

Contents

	PAGE
<i>About the Author</i>	I-5
<i>Preface to Second Edition</i>	I-7
<i>Gratitude</i>	I-11
<i>Chapter-Heads</i>	I-13

1

INTRODUCTION TO AUDIT OF FINANCIAL STATEMENTS

1.1	Financial Statements	1
1.2	Audit of Financial Statements	5
1.3	The need for a structured approach for 'Audit of Financial Statements'	7

2

PRELIMINARY ACTIVITIES, APPOINTMENT, ROTATION, RESIGNATION AND REMOVAL OF AUDITORS

2.1	Introduction	10
2.2	Appointment as auditors	11
2.3	Auditor Independence	15
2.4	Rotation of auditors	17
2.5	Resignation by auditors	18
2.6	Removal of auditors	20
2.7	Reporting requirements	24
APPENDIX 1	: Proposal for appointment	25

	PAGE
APPENDIX 2 : Client/Engagement Acceptance and Continuance Form	26
APPENDIX 3 : Consent and auditor certificate	31
APPENDIX 4 : Appointment letter	32
APPENDIX 5(a) : NOC Request from previous auditors	34
APPENDIX 5(b) : Reply to NOC Request	35
APPENDIX 6 : Acceptance of appointment	36
APPENDIX 7 : Know your client	37
APPENDIX 8 : Engagement letter	40
APPENDIX 9 : Independence and confidentiality declaration	47

3

JOINT AUDIT

3.1 Introduction	49
3.2 Legal provisions	49
3.3 Joint audits	50
3.4 Other matters	53
APPENDIX 1 : Statutory audit of PQR limited	55
APPENDIX 2 : Work distribution between the joint auditors for the year ended: March 31, 2023	58

4

ASSESSMENT OF RISKS OF MATERIAL MISSTATEMENT

4.1 Introduction	61
4.2 Reasonable assurance	61
4.3 Material misstatement	62
4.4 Audit risk	62
4.5 Inherent risk	63
4.6 Control risk	63
4.7 Detection risk	63
4.8 Benefits of risk based audit	63
4.9 Concept of risk assessment	64

	PAGE
APPENDIX 1 : Risk assessment procedures	78
APPENDIX 2 : Risk table	79

5

ASSESSING INHERENT RISKS OF MATERIAL MISSTATEMENT

5.1 Introduction	80
5.2 Understanding the entity and its environment	81
5.3 Preliminary analytical review	90
5.4 Conclusion	92
APPENDIX 1 : Understanding the entity and its environment	93

6

EVALUATION AND RESPONSE TO RISK OF FRAUD

6.1 Introduction	94
6.2 Characteristics of fraud	94
6.3 Fraud triangle	95
6.4 Types of fraud	96
6.5 Responsibility for the prevention and detection of fraud	97
6.6 Responsibilities of the auditor	98
6.7 Planning to detect fraud	99
6.8 Responses to risks of material misstatement due to fraud	105
6.9 Evaluation of audit evidence	108
6.10 Consideration of impact on the financial statements	109
6.11 Communication to management and those charged with governance	109
6.12 Reporting requirements and audit opinion	109
6.13 Documentation	110
6.14 Management representations	111
6.15 Withdrawal from the engagement	111
APPENDIX 1 : Illustrative checklist for inquiries with board/audit committee, management and internal auditor	113
APPENDIX 2 : Fraud risk assessment	118

7**EVALUATION OF INFORMATION
TECHNOLOGY ENVIRONMENT**

7.1	Introduction	<i>120</i>
7.1A	Information technology controls	<i>120</i>
7.2	General information technology controls	<i>121</i>
7.3	Audit trail	<i>123</i>
7.4	Conclusion	<i>125</i>
APPENDIX 1 :	Evaluation of IT environment	<i>126</i>

8**UNDERSTANDING INTERNAL CONTROLS**

8.1	Introduction	<i>127</i>
8.2	Objectives of internal control	<i>127</i>
8.3	Need for understanding internal control	<i>128</i>
8.4	Auditor and internal control	<i>128</i>
8.5	Limitations of internal control	<i>131</i>
8.6	Controls relevant to the audit	<i>132</i>
8.7	Components of internal control	<i>133</i>
8.8	What a satisfactory control environment means?	<i>137</i>
8.9	Evaluation of internal controls	<i>138</i>
8.10	Types of controls	<i>139</i>
8.11	Testing of internal controls	<i>142</i>
APPENDIX 1 :	Internal control questionnaire	<i>146</i>
APPENDIX 2 :	Illustrative flow chart for understanding internal controls	<i>174</i>
APPENDIX 3 :	Template for documenting walkthrough of internal controls	<i>175</i>

9**USING THE WORK OF INTERNAL AUDITOR**

9.1	Introduction	<i>177</i>
------------	--------------	------------

	PAGE	
9.2	Legal requirement	177
9.3	Relevance of internal audit function in statutory audit	179
9.4	Consideration of internal audit function at planning stage	181
9.5	Using the work of internal auditor and consideration of reports of internal auditor	181
9.6	Procedures to be performed by the auditor	183
9.7	Reporting requirements	183
APPENDIX 1 :	Evaluation of internal audit function and risks identified	185

10

MATERIALITY

10.1	Introduction	188
10.2	Factors affecting materiality	189
10.3	Types of materiality	190
10.4	Overall materiality	190
10.5	Performance materiality	196
10.6	Specific materiality	198
10.7	Specific performance materiality	199
10.8	Clearly trivial	199
10.9	Revision of materiality	200
10.10	Documentation	201
APPENDIX 1 :	Template for calculating materiality	202

11

RESPONSE TO ASSESSED RISKS

11.1	Introduction	207
11.2	Overall responses to risks at the financial statement level	209
11.3	Response to assessed risks at the assertion level	211
11.4	Timing of audit procedures	217
11.5	Responding to the risk of fraud	218
11.6	Substantive procedures related to the financial statement closing process	219

	PAGE
11.7 Adequacy of presentation and disclosure	220
11.8 Ascertaining whether the audit plan is complete	220
11.9 Documentation	221
11.10 Communication of the plan	221
11.11 Conclusion	221
APPENDIX 1 : Sample audit program	223

12

FURTHER AUDIT PROCEDURES

12.1 Introduction	226
12.2 Substantive procedures	228
12.3 Conclusion	239

13

ENGAGEMENT TEAM DISCUSSIONS

13.1 Introduction	241
13.2 Benefits of engagement team discussion	241
13.3 Objectives of engagement team discussion	242
13.4 Holding engagement team discussions	242
13.5 Documentation	244
APPENDIX 1 : Engagement team discussion	245

14

AUDIT MANAGEMENT AND LOGISTICS

14.1 Introduction	249
14.2 Audit plan	249
14.3 Assigning roles & responsibilities	255
14.4 Time budget	255
14.5 Audit planning memorandum	256
14.6 Audit program	256
14.7 Requirement list	257
APPENDIX 1 : Illustrative audit timetable	260

	PAGE
APPENDIX 2 : Roles & responsibilities	262
APPENDIX 3 : Total budgeted hours	265
APPENDIX 4 : Audit planning memorandum	270
APPENDIX 5 : Illustrative audit program	274
APPENDIX 6 : Requirement list	284

15

COMMUNICATION WITH THOSE CHARGED WITH GOVERNANCE

15.1 Introduction	286
15.2 Matters to be communicated	287
15.3 Other considerations	288
APPENDIX 1 : Requirements of SQC 1 & Standards on Auditing Regarding Communication with TCWG	289
APPENDIX 2 : Draft letter to those charged with governance	297

16

COMPLETION OF PLANNING

16.1 Introduction	301
16.2 Matters to be considered	301
16.3 Conclusion	302

17

CORE CONCEPTS

17.1 Introduction	303
17.2 Professional skepticism	303
17.3 Evaluating misstatements	306
17.4 Confirmations	315
17.5 Audit documentation	323
APPENDIX 1 : Summary of adjusted audit differences	330
APPENDIX 2 : Illustrative control sheet for external confirmations	333

18**AUDIT EVIDENCE**

18.1	Introduction	334
18.2	Audit evidence	334
18.3	Possible sources from which the auditor can gather audit evidence	334
18.4	Key characteristics of audit evidence	335
18.5	Factors affecting sufficiency and appropriateness of audit evidence	335
18.6	Factors affecting reliability of audit evidence	336
18.7	Obtaining sufficient & appropriate audit evidence	336
18.8	Types of audit evidence	337
18.9	Specific considerations for selected items	338

19**OPENING BALANCES**

19.1	Introduction	340
19.2	Continuing engagements	340
19.3	Initial engagements	341
APPENDIX 1 :	Verification of opening balances brought forward	345

20**AUDIT SAMPLING**

20.1	Introduction	346
20.2	Types of sampling	347
20.3	Factors affecting the sample size	347
20.4	The sampling process	348
20.5	Other matters	350

21**AUDIT OF SHARE CAPITAL**

21.1	Introduction	351
21.2	Audit of share capital	353
21.3	Reporting requirements	368
21.4	Disclosure requirements as per Schedule III (Division 1) of the Companies Act, 2013	369

22**AUDIT OF RESERVES & SURPLUS**

22.1	Introduction	373
22.2	Audit of reserves and surplus	374
22.3	Disclosure requirements as per Schedule III (Division 1) of the Companies Act, 2013	376

23**AUDIT OF BORROWINGS**

23.1	Introduction	379
23.2	Audit of borrowings	380
23.3	Reporting requirements	388
23.4	Disclosure requirements as per Schedule III (Division 1) of the Companies Act, 2013	390
APPENDIX 1 :	Borrowings schedule	394
APPENDIX 2 :	On the letterhead of the client confirmation letter	396

24**AUDIT OF TRADE PAYABLES, OTHER LIABILITIES**

24.1	Introduction	399
24.2	Audit of trade payables and other liabilities	401
24.3	Reporting requirements	416
24.4	Disclosure requirements as per Schedule III (Division 1) of the Companies Act, 2013	417
APPENDIX 1 :	Request for confirmation of balance	422

25**AUDIT OF PROVISIONS AND
CONTINGENT LIABILITIES**

25.1	Introduction	423
25.2	Audit of provisions & contingent liabilities	424
25.3	Reporting requirements	431
25.4	Disclosure requirements as per Schedule III (Division 1) of the Companies Act, 2013 and AS-29 “provisions, contingent liabilities and contingent assets”	431
APPENDIX 1 :	Evaluation of management expert	436
APPENDIX 2 :	On the letterhead of the company lawyer confirmation	439
APPENDIX 3 :	Contingent liability	440

26**AUDIT OF PROPERTY, PLANT AND EQUIPMENT**

26.1	Introduction	443
26.2	Audit of property, plant and equipment	447
26.3	Reporting requirements	454
26.4	Disclosure requirements as per Schedule III (Division 1) of the Companies Act, 2013 and AS-10 “property, plant and equipment”	455

27**AUDIT OF INTANGIBLE ASSETS**

27.1	Introduction	462
27.2	Audit of intangible assets	465
27.3	Reporting requirements	470
27.4	Disclosure requirements as per Schedule III (Division 1) of the Companies Act, 2013 and AS-26 “intangible assets”	470

28**AUDIT OF INVESTMENTS**

28.1	Introduction	475
28.2	Audit of investments	480
28.3	Reporting requirements	486
28.4	Disclosure requirements as per Schedule III (Division 1) of the Companies Act, 2013 and AS-13 “accounting for investments”	487
APPENDIX 1 :	Verification of limits u/s 186 of Companies Act, 2013	493

29**AUDIT OF INVENTORIES**

29.1	Introduction	494
29.2	Audit of inventories	499
29.3	Reporting requirements	509
29.4	Disclosure requirements as per Schedule III (Division 1) of the Companies Act, 2013 and AS-2 “valuation of inventories”	510
APPENDIX 1 :	Format for letter of confirmation of inventories held by others	513

30**AUDIT OF TRADE RECEIVABLES**

30.1	Introduction	514
30.2	Audit of trade receivables	514
30.3	Reporting requirements	522
30.4	Disclosure requirements as per Schedule III (Division 1) of the Companies Act, 2013	523
APPENDIX 1 :	Request for confirmation of balance	528

31**AUDIT OF LOANS & ADVANCES AND OTHER ASSETS**

31.1	Introduction	529
31.2	Audit of loans & advances and other assets	536
31.3	Reporting requirements	544
31.4	Disclosure requirements as per Schedule III (Division 1) of the Companies Act, 2013	545
APPENDIX 1 :	Schedule of loans & advances and compliance with section 186 of Companies Act, 2013	551

32**AUDIT OF CASH AND BANK BALANCES**

32.1	Introduction	553
32.2	Audit of cash and bank balances	557
32.3	Reporting requirements	564
32.4	Disclosure requirements as per Schedule III (Division 1) of the Companies Act, 2013	564
APPENDIX 1 :	Physical verification of cash/cheques-in-hand	566
APPENDIX 2 :	On the letterhead of the entity confirmation letter	568
APPENDIX 3 :	Bank control sheet	571

33**AUDIT OF REVENUE FROM OPERATIONS**

33.1	Introduction	572
33.2	Audit of revenue	575
33.3	Reporting requirements	582
33.4	Disclosure requirements as per Schedule III (Division 1) of the Companies Act, 2013 and AS-9 "revenue recognition"	582

34**AUDIT OF OTHER INCOME**

34.1	Introduction	584
-------------	--------------	-----

	PAGE
34.2 Audit of other income	585
34.3 Reporting requirements	589
34.4 Disclosure requirements as per Schedule III (Division 1) of the Companies Act, 2013 and AS-9 “revenue recognition”	590

35

AUDIT OF PURCHASES

35.1 Introduction	593
35.2 Audit of purchases	594
35.3 Reporting requirements	598
35.4 Disclosure requirements as per Schedule III (Division 1) of the Companies Act, 2013	598

36

AUDIT OF EMPLOYEE BENEFITS EXPENSES

36.1 Introduction	603
36.2 Audit of employee benefits expenses	605
36.3 Reporting requirements	610
36.4 Disclosure requirements as per Schedule III (Division 1) of the Companies Act, 2013	611
APPENDIX 1 : Work paper for payroll testing	617
APPENDIX 2 : Illustrative disclosure as per AS-15	622

37

AUDIT OF OTHER EXPENSES

37.1 Introduction	626
37.2 Audit of other expenses	626
37.3 Reporting requirements	637
37.4 Disclosure requirements as per Schedule III (Division 1) of the Companies Act, 2013	637
APPENDIX 1 : Lease schedule	642
APPENDIX 2 : Legal & professional expenses - Retainership basis	643
APPENDIX 3 : Work paper for testing other expenses	644

38**OTHER AUDIT PROCEDURES**

38.1	Other procedures	645
38.2	Minutes of meetings of board of directors and committees	645
38.3	Investor education and protection fund	647
38.4	Directors' Disqualification u/s 164(2) of the Companies Act, 2013	648
38.5	Use of data from GSTIN Portal	649
APPENDIX 1 :	Summary of minutes of meeting	650
APPENDIX 2 :	Directors' declaration u/s 164(2) of the Companies Act, 2013	651

39**AUDIT OF RELATED PARTY TRANSACTIONS**

39.1	Introduction	652
39.2	Related parties under various pronouncements	653
39.3	Audit procedures	655
39.4	Reporting requirements	659
39.5	Disclosure requirements as per accounting standard AS-18	659

40**CONSOLIDATED FINANCIAL STATEMENTS**

40.1	Introduction	661
40.2	Preparation of consolidated financial statements	662
40.3	Considerations by the auditor in audit of consolidated financial statements	662
40.4	Disclosures in consolidated financial statements	666
40.5	Reporting requirements	668
APPENDIX 1 :	Independent auditor's report	669

41**OVERVIEW OF BANK AUDIT**

41.1	Introduction	677
41.2	Auditor	678
41.3	Key areas of focus in bank audit	678
41.4	Other matters	680

42**ASSESSMENT OF GOING CONCERN**

42.1	Introduction	682
42.2	Events or conditions that may cast significant doubt on the entity's ability to continue as a going concern	683
42.3	Management's assessment of going concern	685
42.4	Auditor's responsibilities and procedures to be followed	685
42.5	Auditor's conclusion and reporting	688
42.6	Communication with those charged with governance	690
42.7	Other matters	691

43**ASSESSMENT OF SUBSEQUENT EVENTS**

43.1	Introduction	692
43.2	Procedures to be performed by the auditor	694
43.3	Other considerations	696
APPENDIX 1 :	Subsequent events inquiry questionnaire	697

44**OVERVIEW OF STANDARDS ON AUDITING**

44.1	Introduction	700
44.2	Standards on auditing	701
44.3	List of engagement and quality control standards	701
44.4	Specific documentation requirements	705
44.5	Others	706

45**OVERVIEW OF ACCOUNTING STANDARDS**

45.1	Introduction	708
45.2	Accounting standards in India	708
45.3	Applicability of accounting standards: Corporate entities	709
45.4	Applicability of accounting standards: Non-corporate entities	711
45.5	List of accounting standards	712
45.6	Other matters	713

46**WRITTEN REPRESENTATIONS**

46.1	Introduction	716
46.2	Written representations as audit evidence	716
46.3	Key written representations	717
46.4	Other considerations	718

47**AUDIT QUALITY ASSURANCE, AUDIT COMPLETION AND
EVALUATION OF RESULTS OF TESTS PERFORMED**

47.1	Introduction	721
47.2	Audit quality assurance	722
47.3	Reassessment of materiality	723
47.4	Risks of material misstatements	723
47.5	Final analytical review procedures	724
47.6	Evaluation of misstatements	726
47.7	Evaluation of internal control	728
47.8	Evaluation of risk of fraud	728
47.9	Evaluation of financial statements	728
47.10	Ensuring quality of financial statements	730
APPENDIX 1 :	Audit quality assurance checklist	732
APPENDIX 2 :	Risk table : Conclusion on risk	738

48**COMMUNICATION WITH THOSE
CHARGED WITH GOVERNANCE**

48.1	Introduction	739
48.2	Matters to be communicated: Audit completion	739
48.3	Requirements of SA 265	740
APPENDIX 1 :	Letter to those charge governance	742
APPENDIX 2 :	ABC Limited Management letter year ended 31 March, 202X	745

49**FORMING AN OPINION - AUDIT
REPORT ON THE FINANCIAL STATEMENTS**

49.1	Introduction	748
49.2	Standards on audit for audit reporting	749
49.3	Reporting under the Companies Act, 2013	755
APPENDIX 1 :	Independent auditor's report	763
APPENDIX 2 :	Draft auditor's report for trust	770
APPENDIX 3 :	CARO report	773
APPENDIX 4 :	CARO checklist	781