



CAAP — Certified Accounting & Audit Professional – Auditing

Complete Book | Table of Contents | 25 chapters + 9 sections

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CH-1

Introduction to Auditing and Types of Audits

Topic 1 — Meaning and Definition of Audit

- **Meaning** — Audit is the **systematic examination and verification** of an organisation's financial records, transactions, procedures or systems.
- **Financial-statement audit** — It obtains **reasonable assurance** that the statements are free from **material misstatement**.
- **Output** — The auditor reports an **opinion** under the applicable financial reporting framework.

Definition by Spicer and Pegler

- **Examination** — Audit examines the **books, accounts and vouchers** of a business.
- **Purpose** — The auditor satisfies himself whether the **Balance Sheet** is properly drawn up.
- **View** — It must exhibit a **true and correct view** of the state of affairs.
- **Basis** — He judges by his best information, the explanations given to him and the books.
- **If not** — He states in what respects the Balance Sheet is untrue or incorrect.

Remember this

- Audit = examination → evidence → **opinion** (reasonable, not absolute, assurance).

Topic 2 — Features of Auditing

Feature	What it means in practice
Systematic and scientific	Planned examination of the books of a business or non-business entity
Verification of results	Checks results shown by the Profit & Loss Account and the state of affairs shown by the Balance Sheet
Critical review	Reviews the accounting system and internal control
Independence	Done by an independent, duly qualified person or body of persons
Evidence-based	Uses vouchers, documents, information and explanations from the entity's authorities
Opinion on true and fair view	Auditor satisfies himself on authenticity and reports whether statements show a true and fair view
Techniques	Inspect, compare, check, review and scrutinise vouchers supporting transactions
Statutory records	Examines correspondence, minutes books of shareholders and directors, Memorandum and Articles of Association , bye-laws
Mode of work	On-site and remote procedures; nature and extent depend on the engagement and the need for sufficient appropriate evidence

Topic 3 — Importance and Purpose of Audit

Importance	How audit helps
Enhancing credibility	Assures investors, lenders and shareholders about the accuracy and reliability of financial information
Detecting errors and fraud	Identifies errors, irregularities or fraud so that timely corrective action can be taken
Compliance assurance	Assesses relevant compliance within its scope ; it does not guarantee compliance with every law or internal policy
Operational efficiency	Uncovers inefficiencies and redundancies, leading to cost savings
Risk management	Identifies weaknesses in internal control and processes, helping mitigate fraud, error and inefficiency

Purpose of an audit

- An **objective and independent** examination of the financial statements.
- To enhance the **credibility** of the financial statements and increase users' confidence, reducing risk to investors.
- To assess conformity with **Generally Accepted Accounting Principles (GAAP)** and the prescribed **Accounting Standards / Ind AS**.
- To understand and test relevant **internal controls** as needed to assess risks and design procedures. This does not by itself produce a separate opinion on controls.

Topic 4 — Scope of Audit

- **Widening scope** — The scope of audit widens as business becomes more complex.
- **Long-term aim** — Audit serves as a **guide to management's future decisions**.
- **Wider meaning** — Audit verifies accounts to give an opinion on their reliability.
- **Other engagements** — So the term also covers **cost audit, management audit, social audit** and similar work.

The auditor **expresses an opinion** and discharges statutory reporting duties, including reporting of fraud. The auditor does **not** impose punishment; prosecution is for the authorities.

Topic 5 — Objectives of Auditing

Objective	Content
Primary	Section 143, Companies Act, 2013 : the auditor reports to members on whether statements give a true and fair view of financial position, profit or loss and cash flows . He also checks correct recording and recognised accounting policies
Secondary – errors	Find errors through examination of records; recommend corrective action and better internal control to prevent recurrence
Secondary – frauds	Assess fraud risk and respond to get reasonable assurance on material misstatement. Detecting every fraud is not guaranteed . Advise anti-fraud measures such as segregation of duties and fraud-awareness training

Topic 6 — Accounting Errors

- **Meaning** — **Accounting errors** are unintentional mistakes in recording, processing or reporting transactions.
- **Effect** — They make the financial statements inaccurate.
- **Errors of principle** — These arise from **ignorance of accounting principles**.
- **Clerical errors** — These arise from **negligence of accounting staff**.



Type	Nature	Effect on trial balance
Clerical errors	Mistakes in recording, data entry, calculation or reporting	Depends on the sub-type
Error of complete omission	Transaction wholly not recorded, e.g. credit purchase from Mr Ram not entered in the purchase journal	Does not affect the trial balance
Error of partial omission	Only part of the transaction recorded, e.g. posted to one account but not the other	Trial balance disagrees
Error of commission	Correct amount on wrong side; wrong amount on correct side; wrong amount on wrong side; totalling error in a subsidiary book or ledger; balancing error	Usually disagrees (a wrong amount in the original entry, e.g. goods ₹30,000 entered as ₹3,000, does not)
Compensating errors	Two or more errors offset each other, so totals look correct	Does not affect the trial balance
Errors of principle	Violation of accounting principles in recording or presentation, e.g. capital expenditure treated as revenue	Does not affect the trial balance

Example: Salary paid ₹25,000 is recorded as ₹52,000 (transposition, a clerical error). If the sales account is also over-credited by ₹27,000, the two errors compensate and the trial balance still agrees, yet both accounts are wrong.

Topic 7 — Procedures to Locate and Rectify Errors

Step	Auditor's action
Review trial balance	Check totals of debit and credit balances
Match account names	Compare ledger account names with the trial balance to ensure all accounts are included and correctly named
Verify totals and balances	Check every account total and balance and its proper presentation
Check postings	Trace entries from books of original entry to the ledger and the trial balance
Review round figures	Investigate differences of round figures such as 10, 100 or 1,000 , which often point to casting or carry-forward errors

Topic 8 — Fraud and Its Types

- **Meaning** — **Fraud** is an **intentional deception** to secure an unfair or unlawful gain, directly or indirectly.
- **Fraud vs error** — Intention separates fraud from error.
- **Primary responsibility** — **Management** and those charged with governance must prevent and detect fraud.
- **Auditor's role** — The auditor examines evidence and communicates findings under applicable duties.

Type	Method	Detection
Misappropriation of cash	Most common; inflated expenses or suppressed receipts. Teeming and lading : cash from one customer is pocketed and covered by later receipts from another	Vouching, debtor confirmations, surprise cash counts
Misappropriation of goods	Records show goods not purchased or not issued to production; goods used personally	Stock records and physical verification

Type	Method	Detection
Manipulation of accounts (window dressing)	Statements misrepresented to evade tax, borrow from banks or raise share prices	Thorough scrutiny and analysis of transactions

- **₹1 crore or more** — Under **Section 143(12), Companies Act, 2013**, a company auditor reports suspected fraud by officers or employees to the **Central Government**.
- **Below ₹1 crore** — Such frauds are reported to the **Audit Committee / Board**.

Topic 9 — Advantages of Audit

Business point of view	Investors' point of view	Other advantages
Detection of errors and frauds	Protects investors' interest	Settlement of claims and of accounts
Evaluates financial status	Enhances confidence in the company's ability	Proper valuation of assets
Helps in loan formalities	Supports listing of shares	Good security / evidence; government acceptance as it facilitates taxation
Builds reputation	Proper valuation of investments	Updated position of accounts available readily; facilitates purchase consideration in mergers

Audited accounts are **evidence** before courts and authorities, but **not conclusive proof**.

Topic 10 — Limitations of Auditing

Limitation	Details
Non-detection of errors and frauds	Frauds committed with mala fide intention , collusion or management override may remain undetected; this does not excuse inadequate work
Dependence on explanations	Explanations must be evaluated critically; management representations do not replace sufficient appropriate evidence
Dependence on experts	Relies on lawyers, engineers, architects, valuers; the auditor still evaluates the expert and remains responsible for the opinion
Conflict of opinion	Differences with accountants, management or engineers are resolved by personal judgement , which varies between auditors
Effect of inflation	Statements on historical cost may not show the true picture during inflation
Improper influence	Pressure from management is a threat to independence requiring safeguards, not an acceptable limitation
No assurance on future	No assurance about future profitability or prospects
Detailed checking not possible	Risk-based selection and sampling are used instead of checking every transaction

Topic 11 — Reasonable Assurance and Responsibilities

Standard / rule	Requirement
SA 200	Reasonable assurance – a high but not absolute level – that statements as a whole are free from material misstatement due to fraud or error; not certification of every transaction or of future performance
SA 240	Auditor assesses fraud risks , responds with procedures and maintains professional scepticism . Collusion and management override raise non-detection risk but do not excuse inadequate work
Investigation	May be voluntary, regulatory or statutory ; its scope depends on its purpose and authority
Quality control	ICAI has deferred the mandatory date of SQM 1 and SQM 2 until further announcement. SQC 1 continues. Current Indian standards are not replaced automatically by international standards or earlier scheduled dates

Topic 12 — Types of Audits

Audit	Essence	Key point
Statutory	Required by law, e.g. all companies under the Companies Act, 2013	Independent opinion to shareholders on true and fair view
Periodical / Annual	Starts after the financial year closes	Common in small organisations
Interim	During the year, before year-end, often mid-way	Periodic insights for management
Balance Sheet	Partial audit of Balance Sheet items only	Assets and liabilities fairly stated
Cost	Verification of cost accounting records	Statutory only for prescribed companies meeting thresholds
Management	Evaluates management practices, policies and strategies	Improves management performance
Continuous	Auditor visits at regular intervals through the year	Real-time or near-real-time checking
Compliance	Checks adherence to internal or regulatory standards	Regulated industries, education, hospitals
Financial	Fairness of financial statements	Most common; at or after year-end
Information Systems	Controls over IT systems	Confidentiality, integrity, availability of information
Investigation	Specific area or person on suspicion of fraud	Locate control breaches; collect evidence for charges
Operational	Efficiency and effectiveness of operations	Streamline operations
Tax	Checks that the correct tax is paid	Income-tax audit under statutory conditions; GST audits differ from self-certified reconciliation
Product	A product or service against specifications	Quality, reliability, conformity
Process	Processes, procedures and workflows	Effectiveness, efficiency, compliance
Follow-up	Whether earlier recommendations were implemented	Effectiveness of corrective action

Cost audit thresholds (Companies (Cost Records and Audit) Rules)

- Regulated sectors** — Overall turnover of **₹50 crore or more** and individual product turnover of **₹25 crore or more**.
- Non-regulated sectors** — Overall turnover of **₹100 crore or more** and individual product turnover of **₹35 crore or more**.

Topic 13 — Mandatory and Voluntary Audits

Mandatory (required by law)	Voluntary (unless a law requires it)
Companies – Companies Act, 2013	Proprietary concerns
Banking companies – Banking Regulation Act, 1949	Partnership firms
Electricity companies – Companies Act / applicable statute (the Electricity (Supply) Act, 1948 was repealed by section 185 of the Electricity Act, 2003)	Hindu Undivided Families
Co-operative societies – the relevant State or Multi-State Co-operative Societies law (not one universal Act)	—
Public and charitable trusts under religious and endowment Acts	—
Statutory corporations, e.g. Life Insurance Corporation of India	—
Tax audit – Section 63, Income-tax Act, 2025 from tax year 2026-27; periods up to FY 2025-26 remain under Section 44AB of the 1961 Act	—

- Not always voluntary** — Proprietorships, firms and HUFs are **not always outside mandatory audit**.
- Business** — **Tax audit** applies when turnover or gross receipts exceed **₹1 crore**.
- Higher limit** — The limit is **₹10 crore** where cash receipts and cash payments are each **5% or less** of the totals.
- Profession** — Tax audit applies when professional gross receipts exceed **₹50 lakh**.
- Period** — Apply the conditions of the relevant tax period; legal form alone does not decide the duty.
- Cost audit** — It likewise is not automatic for every industrial or service business.
- GSTR-9C** — The former turnover-based **CA / CMA certification** is no longer required.
- Above ₹5 crore** — Taxpayers with aggregate turnover above **₹5 crore** file a **self-certified** reconciliation statement.
- See** — Ch 2 (p. 6) for GST departmental audit (section 65) and special audit (section 66).

Topic 14 — Accounting versus Auditing

Basis	Accounting	Auditing
Meaning	Recording day-to-day transactions leading to financial statements	Critical examination of recorded transactions
Nature	Preparation and finalisation of accounts	Reliability of financial statements
Objective	Ascertain financial results	Express an opinion in all material respects; not certify every result
Scope	Books of account and financial statements; does not go beyond the books	Varies with requirements of management, stakeholders and law
Commencement	Begins when book-keeping ends	Begins when accounting ends

**Topic 15 — Auditing versus Investigation**

Basis	Auditing	Investigation
Objective	Whether statements show a true and fair view	Essential facts about a matter under enquiry
Period	Usually one accounting year	May cover more than one year
Scope	Restricted to financial statements	Wider; may go beyond financial statements
Compulsion	Compulsory for companies and certain entities (income-tax, GST)	Voluntary, or required by law / regulator
Time	Generally at year-end	Any time , on suspicion
Report	Prescribed form ; presented to shareholders	No prescribed form; presented to the client
Appointment	By the owners	Even a third party can appoint
Qualification	Statutory auditor must be duly qualified (CA)	Need not be a Chartered Accountant

CAAP | Module A | CH-1 | MCQs

Q1. An auditor states that the financial statements are free from material misstatement. The level of assurance this opinion carries under SA 200 is: [Ref: Topic 11, p. 4]

- (a) Absolute assurance on every transaction
- (b) Reasonable assurance – high but not absolute
- (c) Limited assurance as in a review
- (d) Assurance on future profitability

Q2. A credit purchase from a supplier is not entered anywhere in the books. The trial balance will: [Ref: Topic 6, p. 2]

- (a) Show a difference equal to the purchase
- (b) Show double the purchase amount
- (c) Still agree
- (d) Show the difference in the suspense account automatically

Q3. Purchase of machinery is debited to the Repairs Account. This is: [Ref: Topic 6, p. 2]

- (a) An error of partial omission
- (b) A compensating error
- (c) A teeming and lading fraud
- (d) An error of principle

Q4. A cashier pockets ₹40,000 received from customer A and later credits A's account using money received from customer B. This fraud is known as: [Ref: Topic 8, p. 3]

- (a) Teeming and lading
- (b) Window dressing
- (c) Misappropriation of goods
- (d) Error of commission

Q5. A statutory auditor of a company suspects a fraud of ₹1.5 crore by employees. Under Section 143(12) of the Companies Act, 2013, it is reported to: [Ref: Topic 8, p. 3]

- (a) The shareholders at the AGM only
- (b) The Audit Committee only
- (c) The Central Government
- (d) The bank's lenders

Q6. While checking a trial balance, the difference is exactly ₹1,000. The auditor should first suspect: [Ref: Topic 7, p. 3]

- (a) An error of principle
- (b) A complete omission
- (c) A compensating error
- (d) A casting or carry-forward error

Q7. Which statement about the auditor's reliance on experts is correct? [Ref: Topic 10, p. 3]

- (a) The auditor evaluates the expert and remains responsible for the opinion
- (b) The expert's opinion fully replaces audit evidence
- (c) Responsibility passes to the expert
- (d) Experts may be used only in tax audits

Q8. Which is NOT a valid limitation of auditing? [Ref: Topic 10, p. 3]

- (a) Use of sampling instead of 100% checking
- (b) No assurance about future profitability
- (c) Accepting improper influence by management
- (d) Historical cost statements during inflation

Q9. A non-regulated sector company has overall turnover of ₹120 crore and one product with turnover of ₹40 crore. Under the cost audit rules, it: [Ref: Topic 12, p. 4]

- (a) Is exempt as turnover is below ₹150 crore
- (b) Needs only a tax audit
- (c) Needs cost audit only if listed
- (d) Is covered, as both ₹100 crore and ₹35 crore limits are met

Q10. A trader's turnover is ₹6 crore and cash receipts and cash payments are each 3% of totals. Under the tax-audit provision (Section 63, Income-tax Act, 2025), audit is: [Ref: Topic 13, p. 4]

- (a) Required, as turnover exceeds ₹1 crore
- (b) Required, as turnover exceeds ₹5 crore
- (c) Not required, as the ₹10 crore limit applies
- (d) Required only for GST

Q11. Which audit begins only on suspicion, may cover several years and can be ordered by a third party? [Ref: Topic 15, p. 5]

- (a) Statutory audit
- (b) Interim audit
- (c) Balance Sheet audit
- (d) Investigation

Q12. Auditing differs from accounting because auditing: [Ref: Topic 14, p. 4]

- (a) Records day-to-day transactions
- (b) Begins when accounting ends and critically examines the records
- (c) Prepares the financial statements
- (d) Begins when book-keeping ends

Q13. A company auditor suspects an employee fraud of ₹80 lakh. Under Section 143(12) of the Companies Act, 2013, it is reported to: [Ref: Topic 8, p. 3]

- (a) The Audit Committee / Board
- (b) The Central Government within 2 days
- (c) The Registrar of Companies
- (d) Only in the CARO annexure

Q14. Fraud at a client involved collusion between senior managers who overrode controls, and the auditor missed it despite weak procedures. Which statement is correct? [Ref: Topic 11, p. 4]

- (a) Collusion fully excuses the auditor
- (b) Management override shifts primary responsibility to the auditor
- (c) Collusion raises non-detection risk but does not excuse inadequate audit work
- (d) SA 240 does not apply to management fraud

Q15. A taxpayer with aggregate GST turnover of ₹8 crore files its GST annual reconciliation. Which is correct? [Ref: Topic 13, p. 4]

- (a) It must be certified by a Chartered Accountant
- (b) It is a departmental audit under section 65
- (c) It is a special audit under section 66
- (d) It files a self-certified reconciliation statement

Answer key

Q	Ans	Q	Ans	Q	Ans	Q	Ans	Q	Ans
1	b	4	a	7	a	10	c	13	a
2	c	5	c	8	c	11	d	14	c
3	d	6	d	9	d	12	b	15	d

CH-2

Bank Audit and Various Types of Audits in Banks

Topic 1 — Bank Audit and the Role of Administrative Offices

- **Meaning** — Bank audit reviews the financial statements, services and procedures of banks and financial institutions.
- **Basis** — It is required by various laws and **RBI directions**.
- **Nature** — It is a routine procedural audit that every financial-services entity undergoes.
- **Purpose** — It confirms adherence to industry standards and regulatory norms.

Banking business is done mainly at **branches**; **administrative offices** (regional, zonal, area and central offices) act as controlling and monitoring authorities.

Functions of administrative offices

Lay down policies, systems and **internal control** procedures in line with statutory and regulatory requirements

Ensure compliance with accepted **accounting principles** covering all transactions and economic events

Ensure proper use of **delegated powers** at each layer and fix responsibility and accountability

- **Technology** — It has enabled anytime-anywhere banking, doorstep services, real-time access to customer data and fast e-banking transactions.
- **Control systems** — Strong controls are therefore essential to contain errors, omissions, irregularities and frauds.
- **Balance** — These controls must work while keeping banking convenient.

Topic 2 — Risk-Based Internal Audit

- **RBI view** — A sound **internal audit** function makes the internal control system effective.
- **RBIA introduced** — **Risk-Based Internal Audit (RBIA)** came for **Scheduled Commercial Banks** by RBI circular of **27 December 2002**.
- **Meaning** — **Internal audit** is an independent, objective evaluation of the bank's internal controls, risk management and governance.
- **Who does it** — It is done by **bank staff**; outside experts may assist.
- **No outsourcing** — The function as a whole **cannot be outsourced**.
- **See** — Ch 4 (p. 14) for the internal audit function and Ch 5 (p. 17) for RBIA.

Topic 3 — Concurrent Audit

- **Meaning** — **Concurrent audit** examines financial transactions and operations **at or close to the time they occur**.
- **Feedback** — It gives timely feedback on internal controls and compliance.
- **Management process** — It is an integral process to establish sound internal accounting and effective controls.
- **Prevention** — These controls prevent significant errors and frauds.
- **Auditors** — Banks may use trained **own staff** or **external auditors** under an approved policy.

Typical compliance checks

Daily **maximum cash balance** (cash retention limit) and **KYC** norms

Typical compliance checks

Documentation of new loan disbursements

Assessment of new loans as per rules and bank policy

Correct charging of interest on loans and payment of interest on deposits to prevent **revenue leakage**

Coverage is **risk-based**. The bank brings the following under concurrent audit when identifying its risk-sensitive areas:

Coverage element	What must be brought under concurrent audit
New risk areas	Centralised operations units , specialised branches and critical head office departments
High-risk branches	Branches rated high risk in the last RBIA , or where internal audit found serious deficiencies
Specialised branches	Agri, SME, Large / Mid Corporate, Exceptionally Large and Very Large Branches (ELBs / VLBs), overseas branches, investment banking, portfolio management, treasury, forex, back office
Fraud-prone activities	Cash, deposits, advances, foreign exchange, off-balance sheet items, credit cards, internet banking

- **Governing rules** — Concurrent audit for commercial banks now follows the **RBI (Commercial Banks – Concurrent Audit) Directions, 2026**.
- **Out of scope** — **Small finance banks, payments banks and local area banks** follow the directions issued for their own category.
- **Review** — Every bank must review its existing concurrent audit system against the current rules.
- **Approval** — Changes need the prior approval of the **Audit Committee of the Board (ACB)**, or the **Local Management Committee (LMC)** for foreign banks.

Element	Current requirement
Coverage	Set by the Head of Internal Audit (HIA) with prior ACB approval (LMC for foreign banks). Must cover risk-sensitive areas of the business model and all Centralised Processing Centres . The old 50% of deposits and advances test is dropped.
Detailed scope	Determined and approved by the ACB / LMC
Appointment	Own staff or external auditors at the bank's discretion under a Board / ACB approved policy; HIA participates in selection and reviews quality of outsourced auditors
Independence	A partner of a CA firm cannot be concurrent auditor if another partner of the firm is a director of the bank; internal staff must be experienced, trained and independent of the unit audited
Accountability	Serious omission or commission by an external firm: appointment cancelled after a reasonable opportunity of being heard, reported to ACB / LMC, RBI and ICAI . Bank frames a policy on accountability of own or retired staff
Tenure	External auditor: continuous tenure with the bank up to 5 years ; no auditor at the same branch / business unit for more than 3 years . Retired staff: age not above 70 years
Remuneration	Fixed by the ACB / LMC ; commensurate with scope, skills, staff and time required
Review	ACB / LMC reviews effectiveness of the system and performance of auditors annually

Remember this

- Tenure code **5-3-70**: 5 years with the bank, 3 years at one unit, retired staff up to age 70.