

Contents

<i>About the Author</i>	PAGE
	I-5
<i>Preface to Fifth Edition</i>	I-7
<i>Gratitude</i>	I-15
<i>Chapter-Heads</i>	I-17

1

INTRODUCTION TO AUDIT OF FINANCIAL STATEMENTS

1.1	Financial Statements	1
1.2	Audit of Financial Statements	6
1.3	The need for a structured approach for 'Audit of Financial Statements'	12

2

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

2.1	Introduction	24
2.2	Appointment as auditors	25
2.3	Auditor Independence	29
2.4	Rotation of auditors	34
2.5	Resignation by auditors	35
2.6	Removal of auditors	38
2.7	Reporting requirements	42
APPENDIX 1:	Proposal for appointment	43

	PAGE
APPENDIX 2 : Information required for Performing Client Acceptance Procedures	44
APPENDIX 2A : Client/Engagement Acceptance and Continuance Form	46
APPENDIX 3 : Consent and auditor certificate	51
APPENDIX 4 : Appointment letter	52
APPENDIX 5(a) : NOC Request from previous auditor	54
APPENDIX 5(b) : Reply to NOC Request	55
APPENDIX 6 : Acceptance of appointment	56
APPENDIX 7 : Know your client	57
APPENDIX 8 : Engagement letter	61
APPENDIX 9 : Independence and confidentiality declaration	76
APPENDIX 10 : Withdrawal/Rejection Decision Checklist	78

3

JOINT AUDIT

3.1 Introduction	82
3.2 Legal provisions	82
3.3 Joint audits	83
3.4 Other matters	86
3.5 Documentation	87
APPENDIX 1 : Illustrative statement of Joint Responsibilities of auditors	88
APPENDIX 2 : Work distribution between the joint auditors for the year ended: March 31, 2026	91

4

ASSESSMENT OF RISKS OF MATERIAL MISSTATEMENT

4.1 Introduction	94
4.2 Reasonable assurance	94
4.3 Material misstatement	95
4.4 Audit risk	95
4.5 Inherent risk	96
4.6 Control risk	97

	PAGE	
4.7	Detection risk	97
4.8	Benefits of risk based audit	97
4.9	Concept of risk assessment	98
APPENDIX 1 :	Risk assessment procedures	<i>115</i>
APPENDIX 2 :	Risk table	<i>116</i>

5

ASSESSING INHERENT RISKS OF MATERIAL MISSTATEMENT

5.1	Introduction	<i>117</i>
5.2	Understanding the entity and its environment	<i>118</i>
5.3	Preliminary analytical review	<i>127</i>
5.4	Conclusion	<i>130</i>
APPENDIX 1 :	Understanding the entity and its environment	<i>131</i>

6

EVALUATION AND RESPONSE TO RISK OF FRAUD

6.1	Introduction	<i>132</i>
6.2	Characteristics of fraud	<i>133</i>
6.3	Fraud triangle	<i>134</i>
6.4	Types of fraud	<i>135</i>
6.5	Responsibility for the prevention and detection of fraud	<i>136</i>
6.6	Responsibilities of the auditor	<i>137</i>
6.7	Planning to detect fraud	<i>138</i>
6.8	Responses to risks of material misstatement due to fraud	<i>144</i>
6.9	Evaluation of audit evidence	<i>147</i>
6.10	Consideration of impact on the financial statements	<i>148</i>
6.11	Communication to management and those charged with governance	<i>149</i>
6.12	Reporting requirements and audit opinion	<i>149</i>
6.13	Judicial perspective: Auditor liability in fraud reporting	<i>150</i>
6.14	Documentation	<i>151</i>
6.15	Management representations	<i>152</i>
6.16	Withdrawal from the engagement	<i>152</i>

	PAGE
6.17 Conclusion	154
APPENDIX 1 : Illustrative checklist for inquiries with board/audit committee, management and internal auditor	156
APPENDIX 2 : Fraud risk assessment	161

7

EVALUATION OF INFORMATION TECHNOLOGY ENVIRONMENT

7.1 Introduction	164
7.1A Risks in use of information technology	164
7.1B Information technology controls	165
7.2 General information technology controls	165
7.3 Audit trail	168
7.4 Conclusion	173
APPENDIX 1 : Evaluation of IT environment	174
APPENDIX 2 : Questionnaire to assist audit team regarding maintenance of audit trail	175
APPENDIX 3 : Questionnaire for evaluating ITGC Controls	179

8

UNDERSTANDING INTERNAL CONTROLS

8.1 Introduction	188
8.2 Objectives of internal control	188
8.3 Need for understanding internal control	189
8.4 Auditor and internal control	189
8.5 Limitations of internal control	192
8.6 Controls relevant to the audit	192
8.7 Components of internal control	193
8.8 What a satisfactory control environment means?	198
8.9 Evaluation of internal controls	198
8.10 Types of controls	200
8.11 Testing of internal controls	202
APPENDIX 1 : Internal control questionnaire	206
APPENDIX 2 : Illustrative flow chart for understanding internal controls	234

	PAGE
APPENDIX 3 : Template for documenting walkthrough of internal controls	235
APPENDIX 4 : Assessment of Entity Level Controls	237

9

USING THE WORK OF INTERNAL AUDITOR

9.1 Introduction	239
9.2 Legal requirement	239
9.3 Relevance of internal audit function in statutory audit	241
9.4 Consideration of internal audit function at planning stage	243
9.5 Using the work of internal auditor and consideration of reports of internal auditor	243
9.6 Procedures to be performed by the auditor	245
9.7 Reporting requirements	245
APPENDIX 1 : Evaluation of internal audit function, Discussion Points with Internal Auditor and risks identified	247

10

MATERIALITY

10.1 Introduction	251
10.2 Factors affecting materiality	252
10.3 Types of materiality	253
10.4 Overall materiality	254
10.5 Performance materiality	259
10.6 Specific materiality	261
10.7 Specific performance materiality	262
10.8 Clearly trivial	262
10.9 Revision of materiality	263
10.10 Documentation	264
APPENDIX 1 : Template for calculating materiality	266

11

RESPONSE TO ASSESSED RISKS

11.1 Introduction	271
--------------------------	-----

	PAGE
11.2 Overall responses to risks at the financial statement level	274
11.3 Response to assessed risks at the assertion level	276
11.4 Timing of audit procedures	282
11.5 Responding to the risk of fraud	283
11.6 Substantive procedures related to the financial statement closing process	285
11.7 Adequacy of presentation and disclosure	285
11.8 Ascertaining whether the audit plan is complete	286
11.9 Documentation	287
11.10 Communication of the plan	287
11.11 Conclusion	287
APPENDIX 1 : Sample audit program	290

12

FURTHER AUDIT PROCEDURES

12.1 Introduction	293
12.2 Substantive procedures	295
12.3 Conclusion	306

13

ENGAGEMENT TEAM DISCUSSIONS

13.1 Introduction	308
13.2 Benefits of engagement team discussion	309
13.3 Objectives of engagement team discussion	309
13.4 Holding engagement team discussions	310
13.5 Documentation	311
APPENDIX 1 : Engagement team discussion	312

14

AUDIT MANAGEMENT AND LOGISTICS

14.1 Introduction	316
14.2 Audit plan	316
14.3 Assigning roles & responsibilities	326

	PAGE
14.4 Time budget	327
14.5 Overall Audit strategy and audit planning memorandum	327
14.6 Audit program	329
14.7 Requirement list	330
14.8 Communication of Audit strategy with those charged with Governance	332
APPENDIX 1 : Illustrative audit timetable	335
APPENDIX 2 : Roles & responsibilities	337
APPENDIX 3 : Illustrative time budget	340
APPENDIX 4 : Overall Audit strategy memorandum and Audit Plan	345
APPENDIX 5 : Illustrative audit program	349
APPENDIX 6 : Requirement list	359

15

COMMUNICATION WITH THOSE CHARGED WITH GOVERNANCE

15.1 Introduction	361
15.2 Matters to be communicated	363
15.3 Other considerations	364
15.4 Conclusion	366
APPENDIX 1 : Requirements of SQC 1 & Standards on Auditing Regarding Communication with TCWG	368
APPENDIX 2 : Draft letter to those charged with governance	376
APPENDIX 3 : Checklist: Communication with TCWG at Planning Stage	380

16

COMPLETION OF PLANNING

16.1 Introduction	382
16.2 Matters to be considered	382
16.3 Conclusion	383
APPENDIX 1 : Checklist: Audit Planning Completion	384

17**CORE CONCEPTS**

17.1	Introduction	390
17.2	Professional skepticism	391
17.3	Evaluating misstatements	395
17.4	Confirmations	405
17.5	Audit documentation	413
17.6	Accounting estimates	420
17.7	Journal entry testing in statutory audit	426
17.8	Auditor's expert under SA 620	433
17.9	Use of service organisations: SA 402 – "Audit considerations relating to an entity using a service organisation"	437
17.10	Ledger Scrutiny in auditing	442
17.11	Conclusion	447
APPENDIX 1 :	Summary of adjusted audit differences	448
APPENDIX 2 :	Illustrative control sheet for external confirmations	451
APPENDIX 3 :	Checklist: Use of Auditor's Expert (SA 620)	452
APPENDIX 4 :	Checklist: Audit Considerations Relating to an entity using a service organisation	456

18**AUDIT EVIDENCE**

18.1	Introduction	458
18.2	Audit evidence	458
18.3	Possible sources from which the auditor can gather audit evidence	458
18.4	Key characteristics of audit evidence	459
18.5	Factors affecting sufficiency and appropriateness of audit evidence	459
18.6	Factors affecting reliability of audit evidence	460
18.7	Obtaining sufficient & appropriate audit evidence	460
18.8	Types of audit evidence	461
18.9	Specific considerations for selected items	462

19**OPENING BALANCES**

19.1	Introduction	464
19.2	Continuing engagements	464
19.3	Initial engagements	465
APPENDIX 1A :	Checklist SA 510-Initial Engagements	469
APPENDIX 1B :	Verification of opening balances brought forward	475
APPENDIX 1C :	Memo on audit procedures to be performed as per SA 510 on initial audit engagement	476

20**AUDIT SAMPLING**

20.1	Introduction	481
20.2	Types of sampling	482
20.3	Factors affecting the sample size	482
20.4	The sampling process	483
20.5	Other matters	485

21**AUDIT OF SHARE CAPITAL**

21.1	Introduction	486
21.2	Audit of share capital	488
21.3	Reporting requirements	503
21.4	Disclosure requirements as per Schedule III (Division 1) of the Companies Act, 2013	504
APPENDIX 1 :	Checklist: Audit of share capital	508

22**AUDIT OF RESERVES & SURPLUS**

22.1	Introduction	518
22.2	Audit of reserves and surplus	519
22.3	Disclosure requirements as per Schedule III (Division 1) of the Companies Act, 2013	521
APPENDIX 1 :	Checklist: Audit of Reserves & Surplus	524

23**AUDIT OF BORROWINGS**

23.1	Introduction	528
23.2	Audit of borrowings	529
23.3	Reporting requirements	537
23.4	Disclosure requirements as per Schedule III (Division 1) of the Companies Act, 2013	539
APPENDIX 1 :	Borrowings schedule	543
APPENDIX 2 :	Confirmation letter	545
APPENDIX 3 :	Checklist: Audit of Borrowings	548

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

24.1	Introduction	554
24.2	Audit of trade payables and other liabilities	556
24.3	Reporting requirements	573
24.4	Disclosure requirements as per Schedule III (Division 1) of the Companies Act, 2013	574
APPENDIX 1 :	Request for confirmation of balance	579
APPENDIX 2 :	Checklist: Audit of trade payables	580
APPENDIX 3 :	Checklist: Audit of other liabilities & provisions	584

25**AUDIT OF PROVISIONS AND CONTINGENT LIABILITIES**

25.1	Introduction	590
25.2	Audit of provisions & contingent liabilities	591
25.3	Reporting requirements	598
25.4	Disclosure requirements as per Schedule III (Division 1) of the Companies Act, 2013 and AS 29 “provisions, contingent liabilities and contingent assets”	599
APPENDIX 1 :	Evaluation of management expert	603

	PAGE
APPENDIX 2 : Lawyer confirmation	606
APPENDIX 3 : Contingent liability	607
APPENDIX 4 : Audit Checklist – Contingent Liabilities and Commitments	610

26

AUDIT OF PROPERTY, PLANT AND EQUIPMENT

26.1 Introduction	612
26.2 Audit of property, plant and equipment	616
26.3 Reporting requirements	623
26.4 Disclosure requirements as per Schedule III (Division 1) of the Companies Act, 2013 and AS 10 “Property, Plant and Equipment”	624
APPENDIX 1 : Checklist: Audit of Property, Plant & Equipment	631

27

AUDIT OF INTANGIBLE ASSETS

27.1 Introduction	637
27.2 Audit of intangible assets	640
27.3 Reporting requirements	645
27.4 Disclosure requirements as per Schedule III (Division 1) of the Companies Act, 2013 and AS 26 “Intangible Assets”	645

28

AUDIT OF INVESTMENTS

28.1 Introduction	650
28.2 Audit of investments	655
28.3 Reporting requirements	661
28.4 Disclosure requirements as per Schedule III (Division 1) of the Companies Act, 2013 and AS 13 “Accounting for Investments”	662
APPENDIX 1 : Verification of limits u/s 186 of Companies Act, 2013	669
APPENDIX 2 : Checklist: Audit of investments	670

29**AUDIT OF INVENTORIES**

29.1	Introduction	680
29.2	Audit of inventories	685
29.3	Reporting requirements	696
29.4	Disclosure requirements as per Schedule III (Division 1) of the Companies Act, 2013 and AS 2 “Valuation of Inventories”	696
APPENDIX 1 :	Format for letter of confirmation of inventories held by others	699
APPENDIX 2A :	Physical Inventory Count Observation Checklist (1: Planning)	700
APPENDIX 2B :	Physical Inventory Count Observation Checklist (2: Verification)	702
APPENDIX 3 :	Illustrative report on physical verification of inventory	704
APPENDIX 4 :	Checklist: Audit of inventory	706

30**AUDIT OF TRADE RECEIVABLES**

30.1	Introduction	716
30.2	Audit of trade receivables	716
30.3	Reporting requirements	724
30.4	Disclosure requirements as per Schedule III (Division 1) of the Companies Act, 2013	725
APPENDIX 1 :	Request for confirmation of balance	730
APPENDIX 2 :	Checklist: Audit of trade receivables	731

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

31.1	Introduction	737
31.2	Audit of loans & advances and other assets	744
31.3	Reporting requirements	752

	PAGE
31.4 Disclosure requirements as per Schedule III (Division 1) of the Companies Act, 2013	753
APPENDIX 1 : Schedule of loans & advances and compliance with section 186 of Companies Act, 2013	759
APPENDIX 2 : Checklist: Audit of loans & Advances	761

32

AUDIT OF CASH AND BANK BALANCES

32.1 Introduction	767
32.2 Audit of cash and bank balances	771
32.3 Reporting requirements	778
32.4 Disclosure requirements as per Schedule III (Division 1) of the Companies Act, 2013	778
APPENDIX 1 : Physical verification of cash/cheques-in-hand	780
APPENDIX 2 : Confirmation letter	782
APPENDIX 3 : Control sheet for Bank Confirmations	785
APPENDIX 4 : Checklist: Audit of cash & Bank	786

33

AUDIT OF REVENUE FROM OPERATIONS

33.1 Introduction	790
33.2 Audit of revenue	793
33.3 Reporting requirements	800
33.4 Disclosure requirements as per Schedule III (Division 1) of the Companies Act, 2013 and AS 9 “revenue recognition”	800
APPENDIX 1 : Checklist: Audit of Revenue	803

34

AUDIT OF OTHER INCOME

34.1 Introduction	809
34.2 Audit of other income	810
34.3 Reporting requirements	814
34.4 Disclosure requirements as per Schedule III (Division 1) of the Companies Act, 2013 and AS 9 “revenue recognition”	815
APPENDIX 1 : Checklist: Audit of other income	818

35**AUDIT OF PURCHASES**

35.1	Introduction	822
35.2	Audit of purchases	823
35.3	Reporting requirements	827
35.4	Disclosure requirements as per Schedule III (Division 1) of the Companies Act, 2013	827
APPENDIX 1 :	Checklist: Audit of purchases	832

36**AUDIT OF EMPLOYEE BENEFITS EXPENSES**

36.1	Introduction	838
36.2	Audit of employee benefits expenses	840
36.3	Impact of the new labour codes on audit of payroll expenses	845
36.4	Reporting requirements	856
36.5	Disclosure requirements as per Schedule III (Division 1) of the Companies Act, 2013	857
APPENDIX 1 :	Work paper for payroll testing	865
APPENDIX 2 :	Illustrative disclosures as per AS 15	870
APPENDIX 3 :	Checklist: Audit of payroll	874

37**AUDIT OF OTHER EXPENSES**

37.1	Introduction	878
37.2	Audit of other expenses	878
37.3	Reporting requirements	890
37.4	Disclosure requirements as per Schedule III (Division 1) of the Companies Act, 2013	891
APPENDIX 1 :	Lease schedule	896
APPENDIX 2 :	Legal & professional expenses - Retainership basis	897
APPENDIX 3 :	Work paper for testing other expenses	898

38**OTHER AUDIT PROCEDURES**

38.1	Other procedures	899
38.2	Minutes of meetings of board of directors and committees	899
38.3	Investor education and protection fund	901
38.4	Directors' Disqualification u/s 164(2) of the Companies Act, 2013	902
38.5	Verification of Secretarial Compliances	903
38.6	Use of data from GSTIN Portal	903
APPENDIX 1 :	Summary of minutes of meeting	904
APPENDIX 2 :	Directors' declaration u/s 164(2) of the Companies Act, 2013	905
APPENDIX 3 :	Illustrative list of Secretarial Records	906

39**AUDIT OF RELATED PARTY TRANSACTIONS**

39.1	Introduction	908
39.2	Related parties under various pronouncements	909
39.3	Audit procedures	911
39.4	Communication with TCWG in respect of related parties	918
39.5	Reporting requirements	918
39.6	Disclosure requirements as per Accounting Standard 18	919
APPENDIX 1 :	Audit checklist: Related party transactions	921

40**CONSOLIDATED FINANCIAL STATEMENTS**

40.1	Introduction	925
40.2	Preparation of consolidated financial statements	926
40.3	Considerations by the auditor in audit of consolidated financial statements	927
40.4	Disclosures in consolidated financial statements	931
40.5	Reporting requirements	933
APPENDIX 1 :	Independent auditor's report	935

	PAGE
APPENDIX 2 : Checklist: Audit of consolidated financial statements	943

41

OVERVIEW OF BANK AUDIT

41.1 Introduction	947
41.2 Auditor	948
41.3 Key areas of focus in bank audit	949
41.4 Other matters	950

42

ASSESSMENT OF GOING CONCERN

42.1 Introduction	952
42.2 Events or conditions that may cast significant doubt on the entity's ability to continue as a going concern	953
42.3 Management's assessment of going concern	955
42.4 Auditor's responsibilities and procedures to be followed	955
42.5 Auditor's conclusion and reporting	958
42.6 Communication with those charged with governance	960
42.7 Other matters	961
APPENDIX 1 : Illustrative Checklist for Evaluating Management's Use of Going Concern Basis of Accounting	962

43

ASSESSMENT OF SUBSEQUENT EVENTS

43.1 Introduction	970
43.2 Procedures to be performed by the auditor	972
43.3 Other considerations	974
APPENDIX 1 : Suggested template for subsequent events inquiry questionnaire	975

44

OVERVIEW OF ENGAGEMENT AND QUALITY CONTROL STANDARDS

44.1 Introduction	978
--------------------------	-----

	PAGE
44.2 Standards on auditing	979
44.3 Standard on Quality Control SQC 1	979
44.4 List of engagement and quality control standards	992
44.5 Specific documentation requirements	995
44.6 Others	996
44.7 Audit quality review findings – QRB report 2024–25	997
APPENDIX 1 : Abridged Checklist on Standards on Auditing	1001
APPENDIX 2 : Engagement quality control review Checklist Form A– Planning Stage	1034

45

OVERVIEW OF ACCOUNTING STANDARDS

45.1 Introduction	1038
45.2 Accounting Standards in India	1038
45.3 Applicability of Accounting Standards: Corporate entities	1039
45.4 Applicability of Accounting Standards: Non-corporate entities	1041
45.5 List of Accounting Standards	1042
45.6 Other matters	1043
APPENDIX 1 : Summary Checklist- Accounting Standards (Non-Ind AS)	1045

46

WRITTEN REPRESENTATIONS

46.1 Introduction	1049
46.2 Written representations as audit evidence	1049
46.3 Key written representations	1050
46.4 Other considerations	1051

47

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

47.1 Introduction	1055
47.2 Audit quality assurance	1056
47.3 Reassessment of materiality	1057

	PAGE
47.4 Risks of material misstatements	1057
47.5 Final analytical review procedures	1058
47.6 Evaluation of misstatements	1067
47.7 Evaluation of internal control	1069
47.8 Evaluation of risk of fraud	1069
47.9 Evaluation of financial statements	1070
47.10 Ensuring quality of financial statements	1071
APPENDIX 1 : Audit quality assurance checklist	1074
APPENDIX 2 : Risk Table : Conclusion on risk	1081
APPENDIX 3 : Summary of significant findings/matters and discussions with Management & TCWG	1082
APPENDIX 4 : Abridged Checklist on Schedule III of Companies Act, 2013 - Division I	1083

48

COMMUNICATION WITH THOSE CHARGED WITH GOVERNANCE

48.1 Introduction	1097
48.2 Matters to be communicated: Audit completion	1097
48.3 Requirements of SA 265	1100
48.4 Conclusion	1102
APPENDIX 1 : Letter to those charge governance	1103
APPENDIX 2 : Suggested template for management letter (SA 265)	1106
APPENDIX 3 : Checklist – Completion-stage communication	1109

49

FORMING AN OPINION - AUDIT REPORT ON THE FINANCIAL STATEMENTS

49.1 Introduction	1110
49.2 Standards on audit for audit reporting	1111
49.3 Reporting under the Companies Act, 2013	1117
APPENDIX 1 : Independent auditor's report	1129
APPENDIX 2 : Draft Auditor's Report for trust	1136

	PAGE
APPENDIX 3 : CARO report	1139
APPENDIX 4 : CARO checklist	1147

50

OVERVIEW OF REGULATORY MECHANISM IN INDIA

50.1 Introduction	1201
50.2 Key regulators in India	1202
50.3 Conclusion	1212
APPENDIX 1 : Key Considerations arising out of Regulatory Reviews	1213

51

ACCOUNTING POLICIES – CONCEPT, COMPLIANCE AND REPORTING

51.1 Introduction	1218
51.2 Meaning and role of accounting policies	1218
51.3 Correct identification of the financial reporting framework	1219
51.4 Statutory Framework	1219
51.5 Why accounting policies matter in practice?	1220
51.6 Changes in accounting policies and estimates	1220
51.7 Consequences of non-compliant or incorrectly referenced policies	1221
51.8 Audit implications – from policy evaluation to reporting	1221
51.9 Governance oversight and periodic review	1222
51.10 Common deficiencies observed in practice and regulatory reviews	1222
51.11 When policy deficiencies become audit report matters	1225
51.12 Conclusion	1225
APPENDIX 1 : Illustrative accounting policies aligned with Companies (Accounting Standards) Rules, 2021	1226
APPENDIX 2 : Accounting Policies Review Checklist	1237