is the basis on which an account is treated as out of order and classified as a non-performing asset. Say what follows, not merely that the branch manager is wrong. Equally, not being the lead bank does not excuse a branch from reviewing the stock audit report — where funded exposure exceeds **₹5 crore** the stock audit is required, and **branches must obtain the report from the lead bank** and review it.

Application use the Standard - apply it to the facts · 5 questions

- Present the computation as a statement with running subtotals — paid stock, DP on stock, net debtors, DP on debtors, total DP — and end with the restriction to the sanctioned limit where it bites.
- Read the facts for ineligible items before you compute: damaged stock, debtors beyond the eligible ageing, and creditors to be deducted. Each omission costs a line and a mark.

CSQ 7.1 · PYQ 2022-May [2] (d) · 3M · Pg 658	LEVEL II Application	Easy
CSQ 7.2 · PYQ 2023-May [6] (c) · 3M · Pg 659	LEVEL II Application	Easy
TQ 7.1 · PYQ 2021-Dec [6] (b) · 4M · Pg 657	LEVEL II Application	Medium
CSQ 7.3 · RTP 2023-Nov [27] · Pg 660	LEVEL II Application	Medium
CSQ 7.4 · PYQ 2025-May [5] (c) · 4M · Pg 661	LEVEL II Application	Medium

Analysis break it down and take the parts separately · 1 question

- Drawing power questions are arithmetic before they are judgement. **Compute the drawing power, set it against the outstanding balance**, and only then say what follows.
- Where the outstanding exceeds the drawing power continuously, name the consequence for classification and say for how long it must persist.

CSQ 7.5 · PYQ 2026-Sep [6] (a) · 5M · Pg 662	LEVEL II Analysis	Medium
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Topic 8: Audit of Advances

L2P5-C10-T08

Read first Read ICAI Study Material Chapter 10, Audit of Banks — Audit of Advances: internal controls over advances, the evidence the auditor seeks and how he obtains it, special mention accounts, and the application of the classification and provisioning norms at a branch.

NOTES

Internal controls over advances — eleven points, and the auditor examines their efficacy 'to determine the nature, timing and extent of his substantive procedures'. (1) The bank should make an advance only after satisfying itself as to the creditworthiness of the borrower and after obtaining sanction from the appropriate authorities of the bank. (2) All necessary documents — agreements, demand promissory notes, letters of hypothecation — should be executed by the parties before advances are made. (3) Compliance with the terms of sanction and end use of funds should be ensured. (4) Sufficient margin as specified in the sanction letter should be kept against securities taken so as to cover any decline in their value, and the availability of sufficient margin needs to be ensured at regular intervals. (5) Where the securities are shares, debentures etc., ownership should be transferred in the name of the bank and effective control of such securities retained as part of the documentation. (6) All securities requiring registration should be registered in the name of the bank or otherwise accompanied by documents sufficient to give title to the bank. (7) In the case of goods in the possession of the bank, the contents of packages should be test checked at the time of receipt, and the godowns frequently inspected by responsible officers of the branch in addition to the inspectors of the bank. (8) The Drawing Power Register should be updated every month to record the value of securities hypothecated, and these entries should be checked by an officer. (9) The accounts should be kept within both the drawing power and the sanctioned limit. (10) All accounts which exceed the sanctioned limit or drawing power or are otherwise irregular should be brought to the notice of the controlling authority regularly. (11) The operation of each advance account should be reviewed at least once a year, and at more frequent intervals in the case of large advances.

What the auditor is obtaining evidence about — seven assertions, and this is the answer to 'how will you proceed'. **Advances generally constitute the major part of the assets of the bank**, there are a large number of borrowers and a variety of advances, so **the audit of advances requires the major attention of the auditors**. The auditor is primarily concerned with obtaining evidence that: (1) amounts included in the balance sheet in respect of advances are outstanding at the date of the balance sheet; (2) **advances represent amounts due to the bank**; (3) amounts due to the bank are appropriately supported by loan documents and other documents as applicable to the nature of the advances; (4) **there are no unrecorded advances**; (5) the stated basis of valuation of advances is appropriate and properly applied, and the recoverability of advances is recognised in their valuation; (6) the advances are disclosed, classified and described in accordance with recognised accounting policies and practices and relevant statutory and regulatory requirements; (7) appropriate provisions towards advances have been made as per the RBI norms, Accounting

Standards and generally accepted accounting practices.

And how he obtains it — six procedures, which follow the study and evaluation of internal controls relating to advances: **examining the validity of the recorded amounts; examining loan documentation; reviewing the operation of the accounts; examining the existence, enforceability and valuation of the security;** checking compliance with RBI norms including appropriate classification and provisioning; and **carrying out appropriate analytical procedures.** A question that asks 'besides studying and evaluating internal controls' is asking for these six plus the seven assertions above.

Special Mention Accounts — a short definition with a stated significance, so give both. Special Mention Accounts (SMA) are those accounts which are showing signs of incipient stress leading to the possibility that borrowers may default on debt obligations. These are in the nature of a warning system to alert the banks about probable NPAs so that remedial action can be taken before accounts actually turn NPA. Their significance lies in the fact that proper and timely identification of SMAs can help in preventing potential NPAs from turning into actual NPAs.

At branch level the norms are applied to individual accounts, and the working is the answer. On a **D1 term loan with ₹50 lakh outstanding and security of ₹40 lakh**, the unsecured portion is **₹10 lakh**; the provision is 25% of ₹40 lakh = ₹10 lakh plus 100% of ₹10 lakh = ₹10 lakh, that is ₹20 lakh, so a branch provision of **₹7.50 lakh is not proper**. On a **D1 term loan with ₹140 lakh outstanding and security of ₹80 lakh**, the unsecured portion is **₹60 lakh** and the required provision is **₹20 lakh (25% of ₹80 lakh) plus ₹60 lakh (100% of ₹60 lakh) = ₹80 lakh** — the classification as D1 is appropriate but the provision of ₹70 lakh is inadequate. And where **the realisable value of security is less than 10% of the outstanding — ₹6 lakh against ₹65 lakh** — the existence of security is ignored and the asset is straightaway classified as a loss asset with 100% provision, so classifying it merely as doubtful is **not in accordance with RBI Prudential Norms**.

State the verdict on the branch, not just the correct figure. Every one of these printed answers ends with a sentence saying whether the classification and provisioning made by the branch are or are not in accordance with the RBI Prudential Norms. That sentence is separately marked, and it is the one students leave out after doing all the arithmetic.

Understanding explain it, and place it in context • 2 questions

- Keep the seven evidence assertions apart from the six procedures. The assertions are what the auditor wants to establish; the procedures are how he establishes them.
- Define SMA in one sentence and give its significance in a second. Both halves carry marks.

TQ 8.1 • PYQ 2018-Nov [6] (c) • 5M • Pg 663

LEVEL I
Understanding

Medium

CSQ 8.1 • MTP 2023-Sep [6] (a) • 4M • Pg 667

LEVEL I
Understanding

Medium

Application use the Standard - apply it to the facts · 1 question

- Show the split of outstanding into secured and unsecured before applying any rate. A provision computed on the whole outstanding at a single rate is the commonest error.
- Close with an express verdict: the classification and provisioning made by the branch are, or are not, in accordance with the RBI Prudential Norms.

TQ 8.2 · PYQ 2022-May [4] (d) · 3M · Pg 665

LEVEL II
Application

Hard

Analysis break it down and take the parts separately · 3 questions

- Each scenario gives an outstanding balance, a security value and a classification. **Test the classification against the rules, account by account**, and give a separate conclusion for each.
- State the provisioning that follows from the classification you reach, on the secured and unsecured portions separately. That split is where the marks concentrate.

TQ 8.3 · RTP 2022-Nov [26] (a) · Pg 666

LEVEL II
Analysis

Medium

CSQ 8.2 · MTP 2025-Nov S1 [2] (b) · 5M · Pg 667

LEVEL II
Analysis

Medium

CSQ 8.3 · PYQ 2026-Jan [6] (a) · 5M · Pg 669

LEVEL II
Analysis

Medium

Topic 9: Audit of Revenue Items- Profit and Loss Account

L2P5-C10-T09

Read first Read ICAI Study Material Chapter 10, Audit of Banks — Audit of Revenue Items in the Profit and Loss Account: interest expense, interest income, operating expenses, and provisions and contingencies.

NOTES

Interest expense — the approach is reasonableness first, computation second. In carrying out an audit of interest expense, the auditor is primarily concerned with assessing the overall reasonableness of the amount of interest expense by analysing ratios of interest paid on different types of deposits and borrowings to the average quantum of the respective liabilities during the year; and in modern day banking the entries for interest expenses are automatically generated through a batch process in the CBS system. The auditor should obtain from the bank an analysis of various types of deposits outstanding at the end of each quarter, **work out a weighted average interest rate**, compare that rate with the actual average rate of interest paid on the relevant deposits as per the annual accounts and enquire into the difference if material, and **compare the average rate with the corresponding figures for previous years**. He should obtain the general ledger break-up for interest expense on deposits (savings and term deposits) and borrowings each

month or quarter, **analyse month-on-month or quarter-on-quarter cost, document the reasons for variances**, examine whether the interest expense in the cost analysis agrees with the general ledger, and understand the process of computation of the average balance and re-compute it on a sample basis. On a test check basis he must verify the calculation of interest and ensure that (a) interest has been provided on all deposits up to the date of the balance sheet; (b) interest rates are in accordance with the bank's internal regulations, the RBI directives and agreements with the respective deposit holder; (c) interest on savings accounts is in accordance with the rules framed by the bank or RBI; (d) interest on inter-branch balances has been provided at the rates prescribed by the head office or RBI. He should also ascertain whether there are any changes in interest rates on savings accounts and term deposits during the period, **obtain the interest rate card for the various types of deposits**, examine the completeness of accrual on the entire borrowing portfolio and agree it with the general ledgers, and re-compute the interest accrual by reference to the frequency of payment, rate of interest and period elapsed till the balance sheet date from the term sheet, deal ticket and agreements.

Operating expenses — four steps, and the examiner sets them against a fact pattern of rising costs. The auditor should: (1) study and evaluate the system of internal control relating to expenses, including authorisation procedures, in order to determine the nature, timing and extent of his other audit procedures; (2) examine whether there are any divergent trends in respect of major items of expenses; (3) perform substantive analytical procedures in respect of these expenses — for example, assess the reasonableness of expenses by working out their ratio to total operating expenses and comparing it with the corresponding figures for previous years; (4) verify expenses with reference to supporting documents and check the calculations wherever required. Where the facts give branch managers with discretionary powers and a migration to a centralised expense processing system, the first step must address approval hierarchies, maker-checker controls, system-based authorisation limits and monitoring controls; where they give **an abnormal rise in staff welfare expenses, IT maintenance charges and rent**, the second calls for **branch-wise and region-wise trend analysis**; the third may extend to comparing expense ratios with industry averages of other scheduled commercial banks and correlating expenses with the number of branches, employee strength and business volume; and the fourth should emphasise high-value payments, year-end provisions, related party transactions and expenses at branches where internal audit observations were adverse. Close with the conclusion the answer draws: adopt a risk-based approach combining evaluation of internal controls, analytical procedures and detailed substantive testing, and, where material weaknesses or unexplained abnormal trends remain, report appropriately in the audit report or in the Long Form Audit Report (LFAR) as applicable to banks.

Provisions and contingencies — five steps, and the first two are the ones that carry the RBI compliance marks. The auditor should (1) ensure that the compliances for the various regulatory requirements for provisioning as contained in the various circulars have been fulfilled; (2) obtain an understanding as to how the bank computes provision on standard assets and non-performing assets, which primarily includes checking the basis of classification of loans and receivables into standard, sub-standard, doubtful, loss and non-performing assets, and may verify the loan

classification on a sample basis; (3) obtain the detailed break-up of standard loans and non-performing loans and agree the outstanding balances with the general ledger; (4) obtain the tax provision computation from the bank's management and verify the nature of items debited and credited to the profit and loss account to ascertain that they are appropriately considered in the tax provision computation; (5) examine the other provisions for expenses against the circumstances warranting the provisioning and the adequacy of the same, by discussing and obtaining explanations from the bank's management.

Interest income that does not agree with a rough calculation — two reasons the answer gives. Where advances of **₹300 crore at an average rate of 8%** would suggest interest of **₹24 crore** but the schedule shows **₹10 crore**: (1) cash credit accounts are by their very nature running accounts and their utilisation depends on the needs of the business, and interest on a cash credit account is charged on the extent of funds utilised by the borrower — so the limits may not have been fully utilised during the year; (2) some large accounts may have been sanctioned during the later part of the year, resulting in lower interest income for the whole year. The point being tested is that **a limit is not a balance**.

Take-out finance — a short definition with three objectives and one income-recognition consequence. A take-out loan is a financing arrangement under which a loan obtained at a later stage is used to replace an initial loan; more specifically, take-out financing is a form of long-term finance where the lender commits to provide funding at a specified date or once certain predetermined project completion criteria are met, and **take-out loans are commonly used in property development projects**. The objectives are (a) to widen sources of finance for infrastructure projects by encouraging participation of new entities; (b) to address sectoral, group or entity exposure concerns and asset-liability mismatch issues of lenders; (c) to enhance the availability of long-tenure debt financing for projects. The consequence: in the case of take-out finance, if the loan account is classified as an NPA by the lending bank based on the recovery record, income should not be recognised unless it is actually realised from the borrower or the taking-over institution, if the arrangement so provides.

Understanding explain it, and place it in context • 3 questions

- Give the take-out finance definition, then the three objectives, then the income-recognition consequence. The question is set in three parts and the marks are split across them.

CSQ 9.1 • RTP 2022-Nov [26] (b) • Pg 672

LEVEL I
Understanding

Medium

CSQ 9.4 • MTP 2026-Mar S1 [2] (b) • 5M • Pg 675

LEVEL I
Understanding

Medium

TQ 9.2 • RTP 2022-May [27] (a) • DESC • Pg 672

LEVEL I
Understanding

Hard

Application use the Standard - apply it to the facts · 1 question

- For an operating-expenses scenario, use the four steps as your headings and hang the given facts on them. The facts are there to be matched, not summarised.
- Where a rough interest calculation does not agree with the books, explain why a sanctioned limit is not a drawn balance and why timing of sanction matters. Two reasons is what the question asks for and two is what it rewards.

CSQ 9.2 · PYQ 2024-Sep [6] (a) · 4M · Pg 673

LEVEL II
Application

Medium

Analysis break it down and take the parts separately · 2 questions

- On a provisions-and-contingencies question the bank's figures cover bad debts, sub-standard assets, expenses and income tax. Address the loan-related provisions under the RBI norms and the tax and expense provisions separately.

TQ 9.1 · RTP 2020-May [26] · Pg 670

LEVEL II
Analysis

Medium

CSQ 9.3 · PYQ 2025-Sep [3] (c) · 4M · Pg 674

LEVEL II
Analysis

Medium

Topic 10: Miscellaneous

L2P5-C10-T10

CONCEPT BASE — no exam question asked yet · essential for full preparation

Read first Read ICAI Study Material Chapter 10, Audit of Banks — the miscellaneous provisions at the end of the chapter.

NOTES

No question has been printed on this topic in the Scanner — no past paper, RTP, MTP or model question. It is carried as a concept-base topic, so read the Study Material's own closing section directly; there is no printed answer here to learn the examiner's form from.

Where the rest of the chapter's material sits, so you do not look for it here. The reporting obligations beyond the main audit report — including the **Long Form Audit Report (LFAR)**, the **SLR** report, the **treasury operations** report, and the **Ghosh and Jilani Committee** compliance reports — are set out in the introduction to the chapter. The prudential norms on income recognition, asset classification and provisioning, the **out of order** test and the **erosion in value of security** rules sit under Advances. **Drawing power** and **stock audit** have their own topic, and **interest expense**, **operating expenses and provisions and contingencies** sit under the revenue items topic.

Do not manufacture content for this topic. If a question appears that does not fit any of the examined topics, answer it from the Study Material's own text and keep to the RBI guidelines and the Standards the Study Material actually cites.

CHAPTER 11

Ethics and Terms of Audit Engagements

15 Topics · 58 Classified Questions · Importance: A

ICAI SKILL PROFILE ICAI band for this paper: Level I 40-60% · Level II 40-60% — this chapter reads **on profile**

Level I — Comprehension & Knowledge **54.4%** 129 of 237 marks

Level II — Analysis & Application **45.6%** 108 of 237 marks

This chapter sits inside ICAI's own band for the paper — 54% Level I against 40-60%. Prepare it in those proportions: know the method, then drill it.

Topic 1: Meaning of Ethics-A State of Mind

L2P5-C11-T01

CONCEPT BASE — no exam question asked yet · essential for full preparation

Read first Read ICAI Study Material Chapter 11, Ethics and Terms of Audit Engagements — the meaning of ethics and why it is described as a state of mind.

NOTES

The definition, and it is short enough to be quoted whole: 'Ethics' are the principles of conduct governing an individual or a group. The answers add that professions like law and medicine have their code of ethics; the auditing profession is no exception — rather, **in the profession of auditing the importance of ethics is manifold.**

Why the topic is called 'a state of mind'. The answers on independence make the point directly: **independence is a condition of mind as well as personal character**, and it should not be confused with the superficial and visible standards of independence which are sometimes imposed by law. Rules of professional conduct dealing with independence are framed with a certain objective, but the rules themselves cannot create or ensure the existence of independence. Ethics therefore lives in the auditor, not in the rule book.

The practical consequence the examiner wants stated: an auditor should not limit himself to mere compliance with rules but should also uphold the spirit of ethical principles, applying his **professional knowledge, experience and judgement** to decide the right course of action in a situation no rule anticipated. That sentence is the bridge from this topic to the principles-based approach in the next one.

Do not mistake this topic for a soft one. Everything later in the chapter — the five fundamental principles, independence, the threats and the safeguards — is an attempt to put this state of mind into working form. When a question asks you to 'explain the meaning of ethics', give the definition,

the sentence about law and medicine, and the sentence about auditing, and stop; padding earns nothing.

Topic 2: Need for Professional Ethics

L2P5-C11-T02

CONCEPT BASE — no exam question asked yet • essential for full preparation

Read first Read ICAI Study Material Chapter 11, Ethics and Terms of Audit Engagements — the need for professional ethics in the accountancy profession.

NOTES

Start where the printed answers start: professional integrity and independence are considered essential characteristics of all the professions, but are more so in the case of the accountancy profession. That is the opening sentence of every answer on this theme and it frames everything after it.

The reason is public confidence. The safeguards answer puts it plainly: for the public to have confidence in the quality of audit, it is essential that auditors should always be, and appear to be, independent of the entities that they are auditing. The user of the accounts does not inspect the records himself; he relies on the auditor, so the auditor's conduct is the only thing standing behind the opinion.

Ethics also serves the client relationship. Confidentiality serves the public interest because it facilitates the free flow of information from the client or employing organisation to the accountant, with the understanding that the information will not be disclosed to a third party. Without that assurance the auditor would not get the information he needs to audit at all.

Ethics protects the profession itself. The principle of **professional behaviour** requires the accountant to comply with relevant laws and regulations and to avoid any conduct that he knows or should know might discredit the profession, and provides that he shall not knowingly engage in any employment, occupation or activity that impairs or might impair the integrity, objectivity or good reputation of the profession.

Where the Code alone was not thought enough, the statute steps in. The answers point to the **rotation provisions of the Companies Act, 2013** — mandatory rotation of auditors under section 139(2) — as a legal safeguard built precisely to address familiarity threats. Use that as your closing illustration of why professional ethics needs reinforcement.

Topic 3: Principles Based Approach vs Rules Based Approach to Ethics (Ethical or Legal)

L2P5-C11-T03

Read first Read ICAI Study Material Chapter 11, Ethics and Terms of Audit Engagements — the principles-based and the rules-based approaches to ethics.

NOTES

The principles-based approach: it focuses on following the spirit and purpose of ethical values rather than only following written rules. It requires auditors to apply their professional knowledge, experience and judgement to decide the right course of action in different situations. Its strength is that it reaches situations no rule listed.

The rules-based approach: it emphasises strict compliance with specific rules and regulations. Give both sides, because the answer does: **it provides clear guidance**, but it may result in following the letter of the law without considering the real purpose behind the ethical requirements, and it is less flexible, because every practical situation cannot be covered by predefined rules.

The conclusion the examiner wants written out: auditors should not rely only on rules but should also act in accordance with the spirit of the Code of Ethics by exercising sound professional judgement. An answer that merely contrasts the two and stops has not answered the question the paper actually asked.

How it was examined — paired with professional scepticism. On the unusual year-end sales facts, the attitude expected of the team is **professional scepticism**, which means (1) a questioning and alert mindset; (2) awareness that material misstatements may exist due to fraud or error; and (3) a critical and careful evaluation of all audit evidence before reaching any conclusion. The point is that **documentation is not a substitute for evaluation** — invoices were produced, and the partner still wanted the transactions examined.

The risks that scepticism reduces, and they carry their own marks: (a) ignoring unusual or suspicious transactions; (b) making broad conclusions based on limited audit findings; and (c) using incorrect assumptions while deciding the nature, timing and extent of audit procedures or while evaluating audit results.

Analysis break it down and take the parts separately · 1 question

- The ask contrasts a **principles-based** with a **rules-based** approach. Set them side by side, then say which the Code follows and why that matters on the facts given.
- The facts usually describe something technically permitted but ethically doubtful. Name that gap expressly — it is the point of the question.

CSQ 3.1 · PYQ 2026-May [1] (a) {C} · 5M · Pg 679

LEVEL II
Analysis

Medium

Topic 4: Fundamental Principles of Professional Ethics

L2P5-C11-T04

Read first Read ICAI Study Material Chapter 11, Ethics and Terms of Audit Engagements — the fundamental principles of professional ethics under the Code of Ethics.

NOTES

The rule in one line: the auditor shall comply with relevant ethical requirements, including those pertaining to independence, relating to financial statement audit engagements, and relevant ethical requirements ordinarily comprise the Code of Ethics for Professional Accountants (IESBA Code) related to an audit of financial statements. The Code establishes **five** fundamental principles: 1. Integrity; 2. Objectivity; 3. Professional competence and due care; 4. Confidentiality; and 5. Professional behaviour. Name all five before you explain any of them.

Integrity: it requires the auditor to be straightforward and honest in all professional and business relationships; it **implies fair dealing and truthfulness**. It effectively means he shall not be associated with reports, returns, communications or other information which he believes contains a materially false or misleading statement, contains statements or information provided recklessly or negligently, or omits or obscures required information where such omission or obscurity would be misleading. **Objectivity:** it requires an auditor not to compromise professional judgement because of bias, conflict of interest or undue influence of others, and that a professional accountant shall not undertake a professional activity if a circumstance or relationship unduly influences his professional judgement regarding that activity.

Professional competence and due care: it requires the accountant to attain and maintain professional knowledge and skill at the level required to ensure that a client or employing organisation receives competent professional service, based on current technical and professional standards and relevant legislation, and to act diligently and in accordance with applicable technical and professional standards. Diligence includes the responsibility to act carefully, thoroughly and on a timely basis in accordance with the requirements of an assignment.

Confidentiality: it requires an auditor to respect the confidentiality of information acquired as a result of professional or business relationships. **The exception is where the marks are:** such information may be disclosed when it is required by law; when it is permitted by law and is authorised by the client or employer; or where there is a professional duty or right to disclose and disclosure is not prohibited by law. So the accountant in service who produced documents as evidence in the course of legal proceedings because the law required it has not violated the principle — say that conclusion expressly.

Professional behaviour: it requires the accountant to comply with relevant laws and regulations and to avoid any conduct that he knows or should know might discredit the profession; he shall not knowingly engage in any employment, occupation or activity that impairs or might impair the integrity, objectivity or good reputation of the profession. **The printed example:** a chartered accountant who **did not bother to reply to ICAI's letter on audit matters despite reminders** —

failure to reply to the professional body smacks of lack of courtesy and professional responsibility and breaches this principle.

The identification drill, which is how this topic is actually set. Learn the printed mappings: **appointment as auditor of a firm in which his sister is a partner — objectivity; auditing his brother-in-law's partnership firm — objectivity; passing insider information about a client to a friend — confidentiality; failing to inform the client of a change in the law applicable to him — professional competence and due care; missing a new deduction under the Income-tax Act so that the client overpays tax — professional competence and due care; understating sales on the client's instruction — integrity; associating with a report believed to contain a materially false or misleading statement — integrity; failing to send the audit engagement letter required by SA 210 — professional competence and due care, because maintaining competence requires awareness of current technical and professional standards.**

The trap, stated plainly: the **five fundamental principles** and the **five threats to independence** are two different lists. Integrity, objectivity, professional competence and due care, confidentiality and professional behaviour are principles; self-interest, self-review, advocacy, familiarity and intimidation are threats. **Professional scepticism and independence are not in the list of five principles** — independence is a separate ethical requirement the auditor must comply with, and the answers treat integrity, objectivity and professional scepticism as the key principles that make independence necessary.

Remembering reproduce what you have learnt · 1 question

- List all five principles by name first, in the Code's order, and then expand. Marks follow the number of principles correctly named.

CSQ 4.3 · MTP 2024-Jul [4] (b) · 5M · Pg 685

LEVEL I
Remembering

Medium

Understanding explain it, and place it in context · 5 questions

- Quote each definition in full — 'straightforward and honest', 'fair dealing and truthfulness', 'attain and maintain professional knowledge and skill' are the marked words.
- For confidentiality, always add the three circumstances in which disclosure is allowed; a question is far more likely to test the exception than the rule.

CSQ 4.1 · MTP 2024-Mar [5] (d) · 3M · Pg 682

LEVEL I
Understanding

Easy

CSQ 4.2 · PYQ 2024-May [5] (c) · 3M · Pg 683

LEVEL I
Understanding

Easy

TQ 4.1 · PYQ 2021-Jan [2] (a) · 4M · Pg 681

LEVEL I
Understanding

Medium

TQ 4.2 · PYQ 2025-Jan [6] (c) · 4M · Pg 682

LEVEL I

Medium

Understanding

CSQ 4.5 • RTP 2026-Jan [20] • Pg 687

LEVEL I

Understanding

Medium

Application use the Standard - apply it to the facts • 1 question

- For each situation: name the principle, quote its definition, then say in one sentence why these facts breach it. Naming without the definition, or the definition without the application, each lose marks.
- Where the facts show a disclosure required by law, the conclusion is that the principle was not violated. Do not assume every scenario is a breach.

CSQ 4.4 • PYQ 2024-Sep [6] (b) • 4M • Pg 686

LEVEL II

Application

Medium

Topic 5: Independence of Auditors

L2P5-C11-T05

Read first Read ICAI Study Material Chapter 11, Ethics and Terms of Audit Engagements — independence of auditors, independence of mind and independence in appearance.

NOTES

The rule in one line: independence implies that the judgement of a person is not subordinate to the wishes or direction of another person who might have engaged him, or to his own self-interest, and **the auditor should be independent of the entity subject to the audit. It is not possible to define independence precisely**; rules of professional conduct cannot themselves create or ensure the existence of independence, because **independence is a condition of mind as well as personal character** and should not be confused with the superficial and visible standards of independence which are sometimes imposed by law.

The definition, from the Code of Ethics for Professional Accountants issued by IFAC, and it has two limbs — both are needed even for one mark. Independence of mind: the state of mind that permits the provision of an opinion without being affected by influences that compromise professional judgement, allowing an individual to act with integrity and exercise objectivity and professional scepticism. Independence in appearance: the avoidance of facts and circumstances that are so significant that a reasonable and informed third party, having knowledge of all relevant information including any safeguards applied, would reasonably conclude that a firm's, or a member of the assurance team's, integrity, objectivity or professional scepticism had been compromised.

The two-sided test the answers actually run: independence has not only to exist in fact, but also to appear to so exist to all reasonable persons. So the relationship between auditor and client must be such that **first, he is himself satisfied about his independence**, and second, no unbiased person would be forced to the conclusion that, on an objective assessment of the circumstances,

there is likely to be an abridgement of the auditor's independence. Both limbs must be satisfied; failing either is enough to condemn the engagement.

How the fact pattern is decided. On the listed infrastructure company facts — **a close personal relationship between the audit partner and the CFO**, consultancy services for designing internal financial controls in the same financial year (a self-review threat), and a substantial portion of the firm's revenue dependent on fees from that one client (economic dependence) — the printed conclusion is that although the auditor may be maintaining objectivity, that is, independence of mind, these circumstances may lead a reasonable third party to conclude that independence is compromised. Independence in appearance is the limb that fails. Write that sentence; it is the conclusion the examiner is marking.

Watch the reporting step. Where a team member has a close business relationship with a senior executive of the client, the partner evaluates and applies safeguards — but he must promptly report to the firm any inability to resolve the matter for appropriate action. Candidates routinely stop at 'apply safeguards' and lose that mark.

Remembering reproduce what you have learnt • 1 question

- A short-mark definition question. **Give the definition and stop** — a one-mark question does not reward examples.
- Use the Code's own vocabulary: independence of mind and independence in appearance are two limbs, and both are wanted.

CSQ 5.2 • PYQ 2026-Sep [2] (c) (i) • 1M • Pg 691

LEVEL I
Remembering

Easy

Understanding explain it, and place it in context • 1 question

- Give both limbs with their full definitions even in a one-mark question; the answer is designed so that neither limb alone scores.
- Add the 'has not only to exist in fact but also to appear to so exist' sentence — it is what makes the two limbs interlinked, which is what the question usually asks.

TQ 5.1 • PYQ 2019-May [3] (c) • 3M • Pg 689

LEVEL I
Understanding

Easy

Application use the Standard - apply it to the facts • 1 question

- Take each circumstance in the facts separately, label the threat it creates, and then say which limb of independence it damages. Close by stating whether independence is compromised — an answer without that conclusion loses the application marks.

CSQ 5.1 • MTP 2026-Apr S2 [4] (b) • 5M • Pg 690

LEVEL II
Application

Medium

Topic 6: Threats to Independence

L2P5-C11-T06

Read first Read ICAI Study Material Chapter 11, Ethics and Terms of Audit Engagements — the threats to the independence of auditors.

NOTES

The rule in one line: compliance with the fundamental principles may potentially be threatened by a broad range of circumstances, and the Code of Ethics for Professional Accountants prepared by IFAC identifies five types of threats: **self-interest, self-review, advocacy, familiarity and intimidation**. Name all five before explaining any, even when the question asks for only one.

Self-interest threats occur when an auditing firm, its partner or associate could benefit from a financial interest in an audit client. Examples: (i) direct financial interest or materially significant indirect financial interest in a client; (ii) loan or guarantee to or from the concerned client; (iii) undue dependence on a client's fees and hence concern about losing the engagement; (iv) close business relationship with an audit client; (v) potential employment with the client; and (vi) contingent fees for the audit engagement.

Self-review threats occur during a review of any judgement or conclusion reached in a previous audit or non-audit engagement, or when a member of the audit team was previously a director or senior employee of the client. Non-audit services include any professional services provided to an entity by an auditor other than audit or review of the financial statements — management services, internal audit, investment advisory service, design and implementation of information technology systems. The two printed instances are **the auditor having recently been a director or senior officer of the company** and **auditors performing services that are themselves the subject matter of audit**.

Advocacy threats occur when the auditor promotes, or is perceived to promote, a client's opinion or interest to a point where people may believe that objectivity is getting compromised — for example when an auditor deals with the shares or securities of the audited company, **becomes the client's advocate in litigation and third party disputes, or acts as arbitrator in a dispute between the client and its vendor**.

Familiarity threats are self-evident, and occur when auditors form relationships with the client where they end up being too sympathetic to the client's interests. This can occur in many ways: (i) a close relative of the audit team working in a senior position in the client company; (ii) a former partner of the audit firm being a director or senior employee of the client; (iii) long association between specific auditors and their specific client counterparts; and (iv) acceptance of significant gifts or hospitality from the client company, its directors or employees — including free holidays and air travel for the engagement team, or travel and stay of family members borne by the client. The provisions in the Companies Act, 2013 regarding rotation of auditors mainly address these very familiarity threats: the auditor is rotated after a certain number of years so that auditors do

not become too familiar with their clients.

Intimidation threats occur when auditors are deterred from acting objectively with an adequate degree of professional scepticism. These arise from threat of replacement over disagreements with the application of accounting principles, pressure to disproportionately reduce audit work in response to reduced audit fees, **demands for lower audit fees**, or **threats of litigation** — for instance where a client threatens to replace the auditors because the team insisted on a provision for expected credit loss.

Two things the examiner keeps checking. First, **the classification pairs students flip**: a close business relationship with an audit client is self-interest, not familiarity; performing services that are themselves the subject matter of the audit is self-review, not self-interest; dealing in the shares or securities of the audited company is classified as advocacy in the printed answers; **long association is familiarity**; **being deterred from acting objectively is intimidation**; and a contingent fee, and a material significant indirect financial interest, are both self-interest. Second, **always say what the auditor must do**: either refrain from taking on the task, eliminate the threat, or at a minimum implement safeguards to reduce the threat to an acceptable level, documenting all measures so as to evidence compliance with due process; and if he cannot fully implement credible and adequate safeguards, he must not accept the assignment.

Understanding explain it, and place it in context · 6 questions

- Each threat needs its one-line definition plus at least two printed examples. A bare name with no definition scores little.

CSQ 6.2 · MTP 2024-Mar [1] (d) {C} · 3M · Pg 698	LEVEL I Understanding	Easy
TQ 6.1 · RTP 2023-May [2] (a) · Pg 692	LEVEL I Understanding	Medium
TQ 6.2 · MTP 2024-Dec S2 [5] (c) · 4M · Pg 693	LEVEL I Understanding	Medium
TQ 6.4 · MTP 2026-Apr S2 [6] (b) · DESC · 5M · Pg 695	LEVEL I Understanding	Medium
TQ 6.5 · PYQ 2026-Sep [3] (b) · 4M · Pg 695	LEVEL I Understanding	Medium
CSQ 6.1 · PYQ 2021-Jan [5] (b) · DESC · 5M · Pg 696	LEVEL I Understanding	Medium

Analysis break it down and take the parts separately · 2 questions

- Where six situations are listed, tabulate them — situation, threat, reason — and take them strictly one at a time. Do not group two situations under one head; each carries its own mark.

TQ 6.3 · PYQ 2025-Sep [6] (Or) (c) · 4M · Pg 693

LEVEL II
Analysis

Medium

CSQ 6.3 · PYQ 2025-Jan [2] (b) · 5M · Pg 699

LEVEL II
Analysis

Medium

Topic 7: Safeguards to Independence

L2P5-C11-T07

Read first Read ICAI Study Material Chapter 11, Ethics and Terms of Audit Engagements — the safeguards available to eliminate threats to independence.

NOTES

The rule in one line: the chartered accountant has a responsibility to remain independent by taking into account the context in which he practises, the threats to independence, and the safeguards available to eliminate the threats. The answers then give **four guiding principles** and the marks are distributed across them.

The four guiding principles, in order: (1) **Independence in fact and appearance** — for the public to have confidence in the quality of audit it is essential that auditors should always be, and appear to be, independent of the entities they audit; (2) **Fundamental principles** — in the case of audit the key fundamental principles are integrity, objectivity and professional scepticism, which necessarily require the auditor to be independent; (3) **Consider threats before accepting work** — before taking on any work an auditor must conscientiously consider whether it involves threats to his independence, and where such threats exist he should either desist from the task or put in place safeguards that eliminate the threats; (4) **Inability to implement safeguards** — if the auditor is unable to fully implement credible and adequate safeguards, then he must not accept the work.

The order of the remedies, and it is an order: refrain from the task, or eliminate the threat, or at a minimum implement safeguards that reduce the threat to an acceptable level. All measures related to these safeguards should be documented in a way that provides evidence of compliance with due process. Documentation is a separate mark; do not omit it.

The statutory safeguard the answers name: mandatory rotation of auditors under section 139(2) of the Companies Act, 2013 — for prescribed classes of companies, an individual as auditor for one term of five consecutive years and **an audit firm for two terms of five consecutive years, with a cooling-off period thereafter**. These are the figures; quote them exactly.

How the safeguards are applied to facts. On the nominee-shares facts — the auditor is named nominee for shares of substantial value in the company he is to audit, and **holding such shares through a distant relative does not violate legal provisions** — the printed answer still finds a **self-interest threat to his independence**, and directs that before accepting the audit appointment he should eliminate the threat by disposing of the shares, and that if he is unable to eliminate the threat through credible and adequate safeguards, he should not accept the appointment. The classic wrong answer is that no legal provision is broken, so the appointment may be accepted.

Legality is not the test; the threat is.

Remembering reproduce what you have learnt · 1 question

- Number the four guiding principles and give each its heading before you explain it. The heading itself is what the examiner ticks.

TQ 7.2 · PYQ 2026-Sep [3] (b) (ii) · 1M · Pg 702

LEVEL I
Remembering

Easy

Application use the Standard - apply it to the facts · 1 question

- Identify the threat first, then run the ladder — desist, eliminate, safeguards, and refuse the work if safeguards are inadequate — and finish with what the auditor should actually do on these facts.
- Say expressly that the absence of a legal breach does not settle the question. That sentence is the difference between a pass and a good answer on the nominee-shares type of problem.

TQ 7.1 · PYQ 2020-Nov [2] (a) · 4M · Pg 701

LEVEL II
Application

Hard

Topic 8: Professional Skepticism

L2P5-C11-T08

Read first Read ICAI Study Material Chapter 11, Ethics and Terms of Audit Engagements — professional scepticism.

NOTES

The rule in one line: the auditor shall plan and perform an audit with professional scepticism, recognising that circumstances may exist that cause the financial statements to be materially misstated. Open every answer with that sentence.

The four examples of what professional scepticism includes being alert to — these are the list marks: (1) audit evidence that contradicts other audit evidence obtained; (2) information that brings into question the reliability of documents and responses to inquiries to be used as audit evidence; (3) conditions that may indicate possible fraud; and (4) circumstances that suggest the need for audit procedures in addition to those required by the SAs.

The three risks that maintaining scepticism throughout the audit reduces: (a) overlooking unusual circumstances; (b) over-generalising when drawing conclusions from audit observations; and (c) using inappropriate assumptions in determining the nature, timing and extent of audit procedures and evaluating the results thereof. Almost every question on this topic wants both lists, so write both.

What scepticism is, put as an attitude: a questioning and alert mindset; awareness that material

misstatements may exist due to fraud or error; and a critical and careful evaluation of all audit evidence before reaching any conclusion.

The limb about past experience, which is examined on its own. The auditor may accept records and documents as genuine unless he has reason to believe the contrary, and he cannot be expected to disregard past experience of the honesty and integrity of the entity's management and those charged with governance. Nevertheless, a belief that management and those charged with governance are honest and have integrity does not relieve the auditor of the need to maintain professional scepticism. In cases of doubt about the reliability of information, or indications of possible fraud, the SAs require the auditor to investigate further and determine what modifications or additions to audit procedures are necessary to resolve the matter.

How it is applied to a fact pattern. Where a **large, material purchase is supported by only one internal document** and **management assures the auditor that this is the usual practice**, the printed answer says such a response **could affect the auditor's exercise of professional scepticism** and then runs the rule: professional scepticism is necessary to the critical assessment of audit evidence and includes consideration of the sufficiency and appropriateness of audit evidence obtained in the light of the circumstances — for example where fraud risk factors exist and a single document, of a nature susceptible to fraud, is the sole supporting evidence for a material financial statement amount. Management's assurance is not audit evidence; external corroboration is what is missing.

Understanding explain it, and place it in context • 2 questions

- Give the four examples and the three risks as two separate numbered lists. Running them together costs marks because the examiner counts items.
- Where the question quotes the 'past experience of honesty and integrity' sentence, the answer must end with the words 'does not relieve the auditor of the need to maintain professional scepticism'.

TQ 8.1 • PYQ 2019-Nov [2] (a) • 4M • Pg 703

LEVEL I
Understanding

Medium

TQ 8.2 • RTP 2022-Nov [2] (b) • Pg 704

LEVEL I
Understanding

Medium

Application use the Standard - apply it to the facts • 1 question

- State the rule sentence, then say what is wrong with the evidence on these facts, then say what the auditor should do — extend procedures and obtain corroboration — before concluding.

TQ 8.3 • MTP 2025-Aug S2 [4] (b) • 5M • Pg 704

LEVEL II
Application

Medium

Topic 9: Agreeing the Terms of Audit Engagements

L2P5-C11-T09

Read first Read ICAI Study Material Chapter 11, Ethics and Terms of Audit Engagements — SA 210, Agreeing the Terms of Audit Engagements, and the audit engagement letter.

NOTES

The Standard and its objective: SA 210, 'Agreeing the Terms of Audit Engagements', deals with the auditor's responsibilities in agreeing the terms of the audit engagement with management and, where appropriate, those charged with governance. The objective of the auditor is to accept or continue an audit engagement only when the basis upon which it is to be performed has been agreed, through (A) establishing whether the preconditions for an audit are present, and (B) confirming that there is a common understanding between the auditor and management and, where appropriate, those charged with governance, of the terms of the audit engagement. Two limbs; both are marked.

Preconditions, the test in full. In order to establish whether the preconditions for an audit are present, the auditor shall: (1) determine whether the financial reporting framework is acceptable; and (2) obtain the agreement of management that it acknowledges and understands its responsibility — (i) for the preparation of the financial statements in accordance with the applicable financial reporting framework, including their fair presentation where relevant; (ii) for such internal control as management considers necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; and (iii) to provide the auditor with access to all information such as records, documentation and other matters; additional information that the auditor may request from management for the purpose of the audit; and unrestricted access to persons within the entity from whom the auditor determines it necessary to obtain audit evidence.

The engagement letter: the auditor shall agree the terms of the audit engagement with management or those charged with governance, as appropriate, and the agreed terms shall be recorded in an audit engagement letter or other suitable form of written agreement. It is sent by the auditor to his client, and it is in the interest of both that it be issued, so that the possibility of misunderstanding is reduced to a great extent. **The contents are five:** (1) the objective and scope of the audit of the financial statements; (2) the responsibilities of the auditor; (3) the responsibilities of management; (4) identification of the applicable financial reporting framework for the preparation of the financial statements; and (5) reference to the expected form and content of any reports to be issued by the auditor and a statement that there may be circumstances in which a report may differ from its expected form and content.

The exception, which is asked as a separate limb: if law or regulation prescribes in sufficient detail the terms of the audit engagement, the auditor need not record them in a written agreement, except for the fact that such law or regulation applies and that management acknowledges and

understands its responsibilities as set out above.

The auditor's responsibilities as spelt out in the letter — asked as 'illustrate any five': (1) to conduct the audit in accordance with the Standards on Auditing issued by ICAI, complying with ethical requirements, applying professional judgement and maintaining professional scepticism throughout; (2) to identify and assess the risks of material misstatement whether due to fraud or error and perform procedures to obtain sufficient appropriate audit evidence — noting that the risk of not detecting fraud is greater than that of not detecting error, because fraud may involve collusion, forgery or management override of controls; (3) to obtain an understanding of internal control relevant to the audit, but not for the purpose of expressing an opinion on its effectiveness, communicating significant deficiencies in writing to management or those charged with governance; (4) to evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures; (5) to conclude on the appropriateness of management's use of the going concern basis and on whether a material uncertainty exists, based on the audit evidence obtained up to the date of the auditor's report, drawing attention to it in the report or modifying the opinion where disclosures are inadequate.

The trap this topic carries. Failing to send the engagement letter is not a mere procedural lapse: where the client's governing body consequently believed the purpose of the audit was to provide absolute assurance against probable errors and frauds, the printed answer holds that by not following the requirements of SA 210 the auditor is not acting ethically and has violated the principle of professional competence and due care, because maintaining professional competence requires awareness of current technical and professional standards. Link SA 210 to the ethics side of the chapter when the question invites it.

A request to convert the engagement is decided under this Standard too. Where, after significant audit procedures had been performed and serious inconsistencies in inventory records had been found, management asks for the audit to become a review engagement citing **time constraints and cost considerations**, the governing idea is that **a change is allowed only where there is reasonable justification** — and those two reasons are precisely the ones the Standard does not accept. The detail is in the topic on acceptance of a change in terms.

Understanding explain it, and place it in context · 2 questions

- The objective has two limbs: preconditions, and common understanding of terms. Give both; a question asking for the 'objective of the auditor' is marked on the pair.
- Where the question asks when a written agreement is not required, quote the exception in full including the two things that must still be recorded.

CSQ 9.1 · RTP 2024-May [24] · Pg 706

LEVEL I
Understanding

Medium

CSQ 9.5 · PYQ 2026-May [6] (a) · 5M · Pg 710

LEVEL I
Understanding

Medium

Application use the Standard - apply it to the facts • 3 questions

- Set out the SA 210 requirement first, then apply it to the facts, then state whose view is proper. An answer that jumps to the conclusion loses the application marks.
- In the 'illustrate any five responsibilities' format, give exactly five, each with its explanatory sentence. Listing ten in one line each does not score better.

CSQ 9.2 • PYQ 2024-Sep [5] (d) • 3M • Pg 707

LEVEL II
Application

Easy

CSQ 9.3 • MTP 2026-Mar S1 [6] (b) • 5M • Pg 708

LEVEL II
Application

Medium

CSQ 9.4 • PYQ 2025-May [3] (c) • 4M • Pg 709

LEVEL II
Application

Medium

Analysis break it down and take the parts separately • 1 question

- Where management restricts the auditor after the engagement has begun, **work the sequence**: request removal of the limitation, then communicate, then consider withdrawal or modification.
- Say what the auditor must not do — accept a change to a lower level of assurance where there is no reasonable justification for it.

CSQ 9.6 • PYQ 2026-Sep [1] (a) {C} • 5M • Pg 711

LEVEL II
Analysis

Medium

Topic 10: What Happens if Preconditions for an Audit are not Present?

L2P5-C11-T10

Read first Read ICAI Study Material Chapter 11, Ethics and Terms of Audit Engagements — SA 210 and what happens if the preconditions for an audit are not present.

NOTES

The definition first, and it is quoted verbatim in the answers: as per SA 210, 'Agreeing the Terms of Audit Engagements', preconditions for an audit may be defined as the use by management of an acceptable financial reporting framework in the preparation of the financial statements and the agreement of management and, where appropriate, those charged with governance to the premise on which an audit is conducted.

The two-step test. In order to establish whether the preconditions for an audit are present, the auditor shall: (a) determine whether the financial reporting framework is acceptable; and (b) obtain the agreement of management that it acknowledges and understands its responsibility — 1. for the preparation of the financial statements in accordance with the applicable financial reporting framework; 2. for the internal control as management considers necessary; and 3. to provide the auditor with access to all information such as records, documentation and other

matters, additional information that the auditor may request for the purpose of the audit, and unrestricted access to persons within the entity from whom the auditor determines it necessary to obtain audit evidence.

The consequence, which is the whole point of this topic: in case management does not provide such agreement acknowledging its responsibility, the auditor shall not accept the proposed audit engagement, unless required by law or regulation to do so. Note both halves — the refusal, and the statutory exception.

How it is applied. Where management says it is the auditor's duty to detect material misstatements and that the auditor's insistence is uncalled for, the printed answer holds that **the auditor's view is proper**, because design, implementation and maintenance of internal control to ensure preparation of reliable financial statements free from material misstatement is management's responsibility. Where management proposes **an internally designed accounting framework**, refuses **to acknowledge its responsibilities formally**, and offers records and personnel **only if considered necessary by management**, each of the three limbs is separately unsatisfied — take them one at a time and conclude that the engagement should be accepted only after an acceptable framework is determined and the acknowledgement obtained.

The classic wrong answer is that the auditor should accept and sort the access problems out during the audit. Unrestricted access is a **precondition**, not a matter to be negotiated later; a restriction agreed at the outset is a reason to decline the engagement.

Application use the Standard - apply it to the facts · 1 question

- Work through the limbs in order — framework, then each of the three acknowledgements — and say for each whether these facts satisfy it.
- End with the consequence in the Standard's words: the auditor shall not accept the engagement unless required by law or regulation.

TQ 10.1 · PYQ 2021-Dec [2] (a) · 4M · Pg 713

LEVEL II
Application

Medium

Topic 11: Acceptance of A Change in the Terms of the Audit Engagement

L2P5-C11-T11

Read first Read ICAI Study Material Chapter 11, Ethics and Terms of Audit Engagements — SA 210 and acceptance of a change in the terms of the audit engagement.

NOTES

The rule in one line: an auditor who, before the completion of the engagement, is requested to change the engagement to one which provides a lower level of assurance should consider the

appropriateness of doing so, and the auditor should not agree to a change of engagement where there is no reasonable justification for doing so. Everything else follows from the words **reasonable justification**.

The three circumstances in which a client may request a change: (1) a change in circumstances affecting the need for the service; (2) a misunderstanding as to the nature of an audit or related service originally requested; and (3) a restriction on the scope of the engagement, whether imposed by management or caused by other circumstances. The auditor would consider carefully the reason given for the request, particularly the implications of a restriction on the scope of the engagement, especially any legal or contractual implications.

Now separate the three, because the Standard treats them quite differently. A change in circumstances that affects the entity's requirements, or a misunderstanding concerning the nature of the service originally requested, may be considered a reasonable basis for requesting a change. In contrast, a change may not be considered reasonable if it appears that the change relates to information that is incorrect, incomplete or otherwise unsatisfactory. **The printed example:** where the auditor is unable to obtain sufficient appropriate audit evidence regarding receivables and the entity asks for the engagement to be changed to a review engagement to avoid a qualified opinion or a disclaimer of opinion, the request is **not reasonable**.

If the change is accepted: the auditor and management shall agree on and record the new terms of the engagement in an engagement letter or other suitable form of written agreement. If the audit work performed complied with the SAs applicable to the changed engagement, the report issued would be appropriate for the revised terms, and in order to avoid confusion the report would not refer to (1) the original engagement, or (2) any procedures that may have been performed in the original engagement — except where the engagement is changed to an engagement to undertake agreed-upon procedures, where reference to the procedures performed is a normal part of the report.

If the change is refused: where the auditor is unable to agree to a change of the terms and is not permitted by management to continue the original audit engagement, the auditor shall (1) withdraw from the audit engagement where possible under applicable law or regulation; and (2) determine whether there is any obligation, either contractual or otherwise, to report the circumstances to other parties, such as those charged with governance, owners or regulators. Both steps carry marks; the second is the one candidates omit.

A case where the change is justified. Where the company **diversified its business and introduced new products**, that is indicative of a significant change in the nature or size of the entity's business, so **the auditor can agree to the request**; the auditor shall check the justification for the change, and if justified shall accept the change and obtain the revised engagement letter.

The recurring trap: the reasons the question dangles — **time constraints, cost considerations, and the wish to avoid a modified opinion** — are exactly the ones the Standard does not accept, especially where the request arrives after significant procedures have been performed and after serious inconsistencies have been found. Draw the inference expressly: the request is to escape

the consequence of the findings, not a genuine change in requirements. The whole mark allocation turns on saying so.

Remembering reproduce what you have learnt • 1 question

- An enumerate question: **name the factors** that make revision or a reminder appropriate. Marks follow the number named, so list before you expand.
- Keep a change of terms apart from a reminder of existing terms; the question asks for both and they are different situations.

TQ 11.3 • PYQ 2025-Sep [3] (b) • 5M • Pg 716

LEVEL I
Remembering

Medium

Understanding explain it, and place it in context • 2 questions

- Give the three circumstances of a request before you sort them into reasonable and unreasonable. The list and the sorting are separately marked.

TQ 11.1 • RTP 2018-May [3] (b) • Pg 714

LEVEL I
Understanding

Medium

TQ 11.2 • RTP 2019-Nov [2] (a) • Pg 715

LEVEL I
Understanding

Medium

Application use the Standard - apply it to the facts • 2 questions

- Run the test in order: rule, the reason given, whether it is reasonable justification, then the consequence — accept and re-document, or refuse, withdraw and consider the duty to report.

CSQ 11.1 • PYQ 2022-Nov [2] (b) • 4M • Pg 716

LEVEL II
Application

Medium

CSQ 11.2 • MTP 2024-Dec S2 [2] (a) • 5M • Pg 717

LEVEL II
Application

Medium

Topic 12: Terms of Engagement in Recurring Audits

L2P5-C11-T12

Read first Read ICAI Study Material Chapter 11, Ethics and Terms of Audit Engagements — SA 210 and the terms of engagement in recurring audits.

NOTES

The rule in one line: as per SA 210, on recurring audits the auditor shall assess whether circumstances require the terms of the audit engagement to be revised and whether there is a need to remind the entity of the existing terms of the audit engagement. The auditor may decide

not to send a new audit engagement letter or other written agreement each period.

The answer to the standard question is yes, the auditor is right: it is not necessary to issue an audit engagement letter each year for a repetitive audit; it is enough if the same had been issued at the time of taking the initial engagement. Say that first, then give the factors.

The eight factors that may make it appropriate to revise the terms or to remind the entity of the existing terms — list them all, the marks are in the count: (1) any indication that the entity misunderstands the objective and scope of the audit; (2) any revised or special terms of the audit engagement; (3) a recent change of senior management; (4) a significant change in ownership; (5) a significant change in the nature or size of the entity's business; (6) a change in legal or regulatory requirements; (7) a change in the financial reporting framework adopted in the preparation of the financial statements; and (8) a change in other reporting requirements.

Notice the overlap with the change-in-terms topic. A significant change in the nature or size of the entity's business is the factor that justified agreeing to a change of terms where the company diversified and launched new products. The same fact can appear either as a reason to revise recurring terms or as a reason to accept a change — read which of the two the question is asking about before you begin.

Understanding explain it, and place it in context • 1 question

- The ask is why a new engagement letter may **not** be needed each period, and when it is. Answer both halves.
- Name the circumstances that make a new letter appropriate — a change in management, in ownership, in the nature or size of the business, or in the reporting framework.

TQ 12.2 • RTP 2021-May [2] (a) • Pg 719

LEVEL I
Understanding

Medium

Application use the Standard - apply it to the facts • 1 question

- Answer the 'is he right?' part first, in one sentence, then give the factors. An answer that opens with the list has not answered the question asked.

TQ 12.1 • PYQ 2015-Nov [1] (c) {C} • 5M • Pg 718

LEVEL II
Application

Medium

Topic 13: SQC 1

L2P5-C11-T13

Read first Read ICAI Study Material Chapter 11, Ethics and Terms of Audit Engagements — SQC 1 and the firm's system of quality control.

NOTES

The Standard and its full title, which is worth writing out: SQC 1, 'Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements'. The firm's system of quality control should include policies and procedures addressing each of the following elements: (a) leadership responsibilities for quality within the firm; (b) ethical requirements; (c) acceptance and continuance of client relationships and specific engagements; (d) human resources; (e) engagement performance; and (f) monitoring. Quality control policies and procedures should be documented and communicated to the firm's personnel; by communicating, the firm recognises the importance of obtaining feedback on its quality control system from its personnel, and therefore encourages its personnel to communicate their views or concerns on quality control matters.

Leadership responsibilities, and note the scope point the examiner sets: SQC 1 requires firms to establish policies and procedures designed to promote an internal culture based on the recognition that quality is essential in performing engagements — so such leadership responsibilities are required for all engagements, not for audit engagements only. The policies should require the firm's chief executive officer or managing partners to assume ultimate responsibility for the firm's system of quality control; the example set by the firm's leadership encourages an inner culture that recognises high quality audit work; and persons assigned operational responsibility for the system by the chief executive officer or managing partners should have sufficient and appropriate experience, ability and the necessary authority to assume that responsibility.

Ethical requirements and independence — three mechanisms, each asked on its own. There should exist a mechanism by which engagement partners provide the firm with relevant information about client engagements; personnel should promptly notify the firm of circumstances and relationships that create a threat to independence, and all breaches of independence should be promptly notified to the firm for appropriate action. And at least annually, the firm should obtain written confirmation of compliance with its policies and procedures on independence from all firm personnel who are required to be independent in terms of the requirements of the Code.

Engagement quality control review (EQCR): significant judgements made in an engagement should be reviewed by an engagement quality control reviewer for taking an objective view before the report is issued. **EQCR is mandatory for all audits of financial statements of listed entities;** in respect of other engagements, the firm should devise criteria to determine the cases requiring performance of an engagement quality control review. It is not mandatory for every engagement — that is the point the question is testing.

Documentation: the two numbers in this chapter. The auditor shall assemble the audit documentation in an audit file and complete the administration process of assembling the final audit file on a timely basis after the date of the auditor's report; an appropriate time limit within which to complete the assembly of the final audit file is ordinarily not more than 60 days after the date of the auditor's report. Assembly is an administrative process that does not involve the performance of new audit procedures or the drawing of new conclusions; permitted changes are

(a) deleting or discarding superseded documentation; (b) sorting, collating and cross-referencing working papers; (c) signing off on completion checklists relating to the file assembly process; and (d) documenting audit evidence that the auditor has obtained, discussed and agreed with the relevant members of the engagement team before the date of the auditor's report. After the assembly of the final audit file has been completed, the auditor shall not delete or discard audit documentation of any nature before the end of its retention period, and the retention period for audit engagements is ordinarily no shorter than 7 years from the date of the auditor's report or, if later, the date of the group auditor's report.

Complaints and allegations. The firm should establish policies and procedures designed to provide it with reasonable assurance that it deals appropriately with (a) complaints and allegations that the work performed by the firm fails to comply with professional standards and regulatory and legal requirements; and (b) allegations of non-compliance with the firm's system of quality control. Such complaints, which do not include those that are clearly frivolous, may originate from within or outside the firm and may be made by firm personnel, clients or other third parties. The firm establishes clearly defined channels for personnel to raise concerns in a manner that enables them to come forward without fear of reprisals; the investigation is supervised by a partner with sufficient and appropriate experience and authority within the firm but who is not otherwise involved in the engagement, and includes involving legal counsel as necessary; small firms and sole practitioners may use the services of a suitably qualified external person or another firm to carry out the investigation; **complaints, allegations and the responses to them are documented**; and where the results indicate deficiencies in design or operation, or non-compliance by an individual, the firm takes appropriate action.

Integrity of the client, before acceptance — seven matters, and the marks are in the count: (1) the identity and business reputation of the client's principal owners, key management personnel, related parties and those charged with governance; (2) the nature of the client's operations, including its business practices; (3) information relating to the attitude of the client's principal owners, key management personnel and those charged with governance towards matters such as aggressive interpretation of accounting standards and the internal control environment; (4) whether the client is excessively focused on keeping the firm's audit fees at the lowest possible level; (5) indications of any inappropriate limitation imposed on the scope of audit work; (6) indications that the client may be involved in money laundering or other criminal activities; and (7) the reasons for the proposed appointment of the audit firm and the non-reappointment of the previous firm.

Understanding explain it, and place it in context · 4 questions

- Where the question asks whether something is mandatory, answer yes or no first: EQCR is mandatory only for audits of listed entities; leadership responsibilities apply to all engagements, not only audits.

TQ 13.2 • MTP 2024-Mar [4] (d) • 3M • Pg 721	LEVEL I Understanding	Easy
TQ 13.3 • MTP 2024-Jul [3] (c) • 4M • Pg 722	LEVEL I Understanding	Medium
TQ 13.4 • MTP 2025-Nov S1 [4] (b) • 5M • Pg 722	LEVEL I Understanding	Medium

Application use the Standard - apply it to the facts • 2 questions

- In a client-acceptance scenario, list the seven integrity matters and then tie two or three of them to the facts given — raids, reluctance over fees, scope limitation. The list alone is only half the answer.

CSQ 13.1 • PYQ 2021-Jan [1] (a) {C} • 5M • Pg 723	LEVEL II Application	Medium
CSQ 13.2 • PYQ 2025-Sep [4] (b) • 5M • Pg 724	LEVEL II Application	Medium

Analysis break it down and take the parts separately • 1 question

- The question puts several short queries in a row. **Answer each in its own lettered line**, and give a direct yes or no before the reason.
- Where the query is whether something is mandatory, say for which engagements it is required rather than answering for all.

CSQ 13.3 • PYQ 2026-Jan [4] (c) • 4M • Pg 725	LEVEL II Analysis	Medium
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Topic 14: Elements of System of Quality Control

L2P5-C11-T14

Read first Read ICAI Study Material Chapter 11, Ethics and Terms of Audit Engagements — the elements of the system of quality control under SQC 1.

NOTES

The six elements again, because every answer in this topic begins by placing itself inside one of them: leadership responsibilities for quality within the firm; ethical requirements; acceptance and continuance of client relationships and specific engagements; human resources; engagement performance; and monitoring. Name the element the question is about, then give its policies.

Acceptance and continuance of client relationships — asked as 'preliminary engagement activities'. It should be ensured that appropriate procedures regarding acceptance and continuance of client relationships and audit engagements have been followed and that the conclusions reached in this regard are appropriate. (1) The firm should obtain information considered necessary in the circumstances before accepting an engagement with a new client, when deciding whether to

continue an existing engagement, and when considering acceptance of a new engagement with an existing client. (2) It should evaluate matters such as the integrity of the principal owners and key management. (3) It should assess the competence of the engagement team to perform the audit engagement. (4) The implications of matters that have arisen during the current and previous audit engagement may need to be considered. (5) In the case of initial engagements, communication with the predecessor auditor should be made where there has been a change of auditors. On facts where new owners withhold records and evidence is hard to obtain, limbs (2) and (4) are the ones that decide continuance.

Human resources. The firm should establish policies and procedures designed to provide it with reasonable assurance that it has sufficient personnel with the capabilities, competence and commitment to ethical principles necessary to perform its engagements in accordance with professional standards and regulatory and legal requirements, and to enable the firm or engagement partners to issue reports that are appropriate in the circumstances. The personnel issues addressed are eight: (a) recruitment; (b) performance evaluation; (c) capabilities; (d) competence; (e) career development; (f) promotion; (g) compensation; and (h) estimation of personnel needs. Addressing these issues enables the firm to ascertain the number and characteristics of the individuals required for the firm's engagements, and the firm's recruitment processes include procedures that help the firm select individuals of integrity as well as the capacity to develop the capabilities and competence necessary to perform the firm's work.

Engagement performance. The firm should establish policies and procedures designed to provide it with reasonable assurance that engagements are performed in accordance with professional standards and regulatory and legal requirements, and that the firm or the engagement partner issues reports that are appropriate in the circumstances. Through its policies and procedures the firm seeks to establish consistency in the quality of engagement performance, often accomplished through written or electronic manuals, software tools or other forms of standardised documentation, and industry or subject-matter specific guidance materials. The matters addressed are: how engagement teams are briefed on the engagement to obtain an understanding of the objectives of their work; processes for complying with applicable engagement standards; processes of engagement supervision, staff training and coaching; methods of reviewing the work performed, the significant judgements made and the form of report being issued; appropriate documentation of the work performed and of the timing and extent of the review; and processes to keep all policies and procedures current.

Monitoring. The purpose of monitoring compliance with quality control policies and procedures is to provide an evaluation of: (1) adherence to professional standards and regulatory and legal requirements; (2) whether the quality control system has been appropriately designed and effectively implemented; and (3) whether the firm's quality control policies and procedures have been appropriately applied, so that reports issued by the firm or engagement partners are appropriate in the circumstances. Three limbs, three marks.

Keep the two levels apart. These elements are the **firm-wide** system under **SQC 1**. The duties of the **engagement partner on a particular audit** belong to **SA 220**. A question about the firm's

policies is answered from the elements; a question about what the partner must do on this audit is answered from SA 220.

Understanding explain it, and place it in context · 2 questions

- The ask is the **policies and procedures** for an element of quality control, and what addressing them achieves. Both halves carry marks.
- Answer in the Standard's own vocabulary — the firm establishes policies and procedures designed to provide it with reasonable assurance. Quote that framing once.

TQ 14.1 · RTP 2021-Nov [3] (a) · Pg 726

LEVEL I
Understanding

Medium

TQ 14.2 · MTP 2023-Mar [2] (a) · 4M · Pg 727

LEVEL I
Understanding

Medium

Application use the Standard - apply it to the facts · 1 question

- In a continuance scenario, run the five acceptance-and-continuance steps in order and say which of them the facts put in issue, rather than writing about the client's conduct in general terms.

TQ 14.3 · PYQ 2026-Jan [2] (b) · 5M · Pg 728

LEVEL II
Application

Medium

Topic 15: SA 220- Quality Control for an Audit of Financial Statements

L2P5-C11-T15

Read first Read ICAI Study Material Chapter 11, Ethics and Terms of Audit Engagements — SA 220, Quality Control for an Audit of Financial Statements.

NOTES

The premise, and it is asked directly. SQC 1 and SA 220 both deal with quality control: SQC 1 applies to the entire firm, whereas SA 220 applies to a particular audit engagement. Based upon the quality control system of the firm established in accordance with SQC 1, quality control policies pertaining to audit engagements are decided by engagement teams, and the engagement partner is responsible for the quality control procedures of a particular audit engagement in accordance with SA 220 — therefore SA 220 is premised on the basis that the firm is subject to SQC 1. Within the context of the firm's system of quality control, engagement teams have a responsibility to implement quality control procedures applicable to the audit engagement. Audit quality is essential to maintain confidence in the independent assurance provided by auditors, and it is the responsibility of the auditor to maintain high audit quality.

The definition to quote: engagement partner refers to the partner or other person in the firm who

is responsible for the audit engagement and its performance, and for the auditor's report that is issued on behalf of the firm, and who, where required, has the appropriate authority from a professional, legal or regulatory body.

Leadership on the engagement. The engagement partner shall take responsibility for the overall quality on each audit engagement to which that partner is assigned. His actions and the appropriate messages to the other members of the engagement team emphasise (a) the importance to audit quality of — 1. performing work that complies with professional standards and regulatory and legal requirements; 2. complying with the firm's quality control policies and procedures as applicable; 3. issuing auditor's reports that are appropriate in the circumstances; and 4. the engagement team's ability to raise concerns without fear of reprisals; and (b) the fact that quality is essential in performing audit engagements.

Independence — the three-step conclusion, which is the most frequently set part of this Standard. The engagement partner shall form a conclusion on compliance with independence requirements that apply to the audit engagement. In doing so, he shall: (a) obtain relevant information from the firm and, where applicable, network firms, to identify and evaluate circumstances and relationships that create threats to independence; (b) evaluate information on identified breaches, if any, of the firm's independence policies and procedures to determine whether they create a threat to independence for the audit engagement; and (c) take appropriate action to eliminate such threats or reduce them to an acceptable level by applying safeguards, or, if considered appropriate, to withdraw from the audit engagement, where withdrawal is permitted by law or regulation. And then the sentence candidates forget: the engagement partner shall promptly report to the firm any inability to resolve the matter for appropriate action. Stopping at 'apply safeguards' loses the reporting mark.

Ethical requirements more generally. The partner's responsibilities are identifying a threat to independence regarding the audit engagement that safeguards may not be able to eliminate or reduce to an acceptable level, and reporting by the engagement partner to the relevant persons within the firm to determine appropriate action, which may include eliminating the activity or interest that creates the threat, or withdrawing from the audit engagement where withdrawal is legally permitted. On facts such as **a team member's spouse holding substantial shares in the client**, the firm having provided consultancy on internal financial controls to the same client, and **a partner offered a position on the advisory board of a group company** — label them as **self-interest, self-review and familiarity** threats, then give the possible actions: disposal of the financial interest, removal of the affected personnel from the engagement, discontinuation of the conflicting services, or withdrawal from the engagement where legally permitted.

Direction, supervision, review — and the EQCR duties. The engagement partner has the responsibility for the direction, supervision and performance of the audit engagement in accordance with professional standards and regulatory and legal requirements; **for ensuring that the auditor's report is appropriate in the circumstances; for review of the audit documentation before the issue of the audit report;** for ensuring that sufficient appropriate audit evidence has been obtained to support the conclusions reached and the issuance of the report; and for ensuring

that appropriate consultation is undertaken on difficult or contentious matters by the engagement team, not only within the team but also with others at an appropriate level within or outside the firm.

For listed entities and other engagements for which the firm has determined that an EQCR is required, the engagement partner shall: (a) determine that an engagement quality control reviewer has been appointed; (b) discuss significant matters arising during the audit engagement, including those identified during the engagement quality control review, with the engagement quality control reviewer; (c) not date the auditor's report until the completion of the engagement quality control review; and (d) where differences of opinion arise within the engagement team, with those consulted, or between the engagement partner and the engagement quality control reviewer, follow the firm's policies and procedures for dealing with and resolving differences of opinion. The conclusion the examiner wants on the pressure scenario is that the report is not to be dated until the EQCR is complete and the differences are resolved, notwithstanding management pressure. On monitoring, remember the three-limb purpose: evaluation of adherence to professional standards and regulatory and legal requirements; whether the quality control system has been appropriately designed and effectively implemented; and whether the firm's policies and procedures have been appropriately applied so that reports issued are appropriate in the circumstances.

Remembering reproduce what you have learnt • 1 question

- Quote the definition of 'engagement partner' in full; it is set as a stand-alone limb and it is two lines.
- Learn the four EQCR duties as a block of four — appointment, discussion, no dating until complete, differences of opinion.

CSQ 15.5 • PYQ 2026-Sep [2] (c) (ii) • 3M • Pg 737

LEVEL I
Remembering

Easy

Understanding explain it, and place it in context • 4 questions

- For 'SA 220 is premised on SQC 1', the answer is the firm level versus engagement level distinction. Say which Standard operates at which level before anything else.

TQ 15.3 • PYQ 2023-Nov [6] (c) • 3M • Pg 730

LEVEL I
Understanding

Easy

TQ 15.4 • RTP 2024-May [25] • Pg 731

LEVEL I
Understanding

Medium

TQ 15.5 • RTP 2024-Sep [10] • Pg 731

LEVEL I
Understanding

Medium

CSQ 15.4 • MTP 2026-Mar S1 [4] (b) • 5M • Pg 735

LEVEL I
Understanding

Medium

Application use the Standard - apply it to the facts · 4 questions

- Where the scenario mixes independence facts with management pressure, deal with them separately: first the three-step independence conclusion plus prompt reporting, then the EQCR duties and the refusal to date the report.
- Always end an independence scenario with the possible actions in escalating order, finishing with withdrawal where permitted by law or regulation.

TQ 15.2 · PYQ 2023-Nov [2] (c) · 3M · Pg 730	LEVEL II Application	Easy
CSQ 15.1 · PYQ 2024-May [6] (a) · 4M · Pg 732	LEVEL II Application	Medium
CSQ 15.2 · PYQ 2025-May [4] (b) · 5M · Pg 733	LEVEL II Application	Medium
CSQ 15.3 · PYQ 2026-Jan [1] (a) {C} · 5M · Pg 734	LEVEL II Application	Medium

Analysis break it down and take the parts separately · 1 question

- The ask is the **actions and the messages** of the engagement partner. Take them as two lists, because the Standard sets them out as two.
- Say what the partner's responsibility covers: the overall quality of that engagement, which is not discharged by the firm's system alone.

TQ 15.1 · MTP 2018-Aug [3] (a) · 5M · Pg 729	LEVEL II Analysis	Medium
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AT THE END OF THE BOOK

Corrigendum

Every printed Topic-Wise Question Frequency table in this Scanner was reconciled against the questions printed under it — topic by topic, on each of the PYQ, RTP and MTP columns separately, counting a question once for the sitting it was set in and once more for every repeat and every "Or" alternative printed on its head. One hundred and fifteen of the hundred and seventeen examined topics reconcile exactly. The two that do not are below, and neither affects a question, an answer or a page reference.

Counts that do not reconcile

Chapter 4, Audit Evidence — topic 1, Audit Evidence (SA 500)

Printed: The table declares 10 PYQ / 16 RTP / 6 MTP.

Read: The questions printed under the topic, with their repeats and "Or" alternatives, come to 10 PYQ / 16 RTP / 5 MTP.

One MTP appearance short. Stated as arithmetic, not as a verdict: it needs a reading of the topic to decide whether the table over-counts or a repeat line is missing from a question head.

Chapter 6, Audit Documentation — topic 5, Form, Content and Extent of Audit Documentation

Printed: The table declares 2 PYQ / 3 RTP / 1 MTP.

Read: The printed questions, with their repeats, come to 2 PYQ / 2 RTP / 1 MTP.

One RTP appearance short, on the same footing.

A block head printed without its section label

Chapter 5, Audit of Items of Financial Statements — topic 3.12, Balance Sheet Captions: Miscellaneous (page 353)

Printed: The block head "3.12" is followed straight by TQ 3.12.1, with no THEORY QUESTIONS label between them, unlike every other block in the book.

Read: The topic and its question are both correctly placed; only the section label is absent.

Recorded because a reader working down the chapter will notice the break in the pattern. These notes carry the topic in its own right.

Counted afresh on this edition: 662 questions across 132 declared topics, of which 117 carry questions and 15 are declared but not yet examined. 2,682 marks are printed on the question heads, and 71 questions carry an "Or" alternative — the same answer, set again in a different sitting. Questions from the newest sitting carry the Scanner's own answer key and solution hints rather than a worked answer, as the Front Matter explains.

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One MTP appearance short. Stated as arithmetic, not as a verdict: it needs a reading of the topic to decide whether the table over-counts or a repeat line is missing from a question head.

Chapter 6, Audit Documentation — topic 5, Form, Content and Extent of Audit Documentation

Printed: The table declares 2 PYQ / 3 RTP / 1 MTP.

Read: The printed questions, with their repeats, come to 2 PYQ / 2 RTP / 1 MTP.

One RTP appearance short, on the same footing.

A block head printed without its section label

Chapter 5, Audit of Items of Financial Statements — topic 3.12, Balance Sheet Captions: Miscellaneous (page 353)

Printed: The block head "3.12" is followed straight by TQ 3.12.1, with no THEORY QUESTIONS label between them, unlike every other block in the book.

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