

AUDIT OF ITEMS OF FINANCIAL STATEMENTS



LEARNING OUTCOMES

After studying this chapter, you will be able to:

- ☐ The general considerations in audit of financial statements.
- ☐ The specific procedures for auditing heads of balance sheet and statement of profit or loss.
- ☐ Audit procedures in respect of certain disclosures in the financial statements



INTRODUCTION

Companies prepare their financial statements in accordance with the framework of **generally accepted accounting principles (Indian GAAP)**, also commonly referred to as **accounting standards (AS)**.

A **financial statement audit** comprises the examination of an entity's **financial statements** and accompanying disclosures by an independent **auditor**. The result of this examination is a report by the **auditor**, attesting to the truth and fairness of presentation of the **financial statements** and related disclosures.

In preparing financial statements, Company's management makes implicit or explicit claims (i.e. assertions) regarding:

- completeness;
- cut-off;
- existence/ occurrence;
- valuation/ measurement;
- rights and obligations; and
- presentation and disclosure

of assets, liabilities, equity, income, expenses and disclosures in accordance with the applicable accounting standards.

Example

If Company X's balance sheet shows building with carrying amount of ₹ 50 lakh, the auditor shall assume that the management has claimed/ asserted that:

- The building recognized in the balance sheet exists as at the period- end (existence assertion);
- Company X owns and controls such building (Rights and obligations assertion);
- The building has been valued accurately in accordance with the measurement principles (Valuation assertion);
- All buildings owned and controlled by Company X are included within the carrying amount of ₹ 50 lakh (Completeness assertion).

The auditor then needs to draw an audit programme to verify and obtain sufficient and appropriate audit evidence for each of the above claims/ assertions made by the management.

ASSERTIONS MAY BE BROADLY CLASSIFIED INTO THE FOLLOWING TYPES

1. INCOME STATEMENT CAPTIONS COMPRISING REVENUE AND EXPENSE BALANCES

Assertions	Explanation	Example: Employee benefit expenses
Occurrence	Transactions recognized in the financial statements have occurred and relate to the entity.	Employee benefit expense has been incurred during the period in respect of the personnel employed by the entity. Employee benefit expense does not include the cost of any unauthorized personnel.
Completeness	All transactions that were supposed to be recorded have been recognized in the financial statements.	Employee benefit expenses in respect of all personnel have been fully accounted for.
Cut-off	Whether all income and expenses are reported in the appropriate period. Cut-off 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 recognized during the period relates to the current accounting period only.
Measurement	Transactions have been recorded accurately at their appropriate amounts in the financial statements.	Employee benefit expense has been measured/ calculated accurately. Any adjustments such as tax deduction at source have been correctly reconciled and accounted for.
Presentation and Disclosure	Transactions have been classified and presented	Employee benefit expense has been fairly allocated between:

	<p>fairly in the financial statements.</p> <p>Presentation and disclosure assertions are considered during the course of the audit by procedures to determine that disclosures are complete and accurate.</p> <p>The disclosures that are most susceptible to material misstatement are those that require significant judgment and qualitative assessments.</p> <p>Audit teams assess the completeness and accuracy of disclosures by determining that the disclosures provide information in a manner that does not materially omit, distort or mislead the user.</p>	<ul style="list-style-type: none"> — Operating expenses incurred in production activities; — General and administrative expenses; and — Cost of personnel relating to any self-constructed assets other than inventory.
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2. BALANCE SHEET CAPTIONS COMPRISING ASSETS, LIABILITIES AND EQUITY BALANCES

Assertions	Explanation	Example: Inventory balance
Existence	Assets, liabilities and equity balances exist as at the period end.	Inventory recognized in the balance sheet actually existed as at the period end.
Completeness	All assets, liabilities and equity balances that were supposed to be recorded have been recognized in the financial statements.	All inventory units held by the entity and that should have been recorded, have been recognized in the financial statements. Any inventory held by a third party on behalf of the entity has been included as part of the inventory

		balance.
Cut-off	Whether all assets and liabilities are reported in the appropriate period.	Inventory balance as at the year-end does not include any element of next financial year.
Valuation	Assets, liabilities and equity balances have been valued appropriately.	Inventory has been recognized at the lower of cost and net realizable value in accordance with AS 2 - Inventories. Any costs that could not be reasonably allocated to the cost of production (e.g. general and administrative costs) and any abnormal wastage have been excluded from the cost of inventory. An acceptable valuation basis (eg. FIFO, Weighted average etc.) has been used to value inventory as at the period-end.
Rights& Obligations	Entity has the right to assets i.e. (whether the entity has ownership and title to assets) and the liabilities recognized in the financial statements represent all the entity's the obligations at a given date.	The entity owns or controls the inventory recorded in the financial statements. Any inventory held by the entity on behalf of another entity has not been recognized as part of inventory of the entity.
Presentation and Disclosure	Whether particular items in the financial statements are properly classified, described and disclosed. Presentation and disclosure assertions are considered during the course of the audit by procedures to determine that disclosures are complete and accurate. The disclosures that are most	Example 1 Employee benefit expense has been fairly allocated between: <ul style="list-style-type: none"> — Operating expenses incurred in production activities; — General and administrative expenses; and Cost of personnel relating to any self-constructed assets other than inventory.

	<p>susceptible to material misstatement are those that require significant judgment and qualitative assessments. Audit teams assess the completeness and accuracy of disclosures by determining that the disclosures provide information in a manner that does not materially omit, distort or mislead the user.</p>	<p>Example 2</p> <p>Whether related party transactions have been disclosed appropriately as per the requirements of AS 18 – Related Party Disclosures.</p>
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Following section defines the various procedures an auditor should design to perform around certain balance sheet captions:



3. BALANCE SHEET CAPTIONS

3.1 Share Capital

Every company's lifecycle starts with raising of capital. Other than a private company, every other company issues a prospectus, which may be in the abridged form, or a Statement in lieu of Prospectus, before it proceeds towards allotment of share capital. The Prospectus defines the conditions on which allotment will be made, the projects on which the amount raised shall be spent (when these have been decided upon in advance) and to specify limits on certain expenses incidental to raising of capital. The receipt of applications for shares and allotment of shares in pursuance thereto are two important aspects of every issue of capital in so far as these constitute the legal basis of the transactions in the matter of purchase of shares. These, therefore, should receive a careful attention of the auditor. He must verify that each party, has performed his part of the contract, within the allotted time.



The below table summarises the audit procedures generally required to be undertaken while auditing share capital:

Brief description	Audit procedures
<p>To establish the existence of share capital as at the period-end</p> <p>Equity balances that were supposed to be Recorded have been Recognized in the financial statements.</p> <p>Equity balances have been valued appropriately.</p>	<p>Audit procedures</p> <ul style="list-style-type: none"> • Tally the period-end share capital balance- authorised, issued and paid up, to the previous year audited financial statements. • In case there in no change during the year, obtain a written confirmation/ representation from the Company Secretary that there were no changes to entity's capital structure during the year • In case there is any change, verify whether the paid up capital as at the period-end is within the limits of authorised capital. • Obtain the certified copies of relevant resolutions passed at the meetings of board of directors, shareholders authorising the increase/ decrease in authorised share capital, if required, or paid up share capital. • Also, obtain and verify copies of forms filed with Ministry of Corporate Affairs (MCA) (Form SH 7 for increase in authorised share capital, Form PAS 3 for increase in paid up capital) and with Reserve Bank of India (Form FCGPR in case of Foreign Direct Investment (FDI) by a Non-resident shareholder) and verify the number of securities issued along with the issue price. • In case there was increase in share capital, verify whether the Company has accurately calculated the required fee and stamp duty payable to MCA. <p>Shares Issued at Premium:</p> <p>In case a company has issued shares at a premium, that is, at amount in excess of the nominal value of the shares, whether for cash or</p>

otherwise, Section 52 of the Companies Act, 2013 provides that a Company shall transfer the amount received by it as securities premium to securities premium account and state the means in which the amount in the account can be applied.

The provisions of this Act relating to reduction of share capital of a company shall apply as if the securities premium account were the paid-up share capital of the company.

**Application of securities premium account:
The securities premium account may be applied by the Company:**

- (a) towards the issue of unissued shares of the company to the members of the company as fully paid bonus shares;
- (b) in writing off the preliminary expenses of the Company;
- (c) in writing off the expenses of, or the commission paid or discount allowed on, any issue of shares or debentures of the company;
- (d) in providing for the premium payable on the redemption of any redeemable preference shares or of any debentures of the company; or
- (e) for the purchase of its own shares or other securities under Section 68.

The auditor needs to verify whether the premium received on shares, if any, has been transferred to a "securities premium account" and whether the application of any amount out of the said "securities premium account" is only for the purposes mentioned above.

Shares issued at a discount:

According to Section 53 of the Companies Act, 2013, a company shall not issue shares at a discount, except in the case of an issue of sweat

equity shares given under Section 54 of the Companies Act, 2013.

Any share issued by a company at a discounted price shall be void. Where a company contravenes the provisions of this section, the company shall be punishable with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees and every officer who is in default shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees, or with both.

The auditor needs to check the movement in share capital during the year and wherever there is any issue, he should verify that the Company has not issued any of its shares at a discount by reading the minutes of meeting of its directors and shareholders authorizing issue of share capital and the issue price.

Issue of Sweat Equity Shares:

According to Section 54 of the Companies Act, 2013, the employees may be compensated in the form of 'Sweat Equity Shares'.

"Sweat Equity Shares" mean 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 right in the nature of intellectual property rights or value additions, by whatever name called.

The auditor needs to verify that the Sweat Equity Shares issued by the company are of a class of shares already issued and following conditions have been complied with (as per Section 54):

- (a) the issue is authorized by a special resolution passed by the company;
- (b) the resolution specifies the number of shares, the current market price,

consideration, if any, and the class or classes of directors or employees to whom such equity shares are to be issued;

- (c) not less than one year has, at the date of such issue, elapsed since the date on which the company had commenced business; and
- (d) where the equity shares of the company are listed on a recognised stock exchange, the sweat equity shares are issued in accordance with the regulations made by the Securities and Exchange Board in this behalf and if they are not so listed, the sweat equity shares are issued in accordance with such rules as may be prescribed.
- (e) The rights, limitations, restrictions and provisions as applicable to equity shares shall be applicable to the sweat equity shares issued under this section and the holders of such shares shall rank pari passu with other equity shareholders.

The auditor also needs to verify whether the fresh issue of shares was a rights issue or a preferential issue and whether the relevant requirements for issue of share capital as per provisions of Companies Act, 2013 have been complied with.

Reduction of Capital

For verifying reduction of capital, the auditor needs to undertake the following procedures:

- (i) Verify that the meeting of the shareholders held to pass the special resolution was properly convened and that the proposal was circularized in advance to all the shareholders;
- (ii) Verify that the Articles of Association authorises reduction of capital;
- (iii) Examine the order of the Tribunal

<p>Required disclosures for equity have been appropriately made</p>	<p>confirming the reduction and verify that a copy of the order and the minutes have been registered and filed with the Registrar of Companies;</p> <p>(iv) Check the Registrar's Certificate as regards to reduction of capital;</p> <p>(v) Vouch the accounting entries recorded to reduce the capital and to write down the assets by reference to the resolution of shareholders and other documentary evidence; also check whether the requirements of Schedule III, Part I, have been complied with in relation to presentation;</p> <p>(vi) Confirm whether the revaluation of assets has been properly disclosed in the Balance Sheet;</p> <p>(vii) Verify the adjustment made in the members' accounts in the Register of Members and confirm that either the paid up amount shown on the old share certificates has been altered or new certificates have been issued in lieu of the old, and the old ones have been cancelled;</p> <p>(viii) Confirm that the words "and reduced", if required by the order of the Tribunal, have been added to the name of the company in the Balance Sheet.</p> <p>(ix) Verify that the Memorandum of Association of the company has been suitably amended.</p> <p>Ensure whether the following disclosure requirements of Schedule III (Part 1) to Companies Act, 2013 have been complied with:</p> <p>Issued and subscribed share capital</p> <p>(Number of shares and value)</p> <ul style="list-style-type: none"> • Balance at the beginning of the reporting period
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	<ul style="list-style-type: none"> • Changes in equity share capital during the year • Balance at the end of the reporting period <p>For each class of capital</p> <ul style="list-style-type: none"> • Rights attached • Preferences • Restrictions, including <ul style="list-style-type: none"> ◦ Restrictions on the distribution of dividends ◦ Restrictions on the repayment of capital <p>Shares held in Company by the following entities:</p> <ul style="list-style-type: none"> • Holding company • Ultimate holding company • Subsidiaries of the holding company • Associates of the holding company • Subsidiaries of the ultimate holding company • Associates of the ultimate holding company <p>Shares held in the company held by each shareholder holding more than 5% shares specifying the number of shares held</p> <p>Disclosure to be made for a period of five years immediately preceding the balance sheet date</p> <p>Aggregate number and class of shares:</p> <ul style="list-style-type: none"> • Allotted as fully paid up pursuant to contract(s) without payment being received in cash • Allotted as fully paid up by way of bonus shares • Bought back.
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3.2 Reserves and Surplus

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.

Reserves represent amounts appropriated out of profits, held for purpose of distribution of dividend or financing the expansion of the company or strengthening the company financially. The reserves can be segregated as revenue or capital reserves.

Revenue reserves represent profits that are available for distribution to shareholders or below purposes such as:

Example

To supplement divisible profits in lean years,
to finance an extension of business,
to augment the working capital of the business or
to generally strengthen the company's financial position.

Capital Reserve represents a reserve which does not include any amount regarded as free for distribution.

Example

Securities premium, capital redemption reserve.

It may be noted that if a company appropriates revenue profit for being credited to the asset replacement reserve with the objective that these are to be used for a capital purpose, such a reserve shall also be in the nature of a capital reserve.

A capital reserve, generally, can be utilised for writing down fictitious assets or losses or (subject to provisions in the Articles) for issuing bonus shares if it is realized.

But the amount of securities premium or capital redemption reserve account can be utilised only for the purposes specified in Sections 52 and 55 of the Companies Act, 2013, respectively.



The below table summarises the audit procedures generally required to be undertaken while auditing reserves and surplus:

Brief description	Audit procedures
To establish the existence of reserves and surplus as at the period-end	<p>Audit procedures</p> <p>Trace and tally the opening balance of reserves and surplus to the previous year audited financial financial statements.</p> <p>For addition/utilisation in current year, in case of:</p>

<p>Reserves and Surplus balances that were supposed to be recorded have been recognized in the financial statements.</p>	<p>Profit and Loss balance - Trace the movement to surplus/ deficit as per the Statement of profit and loss for the year under audit. For adjustment related to dividend payment and the tax related thereto i.e. dividend distribution tax, verify the resolution passed by the board of directors regarding the declaration of dividend.</p>
<p>Reserves and Surplus balances have been valued appropriately.</p>	<p>Students should note that as per AS-4 (Revised), if dividends to holders of equity instruments are proposed or declared after the balance sheet date, an entity should not recognize those dividends as a liability as at the balance sheet date. It should, however, disclose the amount of dividends that were proposed or declared after the balance sheet date, but before the financial statements were approved for issue.</p> <p>Securities Premium - It needs to be confirmed that the company has issued shares in excess of the nominal value of the shares and for the same, the auditor should obtain and verify the resolution passed by the board of directors.</p> <p>As already discussed under the caption - 'share capital', the withdrawal from securities premium account could be done only for limited purposes; auditor needs to ensure that same.</p>
<p>Required disclosures for reserves and surplus have been appropriately made</p>	<p>Ensure whether the following disclosure requirements of Schedule III (Part 1) to Companies Act, 2013 have been complied with:</p> <p>Has the company sub-classified reserves and surplus into the following:</p> <ul style="list-style-type: none"> • Capital reserve • Capital redemption reserve • Securities premium reserve • Debenture redemption reserves • Retained earnings • Revaluation surplus • Exchange difference on account of

	<p>translation of financial statements of foreign operations</p> <p>For each component of reserves and surplus, whether the company has disclosed the following (to the extent applicable):</p> <ul style="list-style-type: none"> (i) Balance at the beginning of the reporting period (ii) Changes, if any, due to changes in accounting policy or prior period error (iii) Total profit/ loss for the year (iv) Dividends (v) Transfer to retained earnings (vi) Any other change (to be specified) (vii) Balance at the end of reporting period
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3.3 Borrowings

Liabilities are the financial obligations of an enterprise other than owners' funds. Liabilities include borrowings, trade payables and other current liabilities, deferred payment credits and provisions.

Verification of liabilities is as important as that of assets, for, if any liability is omitted or understated or overstated, the financial statements would not show a true and fair view of the state of affairs of the company.



The below table summarises the audit procedures generally required to be undertaken while auditing borrowings:

Brief description	Audit procedures
All borrowings on the balance sheet represent valid claims by banks or other third parties.	<ul style="list-style-type: none"> Review board minutes for approval of new lending agreements. During review, ensure that new loan agreements or bond issuances were authorized. Ensure that significant debt commitments were approved by the board of directors.

That all borrowings have been accounted for in the books of the company on a timely basis.

- Agree details of loans recorded (interest rate, nature and repayment terms) to the loan agreement. Verify that borrowing limits, if any, imposed by agreements are not exceeded.
- Roll out and obtain independent balance confirmations in respect of all the borrowings from the lender (banks/ financial institutions etc.).
- Agree details of leases and hire purchase creditors recorded to underlying contracts/agreements.
- Examine trust deed for terms and dates of redemption, borrowing restrictions and compliance with covenants.
- When debt is retired, ensure that a discharge is received on assets securing the debt.
- Obtain a schedule of short term and long term borrowings (including debts outstanding at the end of the previous year, as well as any new debt or renewal of debt) showing beginning and ending balances and borrowings taken and repaid during the year, and perform the following:
 - (a) Consider any evidence of additional debt obtained through examination of minutes of the board of directors, significant contracts, confirmations from banks/ lenders, support for subsequent cash disbursements (when testing payables) etc.
 - (b) Trace the closing balances as per the schedules to the general ledger.
- Review subsequent transactions after the end of the reporting period to determine if there are unrecorded liabilities at year-end and the transactions are recorded in the correct period.

	<p>Direct confirmation procedures</p> <ul style="list-style-type: none"> Roll out and obtain independent balance confirmations in respect of all the borrowings from the lender (banks/ financial institutions etc.) and perform the following: <ol style="list-style-type: none"> Ascertain that the confirmation asks for all information likely to be relevant to the tests of debt and related interest balances (e.g., applicable interest rates, due dates, collateral and security interests). Send reminders for non-replies. Compare the balances as per the confirmations obtained to the books of the accounts. Ask for reconciliations, if there are any differences and test the supporting documents for the reconciling items on a test check basis.
That liability is recorded at the correct amount.	<ul style="list-style-type: none"> Determine that the accounting policies and methods of recording debt are appropriate and applied consistently. Agree loan balance and loan payables to the loan agreement. Recompute the interest and discount or premium on redemption, if any. Check computation of the amortization of premium or discount, if any. For foreign currency loans, check the closing exchange rate(s) used and verify the computations of the restatements of foreign currency balances outstanding at year end.
That borrowings have been presented, classified and disclosed in the financial	<ul style="list-style-type: none"> Determine that the following items, if any, are properly recorded, classified, and/or disclosed, as appropriate:

statements in accordance with the requirements of applicable financial reporting framework i.e. Companies Act, 2013 and applicable Indian GAAP

- (a) Bonds/ debentures
- (b) Term loans
 - from banks
 - from related parties.
- (c) Deferred payment liabilities
- (d) Deposits
- (e) Loans and advances from related parties
- (f) Other loans and advances.
- Read the provisions in loan and debt agreements and perform the following:
 - (a) Test that the entity is in compliance with loan covenants and other significant provisions of the agreements.
 - (b) If there are any provisions with which the entity is not in compliance, determine whether the debt should be classified as current. If enforcement of the provisions has been waived by the lender in case of breach of any covenant by the entity, obtain confirmation of the waiver from the lender.
- Examine the due dates on loans for proper classification between long-term and short-term.
- Where instalments of long-term loans falling due within the next twelve months have been disclosed in the financial statements (e.g. in parentheses or by way of a footnote), verify the correctness of the amount of such instalments.
- Examine the debt agreements for any restrictive covenants. Review restrictive covenant and provisions relating to default and ensure disclosure thereof in the financial statements.

- Examine the important terms in the loan agreements and the documents, if any, evidencing charge in respect of such loans and advances. Examine whether the requirements of the applicable statute regarding creation and registration of charges have been complied with including disclosure of the same to the extent mandated by statute and considered necessary for proper understanding of the user of financial statements.
- In case the value of the security falls below the amount of the loan outstanding, examine whether the loan is classified as secured only to the extent of the market value of the security.
- Examine the hire purchase agreements for the purchase of assets by the entity and ensure the correctness of the amounts shown as outstanding in the accounts, and also examine the security aspect.
- Verify whether liabilities towards bank in respect of bills discounted, bills negotiated, cheques discounted, etc. are correctly reflected and disclosed in the financial statements.
- The auditor should also verify that the amount borrowed is within the borrowing powers of the company as laid down by the Articles of Association and Memorandum of Association.
- Verify that the company has not contravened the restrictions laid down by Section 180 of the Companies Act, in respect of the borrowings of the company. Also, check compliance of Sections 185 and 186 of the Companies Act, 2013.
- Examine the purpose for which the amount is borrowed and ensure that the amount is

	<p>not used against the interest of the company.</p> <ul style="list-style-type: none"> Where the entity has accepted deposits, examine whether the directives issued by the Reserve Bank of India or other appropriate authority have been complied with. <p>Ensure whether the following disclosures as required under Schedule III (Part 1) to Companies Act, 2013 are made for each amount disclosed under the heading 'long term borrowings':</p> <ul style="list-style-type: none"> Sub-classification as secured and unsecured. For secured borrowings, nature of security separately in each case. Where loans are guaranteed by directors or others, whether the company has disclosed the aggregate amount of such loans under each head. Terms of repayment for each loan unless the repayment terms of individual loans within a category are similar, in which case, they may be aggregated. Repayment terms should include the period of maturity at the balance sheet date, number and amount of installments due, applicable interest rate and other significant relevant terms (if any). <p>In case of a default in repayment of borrowing and/ or interest on the balance sheet date, ensure that following disclosures have been made separately for each case:</p> <ul style="list-style-type: none"> Period of default. Amount of default.
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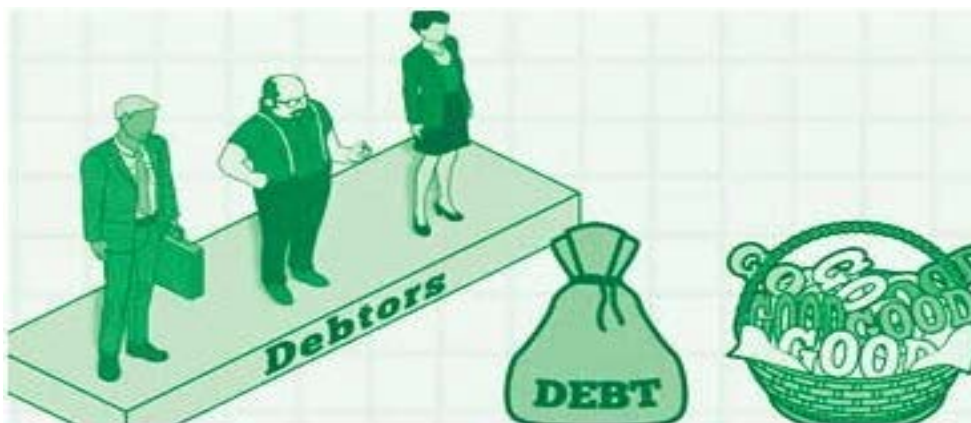
3.4 Trade Receivables

Trade receivable are an essential part of any organisation's balance sheet, often referred to as debtors. Typically, an invoice is raised and issued to the customer

with the invoice amount being recorded as a debtor balance. Until the invoice is paid, the invoice amount is recorded on the organization's balance sheet as accounts receivable. If balances are not recoverable later on, then these amounts need to be written off as an expense in the statement of profit and loss.

It is important to carry out compliance procedures in the sales audit as part of the debtors' audit procedure. Following points need to be considered in respect of trade receivables:

- Only bona fide sales lead to trade receivables.
- All such sales are made to approved customers.
- All such sales are recorded.
- Once recorded, the debtors can be settled only by receipt of cash or on the authority of a responsible official.
- Debtors are collected on time.
- Balances are regularly reviewed. A proper system of follow up exists and if necessary, adequate provision for bad debt should be made.



The below table summarises the audit procedures generally required to be undertaken while auditing trade receivables:

Brief description	Audit procedures
To establish the existence of trade receivables as at the period-end	<ul style="list-style-type: none"> • Check whether there are controls in place to ensure that invoices cannot be recorded more than once and receivable balances are automatically recorded in the general ledger from the original invoice. • Ask for a period-end accounts receivable aging

report and trace the balance as per the report to the general ledger.

- Check whether realization is recorded invoice-wise or not. If not, check that money received from debtors is adjusted chronologically invoice-wise and on FIFO basis i.e. previous bill is adjusted first. If realization is made on account, verify whether the Company has obtained confirmations from debtors in respect of the same.

Direct confirmation procedures

- A significant and important audit activity is to contact customers directly and ask them to confirm the amounts of unpaid accounts receivable as of the end of the reporting period under audit. This should necessarily be done for all significant account balances as at the period-end while certain random customers having smaller outstanding invoices should also be selected.
- The auditor employs direct confirmation procedure with the consent of the entity under audit. There may be situations where the management of the entity requests the auditor not to seek confirmation from certain trade receivables. In such cases, the auditor should consider whether there are valid grounds for such a request. In appropriate cases, the auditor may also need to reconsider the nature, timing and extent of his audit procedures including the degree of planned reliance on management's representations.
- The trade receivables may be requested to confirm the balances either (a) as at the date of the balance sheet, or (b) as at any other selected date which is reasonably close to the date of the balance sheet. The date should be decided by the auditor in consultation with the Company.
- The form of requesting confirmation from the

	<p>trade receivables may be either (a) the form with balance outstanding amount as per the company, wherein the trade receivable is requested to respond whether or not he is in agreement with the balance shown, or (b) the form without any balance mentioned therein, wherein the trade receivable is requested to respond with the balance outstanding as per his records. The use of the form without any balance is preferable.</p>
	<ul style="list-style-type: none"> • The method of selection of the trade receivables to be circularised should not be revealed to the Company until the trial balance of the trade receivables' ledger is handed over to the auditor. A list of trade receivables selected for confirmation should be given to the entity for preparing request letters for confirmation which should be properly addressed. The auditor should maintain strict control to ensure the correctness and proper despatch of request letters. It should be ensured that confirmations as well as any undelivered letters are returned to the auditor and not to the client. • Any discrepancies revealed by the confirmations received or by the additional tests carried out by the auditor may have a bearing on other accounts not included in the original sample. The Company should be asked to investigate and reconcile the discrepancies, if any.
	<ul style="list-style-type: none"> • Where no reply is received, the auditor should perform alternate procedures regarding the balances. This could include: <ul style="list-style-type: none"> — Agreeing the balance to cash received subsequently; — Preparing a detailed analysis of the balance, ensuring it consists of identifiable transactions and confirming that these revenue transactions actually occurred. • If there are any related party receivables, review

	<p>them for collectability as well as whether they were properly authorized and the value of such transactions were reasonable and at arm's length.</p> <ul style="list-style-type: none"> • Check that receivables for other than sales or services are not included in the list. • Review a trend line of sales and accounts receivable, or a comparison of the two over time, to check if there are any unusual trends. Also, measure the average collection period. Make inquiries about reasons for changes in trends from the management and document the same in audit work papers.
Trade receivable balances that were supposed to be recorded have been recognized in the financial statements.	<ul style="list-style-type: none"> • The auditor needs to satisfy himself of the cut-offs. Without a cut-off, sales could be understated or overstated, hence there is a need to perform the following cut off tests: <ul style="list-style-type: none"> — For the invoices issued during the last few days (last 5 days of the reporting year) i.e. cut-off date and which have been included in the debtors; check that the goods should have been dispatched and not lying with the Company; — Ensure that all goods dispatched prior to the period/ year-end have been invoiced and included in debtors on a test check basis; — Ensure that no goods dispatched after the year- end have been invoiced and included in debtors for the period under audit.
	<ul style="list-style-type: none"> • Test invoices listed in receivable report. Select few invoices from the accounts receivable ageing report and compare them to supporting documentation to see if they were billed with the correct amounts, to the correct customers, and on the correct dates. • Match invoices to shipping/ dispatch log. Match invoice dates to the shipment dates for those

	<p>items in the shipping/ dispatch log, to see if sales are being recorded in the correct accounting period. This can include an examination of invoices issued subsequent to the period being audited, to see if they should have been included in the period under audit.</p> <ul style="list-style-type: none"> • Assess bill and hold sales. If there is a situation where the Company is billing customers for sales despite still retaining the goods on-site (known as "bill and hold"), examine supporting documentation to determine whether a sale has actually taken place or not. • Review the receiving log to see if the Company has recorded an inordinately large amount of customer returns after the audit period, which would suggest that the Company may have shipped more goods near the end of the audit period than what the customers had authorized. • Review the process of giving discounts/ incentives and check whether the same were given as per the Company's policy/ general industry trends. • Review credit memos, on a sample basis, issued during the audit period to see if they were properly authorized and whether they were issued in the correct period. Also, review credit memos issued after the period end to see if they relate to transactions belonging to the period under audit. Where any deduction has been made against a bill, check the reason and correspondence for the same.
Trade receivable balances have been valued appropriately.	<ul style="list-style-type: none"> • Review the process followed by the Company to derive an allowance for doubtful accounts. This will include a consistency comparison with the method used in the last year, and a determination of whether the method is appropriate for the underlying business environment.

- Obtain the ageing report of accounts receivable (both Dr/Cr balance), split between not currently due, 30 days old, 30-60 days old, 60- 180 days old, 180- 365 days old and more than 365 days old (refer screenshot below). Also, obtain the list of debtors under litigation and compare with previous year.

Particulars	Sundry Debtors - 1 1-Apr-2018 to 31-Mar-2017		Sundry Debtors - 2 1-Apr-2018 to 31-Mar-2017		Sundry Debtors - 3 1-Apr-2018 to 31-Mar-2017	
	30 to 60 days	60 to 180 days	30 to 60 days	60 to 180 days	30 to 60 days	60 to 180 days
	Debit	Credit	Debit	Credit	Debit	Credit
HDC Power System Ltd Viz	3,99,994.00		5,08,147.00		1,68,883.00	12,96,894.00
Bata Kuma Battery Pvt Ltd	3,35,070.00		69,909.15		48,383.00	8,75,882.50
Kharibattery Ltd	88,368.00		1,50,046.00		6.25	29,84,951.75
Ram Enterprise						13,13,636.00
Shri Eminent Enterprises						2,21,526.00
Tantrac Equipment						2,21,526.00
HDC Power Systems Ltd (BROD Division)					7,34,011.00	3,10,760.00
Grand Total	8,78,232.00		7,29,842.15		4,41,857.25	89,22,829.81

- Scrutinize the analysis and identify those debtors which appear doubtful; discuss with management about reasons as to why these debtors are not included in the provision for bad debts. Perform further testing where any disputes exist.
- Prepare schedule of movements of bad debts – Provision accounts and debts written off and compare the proportion of bad debt expense to sales for the current year in comparison to prior years to see if the current expense appears reasonable.
- Check that write-offs of the receivable balances have been approved by an appropriate authority i.e. the Board of Directors in case of a company.

Required disclosures for trade receivables have been appropriately made

- Check that the restatement of foreign currency trade receivables has been done properly.
- Verify that the split between more than 6 months and less than 6 months has been done from the due date and not from invoice date.
- Check classification of amount due is properly

	<p>disclosed as:</p> <ul style="list-style-type: none"> — Secured, considered good — Unsecured, considered good — Doubtful. <ul style="list-style-type: none"> • Verify that proper disclosure of amounts due from the following parties has been made: <ul style="list-style-type: none"> — Directors — Other officers of the company — Any of them either severally — Jointly with any other person — Firms — Private companies respectively in which any director is a partner or director or member. • Ensure that the transactions with parties covered under Section 189 of the Companies Act, 2013 are reported properly in Companies Auditors' Report Order (CARO).
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3.5 Cash and Cash Equivalents

Cash and cash equivalent in the form of cash in hand, stamps in hand, balances held with bank in current accounts/ margin money accounts, cash credit accounts (debit balance), fixed deposits, cheques in hand etc. represent the most liquid assets of an enterprise. Utmost professional skepticism needs to be exercised while auditing such balances.



The below table summarises the audit procedures generally required to be undertaken while auditing cash and cash equivalents:

Brief description	Audit procedures
To establish the existence of cash and cash equivalent balances as at the period- end.	<ul style="list-style-type: none"> • Special care is necessary in regard to verification of cash balances. Unless they are checked by surprise, there can be no certainty that the cash produced for inspection was in fact held by the custodian. For this reason, the cash should be checked not only on the

<p>Cash and cash equivalent balances that were supposed to be recorded have been recorded in the financial statements.</p>	<p>last day of the year, but also checked again sometime after the close of the year without giving notice of the auditor's visit either to the entity or to his staff. If there are more than one cash balances, e.g., when there is a cashier, a petty cashier, a branch cashier and, in addition, there are imprest balances with employees, all of them should be checked simultaneously, as far as practicable so that the shortage in one balance is not made good by transfer of amount from the others. It is desirable for the cashier to be present while cash is being counted and he should be made to sign the statement prepared containing details of the cash balance counted. If he is absent at the time the cash is being verified, he may hold the auditor responsible for the shortage, if any, in cash.</p>
	<ul style="list-style-type: none"> • If there is any rough Cash Book or details of daily balance are separately kept, the auditor should test entries from the rough Cash Book with those in the Cash Book to prove that entries in the Cash Book are correct. If the auditor finds any slip, chit or I.O.U.s in respect of temporary advances paid to the employees included as part of the cash balance, he should check whether those are approved by an authorized official or not and recorded in the appropriate accounts. • The auditor should also perform a cash sensitivity analysis by compiling a summary of total cash receipts and payments each month and analyzing the trends to see if there have been variations in any specific month and request Brief discrepancies from the management. • The auditor needs to obtain bank reconciliation statements (BRS) for all bank accounts maintained by the entity as at the reporting period and additionally need to understand the client's process and periodicity of making the BRS.
	<p>The auditor should ensure that BRS is signed by the authorized personnel so that he is able to assign responsibility in case of any errors.</p>

	<ul style="list-style-type: none">• Verification of BRS shall entail the following:<ul style="list-style-type: none">— Tallying the balance as per bank book to the bank confirmation/ statement.— Checking of all material reconciling items included under cheques issued but presented for payment to the underlying bank book forming part of books of account. In addition, the auditor should request for bank statements of subsequent period and should verify if the cheques issued have subsequently been cleared by the bank. For all cases where cheques have become stale i.e. 3 months or more have lapsed since the issue date, the same should not appear in the BRS and should instead be taken to liabilities.— Checking of all material reconciling items included under cheques deposited but not credited by bank by requesting for bank deposit slips, duly acknowledged by bank and verifying if the balances were credited by bank subsequently by tallying to the bank statement of subsequent period. For any instances related to cheques not cleared beyond reasonable time, the auditor should seek brief descriptions from the management and in case such explanations are found to be unsatisfactory, the auditor should verify the revenue recognition related to such parties was in order and as per the Company's revenue recognition policy.— Checking of all material reconciling items included under amounts/ charges debited/ credited by bank but not accounted for by requesting for bank statements for the period under audit and tallying the same. If the amounts are found to be material, the auditor should ensure that the management records the adjustments for the same in its books of account.
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	<p>Direct confirmation procedure</p> <ul style="list-style-type: none"> • A significant and important audit activity is to contact banks/ financial institutions directly and ask them to confirm the amounts held in current accounts, deposit accounts, EEFC account, cash credit accounts, restrictive use accounts like dividend, escrow accounts as of the end of the reporting period under audit. This should necessarily be done for all account balances as at the period-end. • The Company should be asked to investigate and reconcile the discrepancies, if any, including seeking written explanations/ clarifications from the banks/ financial institutions on any unresolved queries. • The auditor should emphasize for confirmation of 100% of bank account balances. In remote situations, where no reply is received, the auditor should perform additional testing regarding the balances. This testing could include: <ul style="list-style-type: none"> — Agreeing the balance to bank statement received by the Company or internet/ online login to account in auditor's personal presence; — Sending the audit team member to the bank branch along with the entity's personal to obtain balance confirmation from the bank directly.
Cash and cash equivalent balances have been valued appropriately.	In addition to the procedures performed above, the auditor should ensure that all bank accounts holding foreign currency have been restated at the closing exchange rates.
Required disclosures for cash and cash equivalents have been appropriately made	<p>Ensure whether the following disclosures as required under Schedule III (Part 1) to Companies Act, 2013 have been made:</p> <p>Cash and cash equivalents</p> <p>(i) Cash and cash equivalents shall be classified as:</p> <ul style="list-style-type: none"> (a) Balances with banks; (b) Cheques, drafts on hand;

	<p>(c) Cash on hand;</p> <p>(d) Others (specify nature)</p> <p>(ii) Earmarked balances with banks (for example, for unpaid dividend) shall be separately stated.</p> <p>(iii) Balances with banks to the extent held as margin money or security against the borrowings, guarantees, other commitments shall be disclosed separately.</p> <p>(iv) Repatriation restrictions, if any, in respect of cash and bank balances shall be separately stated.</p> <p>(v) Bank deposits with more than 12 months' maturity shall be disclosed separately.</p>
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3.6 Inventories

Inventories are a form of current assets held for sale in the ordinary course of business or in the process of production for sale or consumption in the production of goods or services for sale or in the form of materials or supplies to be consumed in the production process or rendering of services. As per AS 2 - Valuation of Inventories, inventory is valued at lower of cost and net realisable value.



The below table summarises the audit procedures generally required to be undertaken while auditing inventories:

Brief description	Audit procedures
To establish the existence of Inventories as at the period- end.	<ul style="list-style-type: none"> • Review entity's plan for performing inventory count. • Ensure that consigned goods have been segregated. • Auditor should participate in the inventory count with the management. • Test counts of inventory by auditor should include: <ul style="list-style-type: none"> — observing employees are adhering to the agreed plan. — assuring that all items are properly tagged. — observing that proper amounts are shown on

	<p>tags.</p> <ul style="list-style-type: none"> — determining that tags and summary sheets are controlled and reconciled. — reconciliation of test counts with tags and summary sheets and discrepancies noted, if any, are summarized and agreed with client personnel. — Staying alert at all times and specifically being cautious about empty boxes, etc. and obsolete items. — Performing cut-off testing by documenting last 5-10 receiving reports and shipping documents as of the period end. — Ensuring exclusion of third party stock and damaged or obsolete stock. — Ensuring the accounting of all stock sheets. — Investigating any significant differences between the physical stock take and the stock records as per books. Further, the auditor should ask the entity's personnel to sign all stock count sheets and also agree the variances observed, if any, to avoid any conflicts. <ul style="list-style-type: none"> • When the entity uses periodic system for inventory count, it should be undertaken at the end of the period. If the entity uses perpetual system with proper and adequate records, inventory may be counted at interim dates. • Confirm or investigate any inventory of the entity lying with a third party (specifically relevant for cases where the entity gets job work done in its process of production).
Only the inventories held by entity have been recorded in the financial statements and do not include any	<ul style="list-style-type: none"> • Perform analytical procedures (comparison tests with industry averages, budgets, prior years, trend analysis, etc.). <ul style="list-style-type: none"> — Compute inventory turnover ratio (COGS/ average inventory) — Perform vertical analysis (inventory/ total assets) — Compare budgetary expectations vis-à-vis actuals

inventories that belong to third parties but does include inventories owned by the entity and lying with a third party	<ul style="list-style-type: none"> • Examine non-financial information related to inventory, such as weights and other measurements. • Perform purchase and sales cut-off tests. Trace shipping documents (bills of lading and receiving reports, warehouse records, and inventory records) to 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. • Reconcile physical counts with general ledger control totals.
The entity has valid legal ownership rights over the inventories claimed to be held by the entity and recorded in the financial statements	<ul style="list-style-type: none"> • 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 existence of collateral agreements. • Review consignment agreements. • Review material purchase commitment agreements. • Examine invoices for evidence of ownership. • For instances of inventory held by third party, the auditor should insist on obtaining declaration from the third party on its business letterhead and signed by an authorized personnel of that third party confirming that the items of inventory belong to the entity and are being held by such third party on behalf of and for the benefit of the entity under audit.
Inventories have been valued appropriately and as per generally	<ul style="list-style-type: none"> • Depending on how the business operates, the management may value inventory using First-in first-out (FIFO) or weighted average basis.

accepted accounting policies and practices	<ul style="list-style-type: none"> • Raw materials and consumables <ul style="list-style-type: none"> □ Ascertain what elements of cost are included e.g. carriage inward, non-refundable duties etc. □ If standard costs are used, enquire into basis of standards; how these are compared with actual costs and how variances are analyzed and accounted for/ treated in accounting records. □ Test check cost prices used with purchase invoices received in the month(s) prior to counting. □ Follow up valuation of all damaged or obsolete inventories noted during observance of physical counting with a view to establishing a realistic net realizable value. • Work in progress <ul style="list-style-type: none"> □ Ascertain how the various stages of production/ value add are measured and in case estimates are made, understand the basis for such estimates. □ Ascertain what elements of cost are included. If overheads are included, ascertain the basis on which they are included and compare such basis with the available costing and financial data/ information maintained by the entity. □ Ensure that material costs exclude any abnormal wastage factors. • Finished goods and goods for resale <ul style="list-style-type: none"> □ Enquire as to what costs are included, how these have been established and ensure that the overheads included have been determined based on normal costs and appear reasonable in relation to the information disclosed in the financial statements. □ Ensure that inventories are valued at net realizable value if they are likely to fetch a value lower than their cost. For any such items, also verify if the relevant semi/ partly processed inventories (work in progress) and raw materials
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	<p>have also been written down.</p> <ul style="list-style-type: none"> Follow up for items that are obsolete, damaged, slow moving and ascertain the possible realizable value of such items. For the purpose, request the client to provide inventory ageing split between less than 30 days, 30-60 days old, 60- 90 days old, 90- 180 days old, 180- 365 days old and more than 365 days old (refer screenshot below) <ul style="list-style-type: none"> Follow up any inventories which at time of observance of physical counting were noted as being damaged or obsolete. Compare recorded costs with replacement costs. Examine vendor price lists to determine if recorded cost is less than current prices. Calculate inventory turnover ratio. Obsolete inventory may be revealed if ratio is significantly lower. In manufacturing environments, test overhead allocation rates and ensure that only direct labor, direct material and overhead have been included. Verify the correct application of lower-of-cost-or-net realizable value principles.
Required disclosures for inventories have been appropriately made	<p>Ensure whether the following disclosures as required under Schedule III (Part 1) to the Companies Act, 2013 have been made:</p> <ul style="list-style-type: none"> Whether mode of valuation has been stated separately for each class of inventory Whether inventory has been classified as: <ul style="list-style-type: none"> Raw materials

	<ul style="list-style-type: none"> — Work-in-progress — Finished goods — Stock-in-trade (goods acquired for trading) — Stores and spares — Loose tools — Others (specify nature). <ul style="list-style-type: none"> • Whether goods-in-transit have been disclosed separately under each sub-head of inventory.
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3.7 Tangible Assets Comprising Land, Buildings, Plant & Equipment, Furniture & Fixtures, Vehicles, Office Equipment, Computers etc. referred to as “Property, Plant and Equipment” (“PPE”)

The below table summarises the audit procedures generally required to be undertaken while auditing tangible fixed assets:



Brief description	Audit procedures
To establish the existence of PPE as at the period-end	<ul style="list-style-type: none"> • Review entity's plan for performing physical verification of PPE i.e. whether performed by own staff or by a third party and the policy regarding periodicity i.e. whether physical verification shall be done on annual basis or once in two years/ three years. • Evidence of appropriate supervision of those performing physical verification of PPE should be examined. • Obtain PPE physical verification report backed by the working sheets from the entity and perform the following procedures: <ul style="list-style-type: none"> — Assess if all items of PPE are properly tagged and carry identification marks/

	<p>numbers and physical verification work papers do capture the asset identification numbers for assets physically verified.</p> <ul style="list-style-type: none"> — Reconciliation of items of PPE as physically verified with the fixed asset register maintained by the entity as at the date/ period of undertaking physical verification. Specifically verify if the PPE additions up to the date of physical verification have been updated in the fixed asset register. — Verify the discrepancies noted, based on physical verification undertaken and the manner in which such discrepancies have been dealt with in the entity's books and financial statements. For example, any identified shortages/ assets not in working condition and/or active use should be accounted for as deletions in the books of account post approvals by the entity's the management and depreciation should have ceased to be charged after the date of deletion.
<p>Additions to PPE during the period under audit have been recorded in the financial statements and do not include any PPE that belong to third parties but does include PPE owned and controlled by the entity although lying with a third party</p>	<ul style="list-style-type: none"> • Verify the movement in the PPE schedule (asset class-wise like building, Plant & machinery etc.) compiled by the management i.e. Opening balances + Additions during the period – Deletions during the period = Closing balances. Tally the closing balance to the entity's books of account. • Check the arithmetical accuracy of the movement in PPE schedule. Tally the opening balances to the previous year audited financial statements. For additions during the period under audit, obtain a listing of all additions from the management and perform the following procedures: <ul style="list-style-type: none"> — For all material additions, verify if such expenditure meets the criteria of PPE as

	<p>per AS 10 Revised.</p> <p>These costs include costs incurred initially to acquire or construct an item of property, plant and equipment and costs incurred subsequently to add to, replace part of, or service it.</p> <p>Verify that the cost of an item of property, plant and equipment is as per AS 10 Revised.</p> <p>Verify and ensure that items such as spare parts, stand-by equipment and servicing equipment are recognised as property, plant and equipment only when they are held for more than one period as per the requirements of AS 10 Revised.</p> <ul style="list-style-type: none"> o Ensure that the entity is not recognizing costs of the day-to-day servicing in the carrying amount of an item of property, plant and equipment. o Test the purchase invoice, installation certificate or report or other similar documentation maintained by the entity to verify the date of addition, for all additions samples of PPE during the period under audit. o Verify whether the PPE additions have been approved by authorized personnel. o Verify whether proper internal processes and procedures like inviting competitive quotations/ floating tenders etc. were followed prior to finalizing the vendor for procuring items of PPE/ awarding of work contract for capital projects by checking the supporting documents of the samples selected. <ul style="list-style-type: none"> • In relation to deletions to PPE, understand from the management the reason and rationale for deletion (example could be new purchase of similar asset once the old asset was no longer fit to be used in production process) and the
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	<p>manner of disposal. Obtain the management approval and discard note authoring disposal of the asset from its active use. Verify the process followed for sale of discarded PPE, for example - inviting competitive quotes, tenders and the basis of calculation of sales proceeds. Verify that the management has accurately recorded the deletion of PPE (original cost and accumulated depreciation up to the date of disposal) and the resultant gain/ loss on disposal of PPE item in the entity's books of account.</p>
<p>PPE have been valued appropriately and as per generally accepted accounting policies and practises</p>	<p>It is a common understanding that the value of fixed assets/ PPE depreciates due to efflux of time, use and obsolescence. The diminution of the value represents an item of cost to the entity for earning revenue during a given 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 auditor should:</p> <ul style="list-style-type: none"> • Verify that the entity has charged depreciation on all items of PPE unless any item of PPE is non- depreciable like freehold land; • 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. • The auditor should also verify whether the management has done an impairment assessment to determine whether an item of property, plant and equipment is impaired as per the requirements of AS 28 - Impairment of Assets.
<p>The entity has valid legal ownership rights over the PPE claimed to be held by the entity and recorded in the financial</p>	<ul style="list-style-type: none"> • In addition to the procedures undertaken for verifying completeness of additions to PPE during the period under audit, the auditor while performing testing of additions should also verify that all PPE purchase invoices are in the

statements	<p>name of the entity that entitles legal title of ownership to the respective entity. For all additions to land and building in particular, the auditor should check the conveyance deed/sale deed to verify whether the entity is the legal and valid owner or not.</p> <ul style="list-style-type: none"> The auditor should insist and verify the original title deeds for all immoveable properties held as at the balance sheet date. In case the entity has given such immoveable property as security for any borrowings and the original title deeds are not available with the entity, the auditor should request the entity's management for obtaining a confirmation from the respective lenders that they are holding the original title deeds of immoveable property as security. In addition, the auditor should also verify the register of charges, available with the entity to assess that any charge has been created against the PPE.
Required disclosures for PPE have been appropriately made	<p>Ensure whether the following disclosures as required under Schedule III (Part 1) to Companies Act, 2013 have been made:</p> <ul style="list-style-type: none"> Whether all items of property, plant and equipment have been classified as: <ul style="list-style-type: none"> Land Buildings Plant and equipment Furniture and fixtures Vehicles Office equipment Others (specify nature) Whether the entity has disclosed assets "under lease" separately under each class of asset. The term "under lease" means assets given on operating lease and assets taken on finance lease. For each class of Property, Plant and

	<p>Equipment, whether the entity has disclosed a reconciliation of the gross and net carrying amounts at the beginning and end of the reporting period showing separately:</p> <ul style="list-style-type: none"> o Opening balance of gross carrying amount o Additions o Acquisitions through business combinations o Disposals o Disposals through demergers o Other adjustments <ul style="list-style-type: none"> □ Borrowing costs capitalized o Closing balance of gross carrying amount o For each class of property, plant and equipment, whether the entity has disclosed: <ul style="list-style-type: none"> □ Opening accumulated depreciation □ Charge for the year □ Deduction/ other adjustments for depreciation □ Closing accumulated depreciation o For each class of property, plant and equipment, whether the entity has disclosed: <ul style="list-style-type: none"> □ Opening accumulated impairment losses □ Impairment losses □ Impairment reversals □ Closing accumulated impairment losses.
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3.8 Intangible Assets (comprising Goodwill, Brand/Trademarks, Computer Software etc.)

An intangible asset is an identifiable non-monetary asset, without physical

substance, held for use in the production or supply of goods or services, for rental to others, or for administrative purposes. Enterprises frequently spend resources on the acquisition, development, maintenance or enhancement of intangible assets



such as scientific or technical knowledge, design and implementation of new processes or systems, licenses, intellectual property, market knowledge and trademarks (including brand names and publishing titles). Common examples of items encompassed by these broad headings are computer software, patents, copyrights, motion picture films, customer lists, mortgage servicing rights, fishing licenses, import quotas, franchises, customer or supplier relationships, customer loyalty, market share and marketing rights. Goodwill is another example of an item of intangible nature which either arises on acquisition or may be internally generated. As per AS 26 – Intangible Assets, internally generated goodwill is not recognized as an asset because it is not an identifiable resource controlled by the enterprise that can be measured reliably at cost.

The below table summarises the audit procedures generally required to be undertaken while auditing intangible fixed assets:

Brief description	Audit procedures
To establish the existence of intangible fixed assets as at the period- end	<ul style="list-style-type: none"> Since an intangible asset is an identifiable non-monetary asset, without physical substance, for establishing the existence of such assets, the auditor should verify whether such intangible asset is in active use in the production or supply of goods or services, for rental to others or for administrative purposes. <p>Example- for verifying the existence of</p>

	<p>software, the auditor should verify whether such software is in active use by the entity and for the purpose, the auditor should verify the sale of related services/ goods during the period under audit, in which such software has been used.</p> <p>Example- For verifying the existence of design/ drawings, the auditor should verify the production data to establish if such products for which the design/ drawings were purchased, are being produced and sold by the entity.</p> <p>In case any intangible asset is not in active use, deletion should have been recorded in the books of account post approvals by the entity's management and amortization charge should have ceased beyond the date of deletion.</p>
<p>Additions to Intangible assets during the period under audit have been recorded appropriately in the financial statements</p>	<ul style="list-style-type: none"> • Verify the movement in the intangible assets schedule (asset class wise like software, designs/ drawings, goodwill etc.) compiled by the management i.e. Opening balances + Additions – Deletions = Closing balances. Tally the closing balances to the entity's books of account. • Check the arithmetical accuracy of the movement in intangible assets schedule. <p>For additions during the period under audit, obtain a listing of all additions from the management and undertake the following procedures:</p> <ul style="list-style-type: none"> □ For all material additions, verify whether such expenditure meets the criterion for recognition of an intangible asset as per AS 26. □ Ensure that no cost related to research

	<p>(or from the research phase of an internal project) gets recognized as intangible asset.</p> <ul style="list-style-type: none"> □ Check the certificate or report or other similar documentation maintained by the entity to verify the date of use of the intangible which could be linked to date of commencement of commercial production/ economic use to the entity, for all additions to intangible assets during the period under audit. □ Verify whether the additions (acquisitions) have been approved by appropriate entity's personnel. □ Verify whether proper internal processes and procedures like inviting competitive quotations/ proper tenders etc. were followed prior to finalizing the vendor for procuring item of intangible assets by testing those documents on a sample basis. • In relation to deletions of intangible assets, understand from the management the reason and rationale for deletion and the manner of disposal. Obtain the management approval and disposal note authoring disposal of the asset from its active use. Verify the process followed for sale of discarded asset, example inviting competitive quotes, tenders and the basis of calculation of sales proceeds. Verify that the management has accurately recorded the deletion of intangible asset (original cost and accumulated amortization up to the date of disposal) and the resultant gain/ loss on disposal in the entity's books of account.
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<p>Intangible assets have been valued appropriately and as per generally accepted accounting policies and practices</p>	<p>The value of intangible assets may diminish due to efflux of time, use and/ or obsolescence. The diminution of the value represents cost to the entity for earning revenue during a given period. Unless this cost in the form of amortization is charged to the accounts, the profit or loss would not be correctly ascertained and the values of intangible asset would be shown at higher amounts. The auditor should:</p> <ul style="list-style-type: none"> • Verify that the entity has charged amortization on all intangible assets; • Verify that the amortization method used reflects the pattern in which the asset's future economic benefits are expected to be consumed by the entity. • The auditor should also verify whether the management has done an impairment assessment to determine whether an intangible asset is impaired. For this purpose, the auditor needs to verify whether the entity has applied AS 28 - Impairment of Assets for determining the manner of reviewing the carrying amount of its intangible asset, determining the recoverable amount of the asset to determine impairment loss, if any.
<p>The entity has valid legal ownership rights over the Intangible Assets claimed to be held by the entity and recorded in the financial statements</p>	<ul style="list-style-type: none"> • In addition to the procedures for verifying completeness of additions to intangible assets during the period under audit, the auditor while performing testing of additions should also verify that all expense invoices/ purchase contracts are in the name of the entity that entitles legal title of ownership to the entity.
<p>Required disclosures for Intangible Assets have been</p>	<p>Ensure that the following disclosures as required under Schedule III (Part 1) to</p>

appropriately made	<p>Companies Act, 2013 have been made:</p> <ul style="list-style-type: none"> • Whether all items of intangible assets have been classified as: <ul style="list-style-type: none"> □ Goodwill □ Brands/trademarks □ Computer software □ Mastheads and publishing titles □ Mining rights □ Copyrights, and patents and other intellectual property rights, services and operating rights □ Recipes, formulae, models, designs and prototypes □ Licenses and franchise □ Others (specify nature). • For each class of intangible asset, whether the entity has disclosed a reconciliation of the gross and net carrying amounts at the beginning and end of the reporting period showing separately: <ul style="list-style-type: none"> □ Opening balance of gross carrying amount □ Additions □ Disposals □ Impairments □ Other adjustments. • For each class of intangible assets, whether the entity has disclosed: <ul style="list-style-type: none"> □ Opening accumulated amortization □ Charge for the year □ Deduction/ other adjustments for amortization □ Closing accumulated amortization. • For each class of intangible assets,
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	<p>whether the entity has disclosed:</p> <ul style="list-style-type: none"> □ Opening accumulated impairment losses □ Impairment losses □ Impairment reversals □ Closing accumulated impairment losses.
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3.9 Trade Payables and Other Current Liabilities

Liabilities in addition to borrowings (discussed above), include trade payables and other current liabilities, deferred payment credits and provisions. Verification of liabilities is as important as that of assets, considering if any liability is omitted or understated or overstated, the financial statements would not show a true and fair view of the state of affairs of the entity.



The below table summarises the audit procedures generally required to be undertaken while auditing trade payables and other current liabilities:

Brief description	Audit procedures
To establish the existence of trade payables and other current liabilities as at the period-end	<ul style="list-style-type: none"> • Check whether there are controls in place to ensure that any purchase/ expense invoice does not get recorded more than once and payable balances are automatically recorded in the general ledger at the time of recording of expense. • Obtain the accounts payable ageing report and trace its balances to the general ledger. If there are any differences, investigate reconciling items. If there are journal entries in the accounts payable account in the general ledger, review the justification for larger amounts. <p>Direct confirmation procedure</p> <p>An important audit activity is to contact vendors</p>

	<p>directly/independently and ask them to confirm the amounts of accounts payable as of the end of the reporting period under audit. This should necessarily be done for all significant account payable balances as at the period-end and for parties from whom material purchases have been made during the period under audit even if period-end balance of such parties is not significant.</p>
	<ul style="list-style-type: none"> • The auditor employs direct confirmation procedure with the consent of the entity under audit. There may be situations where the management of the entity requests the auditor not to seek confirmation from certain trade payables. In such cases, the auditor should consider whether there are valid grounds for such a request. In appropriate cases, the auditor may also need to reconsider the nature, timing and extent of his audit procedures including the degree of planned reliance on management's representations. • The trade creditors may be requested to confirm the balances either (a) as at the date of the balance sheet, or (b) as at any other selected date which is reasonably close to the date of the balance sheet. The date should be decided by the auditor in consultation with the Company. • The form of requesting confirmation from the trade creditor may be either (a) the form with balance as at year end wherein the trade creditor is requested to respond whether or not he is in agreement with the balance shown, or (b) the form with no balance wherein the trade creditor is requested to respond the balance as per his records. The use of the form with no balance is preferable.
	<ul style="list-style-type: none"> • The method of selection of the trade creditors to be circularised should not be revealed to the Company until the trial balance of the trade payables' ledger is handed over to the auditor.

	<p>A list of trade creditors selected for confirmation should be given to the entity for preparing request letters for confirmation which should be properly addressed. The auditor should maintain strict control to ensure the correctness and proper dispatch of request letters. In the alternative, the auditor may request the client to furnish duly authorised confirmation letters and the auditor may fill in the names, addresses and the amounts relating to trade creditors selected by him and mail the letters directly. It should be ensured that confirmations as well as any undelivered letters are returned to the auditor and not to the client.</p> <ul style="list-style-type: none">• Any discrepancies revealed by the confirmations received or by the additional tests carried out by the auditor may have a bearing on other accounts not included in the original sample. The entity should be asked to investigate and reconcile the discrepancies. In addition, the auditor should also consider what further tests he can carry out in order to satisfy himself as to the correctness of the amount of trade payables taken as a whole.• Where no reply is received, the auditor should perform additional testing regarding the balances. This testing could include:<ul style="list-style-type: none">□ Testing of subsequent payments in respect of the trade payables to whom confirmations were rolled out but no replies received;□ Agreeing the details of the respective balance to the underlying vendor invoices;□ Preparing a detailed analysis of the balance, ensuring it consists of identifiable transactions and confirming that these purchases/ expense transactions actually occurred.
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	<ul style="list-style-type: none"> • If there are any related party payables, review whether they were properly authorized and the value of such transactions were reasonable and at arm's length. • Review a trend line of purchases/ expenses and accounts payable, or a comparison of the two over time, to see if there are any unusual trends. Make inquiries about reasons for changes in trends from the management.
Trade payables and liability balances that were supposed to be recorded have been recognized in the financial statements.	<ul style="list-style-type: none"> • The auditor needs to perform the following cut off procedures: <ul style="list-style-type: none"> □ For the last 5 invoices received/ recorded at the end of the reporting date (cut off date) and which have been included in the trade payables; the goods should have been received/ risk and rewards of ownership in goods should have been transferred in favour of the entity; □ All goods received prior to the period/ year- end should have been booked in the form of purchases and included in trade creditors. • Test purchases/ expenses on a sample basis selecting the same from the accounts payable ledgers and checking their supporting documents to ensure that the purchases were recorded at the correct amounts and correct dates. • Match purchase invoice dates to the gate entry (inward) dates to check whether the purchases are being recorded in the correct accounting period. This can include an examination of purchase/ expense invoices received subsequent to the period being audited, to see if they should have been included in the period under audit.
	<ul style="list-style-type: none"> • Review subsequent expense vouchers. Review all material expense vouchers recorded post the

balance sheet date to see if they relate to transactions from within the audit period.

- For advance received from customers/ revenue received in advance, obtain the customer wise listing along with its ageing and the nature. Verify if any advances are outstanding beyond 6 months. Enquire from the entity's management if there has been any dispute with the customer and if there is any additional liability to be recorded. For all such advances, the auditor should verify the underlying documentation based on which the entity had received the advance.
- In relation to statutory dues liability like withholding tax (TDS) payable, GST payable, luxury tax payable, professional tax payable, PF and ESI payable etc., prepare a reasonability with respect to sales/ purchases/ employee benefit expenses. Example- GST liability for last month may be calculated by applying the applicable rate to the sales made and in case of any variance with the GST liability recorded by the entity, reasons for variance should be requested from client and in case found satisfactory, the same should be maintained as part of audit documentation.

Similarly, Provident Fund liability for last month may be calculated by applying the applicable rate to the employee benefit expense and in case of any variance with the liability recorded by the entity, reasons for variance should be requested from client and in case found satisfactory, the same should be maintained as part of audit documentation.

Further, the auditor should obtain and verify the challans for deposits made subsequent to the period-end for all statutory liabilities as at the balance sheet date and also analyse the reasons, if any, in consultation with the management for any variance between the amounts deposited subsequently vis-à-

	vis the liability recorded in books of account.
Trade payables and other liability balances have been valued appropriately.	<ul style="list-style-type: none"> Review the process followed by the Company to identify if any old creditor balance/ liability needs to be written back. This will include a consistency comparison with the method used in the last year, and a determination of whether the method is appropriate for the underlying business environment. Obtain the ageing of payable balances, split between current, less than 30 days old, 30-60 days old, 60-180 days old, 180- 365 days old and more than 365 days old (refer screenshot below). Also, obtain the list of vendors with whom the Company has disputes and any claims from customers, under litigation and compare with previous year. Check that write backs in the liability balances assessed as no longer payable have been approved by an appropriate and authorised member of senior management, for example – CEO/MD.
	
	<ul style="list-style-type: none"> Check that the restatement of foreign currency trade payables has been done properly. Understand management's process to identify the principal amount and the interest due thereon (if any) remaining unpaid to any Micro, Small and Medium Sized Enterprises suppliers at the end of accounting year. Test check the management process to assess if the auditor

	could rely on the management process.
Required disclosures for trade payables and other liabilities have been appropriately made	<p>Ensure whether the following disclosures as required under Schedule III (Part 1) to Companies Act, 2013 have been made:</p> <ul style="list-style-type: none"> • Whether the Company has classified a payable as a trade payable if it is in respect of the amount due on account of goods sold or services rendered in the normal course of business. • Whether the Company has disclosed the following details relating to micro and small enterprises in the notes: <ul style="list-style-type: none"> □ the principal amount and the interest due thereon (to be shown separately) remaining unpaid to any supplier at the end of each accounting year. □ the amount of interest paid by the buyer in terms of section 16 of the Micro, Small and Medium Enterprises Development Act, 2006, along with the amount of the payment made to the supplier beyond the appointed day during each accounting year. □ the amount of interest due and payable for the period of delay in making payment (which have been paid but beyond the appointed day during the year) but without adding the interest specified under the Micro, Small and Medium Enterprises Development Act, 2006. □ the amount of interest accrued and remaining unpaid at the end of each accounting year. □ the amount of further interest remaining due and payable even in the succeeding years, until such date when the interest dues above are actually paid to the small enterprise, for the purpose of disallowance of a deductible expenditure

	<p>under section 23 of the Micro, Small and Medium Enterprises Development Act, 2006.</p> <ul style="list-style-type: none"> Whether the amount disclosed under other current liabilities are classified as below: <ul style="list-style-type: none"> Current maturities of long-term debts. Interest accrued Income received in advance Others (specify nature).
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3.10 Loans and Advances and Other Current Assets

Loans and advances include loans and advances to related parties, security deposits, capital advances, amounts recoverable in cash or in kind or for value to be received, e.g., rates, taxes and insurance paid in advance/ prepaid.

Other current assets primarily include balances with statutory/ government authorities etc.



The below table summarises the audit procedures generally required to be undertaken while auditing loans and advances and other current assets:

Brief description	Audit procedures
To establish the existence of loans and advances and other current assets as at the period-end	<ul style="list-style-type: none"> For establishing existence of loans and advances, direct confirmation procedures, similar to those performed for Accounts receivable balances are should be performed with the only difference that while performing circularisation of direct confirmations, in addition to the principal amount, interest receivable, if any, as per the

	agreed terms between the parties, may also be included as part of the balance to be confirmed.
Loans and advances and other current asset balances that were supposed to be recorded have been recognized in the financial statements.	<ul style="list-style-type: none"> • Obtain a list of all advances and other current assets and compare them with balances in the ledger. • Verify loan agreements and acknowledgements of parties in respect of outstanding loans. A loan or an advance, if material, is granted only if authorised by the Memorandum and
	<p>Articles of Association in the case of Company. In addition, the auditor should confirm that the loans advanced were within the competence of persons who had advanced the same, directors in the case of a Company, partners in the case of a firm and trustees in the case of a trust.</p> <ul style="list-style-type: none"> • Inspect the minutes of meeting of board of directors to confirm if all material loans and advances were approved by the board of directors. • Verify that the loan has been acknowledged by the party and in addition, inspect if any security has been deposited against due repayment of the loan. Ascertain if loans are being recovered regularly as per agreed instalments. • If there are any related party loans and advances, review whether they were properly authorized and the value of such transactions were reasonable and at arm's length. • In relation to balances with statutory authorities like GST input credit, prepare a reasonability with respect to purchases/ expenses by applying the applicable rate to the purchases/ expenses and in case of any variance with the asset recorded by the entity, reasons for variance should be requested from the entity. • Further, the auditor should obtain statutory returns filed with the authorities like GST returns and verify whether the amount recorded as per

	books of account tallies with the claim made with the authorities.
Loans and advances and other current asset balances have been valued appropriately.	<ul style="list-style-type: none"> • Assess the allowance for doubtful accounts. Review the process followed by the Company to derive an allowance for doubtful accounts. This will include a consistency comparison with the method used in the last year, and a determination of whether the method is appropriate for the underlying business environment. • Obtain the ageing report of loans and advances, split between not currently due, 30 days old, 30-60 days old, 60- 180 days old, 180- 365 days old and more than 365 days old. Also, obtain the list of loans and advances under litigation and compare with previous year. • Scrutinize the analysis and identify those loans and advances that appear doubtful; discuss with management about the reasons as to why these loans/ advances are not included in the provision for doubtful balances. • Assess bad loans/ advances write-offs. Prepare schedule of movements on Bad loans/ advances – Provision Accounts and loans/ advances written off. • Check that write-offs or other reductions in the recoverable balances have been approved by the BOD. • Check that the restatement of foreign currency loans and advances/ other current assets has been done properly.
Required disclosures for loans and advances and other current assets have been appropriately made	<p>Ensure whether the following disclosures as required under Schedule III (Part 1) to Companies Act, 2013 have been made:</p> <ul style="list-style-type: none"> • Whether loans have been classified as: <ul style="list-style-type: none"> □ Security deposits □ Loans to related parties (giving details

	<p>thereof)</p> <ul style="list-style-type: none"> □ Capital advances □ Other loans (specify nature). • Whether all the above loans have been further sub-classified as: <ul style="list-style-type: none"> □ Secured, considered good □ Unsecured, considered good □ Doubtful. • Whether allowance for bad and doubtful loans has been disclosed separately under the relevant heads i.e. separately for each category of loans • For loans, whether separate disclosure has been made for amounts due by: <ul style="list-style-type: none"> □ Director(s) of the company □ Director(s) of the company jointly with other persons □ Other officer(s) of the company □ Other officer(s) of the company jointly with other persons □ Firm(s) in which director is a partner □ Private company(ies) in which director is a director or a member.
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3.11 Provisions and Contingent Liabilities

A provision is recognised when:

- (i) an entity has a present obligation (legal or constructive) as a result of a past event;
- (ii) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and
- (iii) a reliable estimate can be made of the amount of the obligation. If the above conditions are not met, no provision is recognised.

Example

Provision may include provision for litigation, provision for warranties etc.

A contingent liability is:

- (i) a possible obligation that arises from past events and whose existence will be

confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity; or

- (ii) a present obligation that arises from past events but is not recognized because:
- it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or
 - the amount of the obligation cannot be measured with sufficient reliability.

The below table summarises the audit procedures generally required to be undertaken while auditing provisions and contingent liabilities:

Brief description	Audit procedures
<p>To establish the existence of provisions as at the period-end</p> <p>Provisions that were supposed to be recorded have been recognized in the financial statements.</p> <p>Provision balances have been valued appropriately.</p>	<ul style="list-style-type: none"> • Obtain a list of all provisions and compare them with balances in the ledger. • Inspect the underlying agreements like agreement with customers to assess warranty commitments, any legal and other claims on the entity i.e. litigations. • Obtain the underlying working and the basis for each of the provisions made, from the management and verify whether the same is complete and accurate. • Wherever required, obtain expert's report, calculation and underlying working for the provision amount, example for warranty involving complex calculations, some entities get that valued through an actuary. In such a case, the auditor may request the management to share the actuarial valuation report and in case of any matter under legal dispute, the auditor should request for assessment made by a legal expert in relation to likelihood of a liability devolving on the entity i.e. whether probable or possible or remote

	as defined above. The auditor should then verify the underlying assumptions used by the expert with the data shared by the management.
	<ul style="list-style-type: none"> • As per SA 500 - Audit Evidence, issued by ICAI, when using the work of a management's expert, audit evidence that the auditor should obtain include: <ul style="list-style-type: none"> □ Evaluate the competence, capabilities and objectivity of that expert: <ul style="list-style-type: none"> ▪ Whether the expert is employed by the entity or is an outside party. ▪ Whether the expert is independent in respect of the entity. ▪ Auditor's previous experience of the work of the expert. ▪ Knowledge of the expert, his qualification, membership of a professional body or industry association, etc. □ Obtain an understanding of the work of that expert: <ul style="list-style-type: none"> ▪ Whether the auditor has expertise to evaluate the work of the expert. ▪ Evaluating the assumptions and methods used by the management. ▪ Evaluating the nature of internal or external data used by the expert.
	<ul style="list-style-type: none"> □ Evaluate the appropriateness of his work as audit evidence for the relevant assertion: <ul style="list-style-type: none"> ▪ Relevance and

	<p>reasonableness of the expert's findings or conclusions</p> <ul style="list-style-type: none"> ▪ Evaluating the relevance, completeness and accuracy of the source data used by the expert.
Required disclosures for provisions have been appropriately made	<p>Ensure whether the following disclosures as required under Schedule III (Part 1) to Companies Act, 2013 have been made:</p> <ul style="list-style-type: none"> • Whether current and non-current portions have been split for <ul style="list-style-type: none"> □ Provision for employee benefits □ Others (specify nature) • Whether for each class of provision, disclosure has been made for: <ul style="list-style-type: none"> □ the carrying amount at the beginning and end of the period; □ additional provisions made in the period, including increases to existing provisions; □ amounts used (i.e. incurred and charged against the provision) during the period; □ unused amounts reversed during the period. • Whether for each class of provision, disclosure has been made for: <ul style="list-style-type: none"> □ a brief description of the nature of the obligation and the expected timing of any resulting outflows of economic benefits; □ an indication of the uncertainties about the amount or timing of those outflows. Where necessary to provide adequate information, an entity shall disclose the major assumptions made concerning

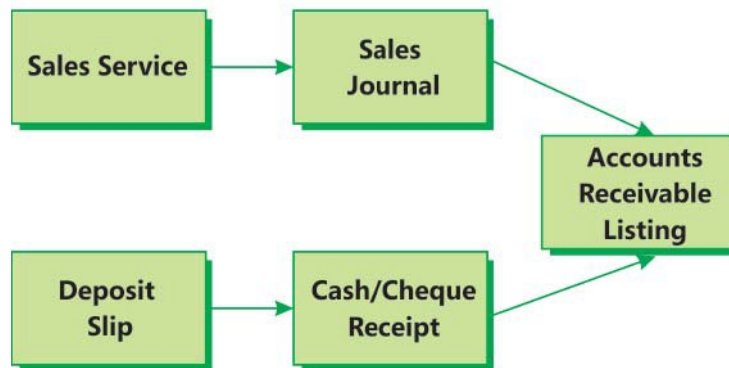
	future events; and
	<ul style="list-style-type: none"> □ the amount of any expected reimbursement, stating the amount of any asset that has been recognized for that expected reimbursement. • Unless the possibility of any outflow in settlement is remote, whether disclosure has been made for each class of contingent liability at the end of the reporting period a brief description of the nature of the contingent liability and, where practicable: <ul style="list-style-type: none"> □ an estimate of its financial effect □ an indication of the uncertainties relating to the amount or timing of any outflow; and □ the possibility of any reimbursement.



4. STATEMENT OF PROFIT AND LOSS-CAPTIONS

4.1 Sale of Products and Services

The sales and collections cycle in a business refers to the set of processes that begin when a customer purchases goods or services and ends when the entity receives complete payment against the sales. As part of the year-end audit of an entity's financial statements, auditors test sales transactions and the internal controls over those transactions to ensure that the entity is not materially misstating its revenues or accounts receivable.

Revenue Cycle

Auditor needs to obtain a clear understanding about the organisation and its revenue centres.

Example

Type of services or products the entity provides, demand for the services or products, major selling product/service, introduction of new products/service line, discontinuance of products/services, major customers, sales term (Credit or cash sales).

1. An auditor needs to obtain an understanding of the management control in respect of sales process.

Example

Whether segregation of duties exist, who checks the credit limit (if applicable), who authorizes sales orders, who raises sales invoice, when and how the goods are delivered or services are provided, who ensures that the risks and rewards are transferred to the customer, how the sales have been recognised in the system.

2. An auditor tests the controls the entity has set up for the sales cycle to determine how strong and reliable they are. If they are strong, the auditor can reduce the extent of substantive testing.

Example

Common internal controls over the sales cycle include numbered sales invoices, customer purchase order authorization over a certain limit and authorization over receivables write-offs.

3. The auditor selects a random sample of transactions and examines the related customer purchase orders, invoices and customer statements. If the control being tested is numbered sales invoices

Example

The auditor ensures that all numbers in a section are accounted for and that none are missing.

4. Performing substantive audit procedures is a must. Substantive analytical procedures will consist of sales trend analysis, comparison with previous accounting period, category-wise sales analysis, any analysis the auditor may find relevant and most important of all, building a sales expectation and comparing that with the client's sales records. The auditor will need to know the sales prices of the products or services over the year, monthly average sales price per product or service, discount policy.

Example

For a manufacturing company, if the average sales price of product X is ₹ 10 and 1,500 units were sold in that month, the auditors expected sales will be ₹ 15,000. The auditor should compare this figure with the client's data and see what they have recorded against Product X. The auditor should consider discussing any variances (see if there were discounts or sales were wrongly booked in the system) between his expectations and client's records. The auditor will have to also identify and understand how the entity accounts for their sales discounts and sales return in the system and how those affect the gross sales.

The below table summarises the audit procedures generally required to be undertaken while auditing sales:

Brief description	Audit procedures
Recorded sales represent goods shipped/ services performed during the period	<ul style="list-style-type: none"> • Ensure revenue is not overstated by performing following audit procedures: <ul style="list-style-type: none"> □ Check whether a single sales invoice is recorded twice or a cancelled sales invoice could also be recorded. □ Whether any fictitious customers and sales have been recorded. □ Whether any shipments were done without the consent and agreement of the customer. □ Whether unearned revenue recorded as earned. □ Whether any substantial uncertainty exists about collectability. □ Whether customer obligations are contingent

	on other actions (financing, resale, etc.).
	<ul style="list-style-type: none"> • Review sequence of sales invoices • Review journal entries for unusual transactions • Calculate the ratio of sales return to sales and compare it with previous year and enquire for the reasons for increase/ decrease. • Check the sales return with sales invoice, challan, credit note, stock register, etc.
All sales made during the period were recorded and there is no understatement or overstatement.	<ul style="list-style-type: none"> • Perform cut-off procedures to ensure that revenues are recognised in the current accounting period and sales were not tampered towards the period end. • Cut-off errors will usually arise when companies recognise revenue based on the date on which the sales invoices are generated rather than the date on which the risks and rewards are transferred to the buyer. In order to perform a robust sales cut-off test, auditors need to understand and consider the specific cut-off error risk of each engagement. • Auditors should also verify the credit notes issued after the accounting period. Sometimes sales team or sales personnel can make fictitious sales before the year-end to meet performance target and cancel out those sales with a post year end credit note. • Trace from the shipping documents to the sales journal. • Check whether quantity is appearing in sales register or not and check reconciliation of total sales/goods dispatched as per stock records and financial records and statutory records like GST. • Review GST tax and GST returns and ensure that the same are reconciled with revenue reported in the profit and loss account. Prepare a reasonableness say of GST by applying the applicable rate to the gross sales value and compare the amount of GST as per statutory returns and analyze the reasons for variance, if any.
All sales are accurately measured	<ul style="list-style-type: none"> • Trace a few transactions from inception to

as per applicable accounting standards and correctly journalized, summarized, and posted	<p>completion.</p> <ul style="list-style-type: none"> • Auditor must understand client's operations and related GAAP issues e.g. point of sale revenue recognition vs. percentage of completion, wherever applicable. • Compare the rate of sales affected with related parties and review them for collectability, as well as whether they were properly authorized and the value of such transactions were reasonable and at arm's length.
Required disclosures for sales have been appropriately made	<p>Ensure whether the following disclosures as required under Schedule III (Part 1) to Companies Act, 2013 have been made:</p> <ul style="list-style-type: none"> • 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: <ul style="list-style-type: none"> □ Sale of products (including excise duty) □ Sale of services □ Other operating revenues. • Whether brokerage and discount on sales other than usual trade discount has been disclosed. • Whether the transactions with related parties are appropriately disclosed in notes to accounts.

4.2 Other Income comprising interest income, dividend income, gain/ loss on sale of investments etc.

Any form of income earned by an entity which is not linked to the entity's core business operations is generally classified as other income. Examples – interest on excess funds parked in fixed deposits with banks (the entity not being a bank or financial institution), interest on loans given to third parties/ within the group, return on mutual fund investment etc.

Interest income on fixed deposits is recognized on a time proportion basis taking into account the amount outstanding and the applicable interest rate.

Dividends are recognised in the statement of profit and loss only when:

- (i) the entity's right to receive payment of the dividend is established;
- (ii) it is probable that the economic benefits associated with the dividend will flow to the entity; and
- (iii) the amount of the dividend can be measured reliably.

Gain/(loss) on sale of investment in mutual funds is recorded as other income on transfer of title from the entity and is determined as the difference between the redemption price and carrying value of the investments.

Brief description	Audit procedures
<p>Recorded other income was earned during the Period</p> <p>Other income earned during the period was appropriately recorded and there is no understatement or overstatement.</p> <p>Other income has been measured appropriately as per the applicable accounting standards</p>	<ul style="list-style-type: none"> • For verifying interest income on fixed deposits: <ul style="list-style-type: none"> □ 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. Verify the arithmetical accuracy of the interest calculation made by the entity by recomputing i.e. multiplying the deposit amount with the applicable rate and number of days during the period under audit. □ For deposits still outstanding as at the period-end, trace the same to the direct confirmations obtained from the respective bank/ financial institution. □ Obtain a confirmation of interest income from the bank and verify that the interest income as per bank reconciles to the calculation shared by the entity. □ Also, obtain a copy of Form 26AS (TDS withholding by the bank/

	financial institution) and reconcile the interest reflected therein to the calculation shared by client.
	<ul style="list-style-type: none"> For Dividends, verify that the same are recognised in the statement of profit and loss only when the entity's right to receive payment of the dividend is established. Verify that Gain/(loss) on sale of investment in mutual funds is recorded as other income only on transfer of title from the entity and is determined as the difference between the redemption price and carrying value of the investments. For the purpose, obtain the mutual fund statement and trace the gain / loss as recorded in the books of account to the gain/ loss as reflected in the statement.
Required disclosures for other income have been appropriately made	<p>Ensure whether the following disclosures as required under Schedule III (Par 1) to Companies Act, 2013 have been made:</p> <ul style="list-style-type: none"> Whether 'other income' has been classified as: <ul style="list-style-type: none"> Interest income Dividend income Other non-operating income (net of expenses directly attributable to such income).

4.3 Purchases

Purchases is another significant process of an entity. Similar to sales as discussed above, purchases and disbursement cycle in a business refers to the set of processes that begin when an order for buying goods or services is placed based on requirements of the production/ user department and ends when the entity received the product and makes complete payment to the vendor. As part of the year-end audit of an entity's financial statements, auditors test purchase transactions and the internal controls over those transactions to ensure that the entity is not materially misstating its purchases or accounts payables.

Auditor needs to obtain a clear understanding about the organisation and its

production centres e.g. type of services or products they procure that are used in the production/ rendering of services, sources of procurement whether domestic or overseas, general availability and terms and conditions of purchase of the service or products, major vendors, credit period, quality checks, purchase terms (Credit or cash purchase) etc.

1. An auditor needs to identify the control points over purchases e.g. whether segregation of duties exist, whether competitive quotes are invited, whether a purchase committee exists who authorises purchase price, issues and authorizes purchase orders, when and how the goods are received and acknowledged, who checks the quality, quantity and specifications of the goods received and prepares Goods Receipt Note (GRN), who approves the vendor invoice, whether a 2 way/ 3 way match process exists (i.e. tally between purchase order, GRN and vendor invoice), how the purchases have been recognised in the system.
2. An auditor tests the controls the entity has set up for the purchase cycle to determine whether they are effective or not. If the controls are effective, the auditor can reduce the extent of substantive testing. Common internal controls over the purchase cycle include inviting competitive quotations for shortlisting the vendors, numbered purchase orders, purchase order authorization over a certain limit, generation of GRN on receipt of goods, quality inspection of goods, 2 way/ 3-way match, authorization of purchase invoices.
3. The auditor selects a random sample of transactions and examines the related purchase orders, GRN, purchase invoices, inward gate entry register and vendor reconciliation/ statements.
4. Performing substantive audit procedures is must. Substantive analytical procedure will consist of purchase trend analysis, comparison with previous accounting period, category wise purchases, any analysis auditor may find relevant and most important of all setting a purchase expectation in relation to the sales made during the period under audit and compare that with the client's purchase records. The auditor would need to know the purchase prices of the products or services over the year, monthly average purchase price per product or service etc.

The below table summarises the audit procedures generally required to be undertaken while auditing purchases:

Brief description	Audit procedures
Recorded purchases represent	• Ensure purchases are not understated/

goods actually received/ services availed during the period	<p>overstated by performing following audit procedures:</p> <ul style="list-style-type: none"> • Whether any fictitious vendors have been booked or purchases have been recorded by reviewing the vendor selection process followed by the entity and also performing procedures to ensure existence of the vendors. • Whether the goods were received at the factory gate and whether there exists an entry in the security gate inward register
	<ul style="list-style-type: none"> • Whether quality inspection of goods was done. • Whether a goods receipt note was prepared and signed by an appropriate client personnel. • Whether the purchase invoice was approved as per delegation of authority and whether a 3 or 2-way match (as discussed above) was done. • Whether stock record has been updated by the stores personnel. <p>Special considerations during audit of purchases</p> <ul style="list-style-type: none"> • The purchase invoice received should be the "Original" copy (and not photocopy/ carbon copy) against which the entity has recorded the purchase in its books of account. • Purchase invoice should have been booked only once risk and reward incidental to ownership has been transferred to the entity. Specific consideration for cases where the terms of delivery as agreed with vendor are F.O.B., C.I.F. etc. • Purchase invoice should be in the name of entity. However, in case of different

	<p>branches, it should be addressed to the appropriate branch.</p> <ul style="list-style-type: none"> • Input tax component should have been booked in the input tax ledger. The auditor should obtain tax returns filed with the authorities and tally the input tax as reflected in the books to the amount disclosed in the returns. • In case of purchases made from related parties or allied and associated concerns, the auditor needs to verify if requisite approval from Board of Directors (appropriate authority) has been obtained and should verify the selected samples and perform analytical procedures in relation to price of goods to confirm that the price charged is at arm's length.
	<ul style="list-style-type: none"> • The auditor should review whether purchases should be capitalized or expensed off in Statement of Profit and loss according to his professional judgement. • Review journal entries for unusual transactions.
<p>All purchases made during the period were recorded and there in no understatement or overstatement.</p> <p>All purchases have been measured appropriately</p>	<p>In addition to the procedures for establishing occurrence of purchases as discussed above, the auditor should:</p> <ul style="list-style-type: none"> • Perform cut-off test to ensure that purchases are recognised in the correct accounting period. For the purpose, the auditor should examine material inward records, say, last 5 transactions at the period end to check that all corresponding invoices have been duly entered in the Purchases book and none have been omitted. • Ensure correct accounting treatment of

	<p>goods – in – transit as per the agreed terms with the vendor regarding transfer of risk and reward of ownership in goods.</p> <ul style="list-style-type: none"> • Perform analytical procedures to obtain audit evidence as to overall reasonableness of purchase quantity and price which may include: <ul style="list-style-type: none"> □ Consumption Analysis: Auditor should scrutinize raw material consumed as per manufacturing account and compare the same with previous years with closing stock and ask for the reasons from the management, if any significant variations are found. □ Stock Composition Analysis: Auditor to collect the reports from management for composition of stock i.e. raw materials as a percentage of total stock and compare the same with previous year and ask for reasons from management in case of significant variations.
	<ul style="list-style-type: none"> □ Ratios: Auditor should compare the creditors turnover ratios and stock turnover ratios of the current year with previous years. □ Auditor should review quantitative reconciliation of closing stocks with opening stock, purchases and consumption.
Required disclosures for purchases have been appropriately made	<p>Ensure whether the following disclosures as required under Schedule III (Part 1) to Companies Act, 2013 have been made:</p> <ul style="list-style-type: none"> • Whether purchases of stock-in-trade have been specifically disclosed.

	<ul style="list-style-type: none"> • Whether changes in inventories of finished goods, stock-in-trade and work-in-progress have been specifically disclosed. • Whether the transactions with related parties are appropriately disclosed in notes to accounts.
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4.4 Employee Benefits Expenses

Employee benefits expenses or commonly called payroll expenses represent the aggregate sum an entity pays to its employees for their labour/ efforts as well as associated expenses such as perquisites/ benefits, post-employment benefits like gratuity, superannuation, leave encashment, provident fund contribution etc. as well as towards their hiring, their welfare and training. In many industries, employee benefits expense is the biggest expense category and hence it is critical for businesses to manage this expenditure shrewdly and for the auditors to verify and ensure that such expenditure is appropriate and has been accounted as per applicable accounting standards and generally accepted accounting principles.

Auditor needs to obtain a clear understanding about the organisation and its hiring, appraisal and retirement process in the following manner:

1. An auditor tests the controls the entity has set around employee benefit payment process to determine how effective they are. If they are effective, the auditor can reduce the substantive testing. Common internal controls over the employee benefit payment cycle includes maintaining of attendance records, employee master, authorisation and approval of monthly payroll processing and disbursement, computation of employee deductions like payroll taxes, accrual of other benefits like gratuity, leave encashment, bonus etc.
2. The auditor selects a random sample of transactions and examines the related appointment letters, appraisal letters, attendance records, HR policies, employee master etc.
3. Performing substantive audit procedures is must. Substantive analytical procedure will consist of monthly expense reasonability, comparison with previous accounting period, any analysis auditor may find relevant and most important of all setting an expectation in relation to the expense incurred during the period under audit and compare that with the client's business operations and overall trend in the industry.

The below table summarises the audit procedures generally required to be

undertaken while auditing employee benefits expenses:

Brief description	Audit procedures
Recorded employee benefit expenses were actually incurred during the period	<ul style="list-style-type: none"> • Obtain an understanding of entity's process of capturing employee attendance. There is always a risk that an entity could record expense for fictitious employees. To address this risk, the auditor may choose to meet the employees in person, on a sample basis. Further, the auditor may choose to select a sample of employees and ask the payroll department to share their bank details/ identity proofs of the employees.
Employee benefit expenses pertaining to the period have been recorded appropriately and there is no understatement or overstatement.	
Employee benefit expenses have been measured appropriately	
	<ul style="list-style-type: none"> • Obtain a list of employees as at the period-end along with a monthly movement split between new hires, leavers and continuing employees. • For a sample (selected randomly) of new hires, obtain the appointment letter and verify whether the salary for first month and subsequent months was processed as per the agreed terms. • For a sample (selected randomly) of resigned employees, obtain their full and final computation and verify whether all their dues including post-retirement benefits like gratuity, leave encashment have been paid and whether the respective employee's acknowledgement on final computation has been obtained. • Obtain the monthly salary registers for all 12 months. Compile a monthly payroll reasonability by calculating the average salary per employee per month and compare with the previous year and preceding month and analyse the reasons for variance which could be attributable to annual increments, an

	<p>employee at senior level joining/ leaving the entity, bonus pay-out etc.</p>
	<ul style="list-style-type: none"> • Verify if accrual/ provision has been made for all employee benefits and obligations like bonus, gratuity, leave encashment, etc. • In case provident fund (PF), employee state insurance (ESI) are applicable to the entity, compile a reasonability by applying the rate to the basic wages and comparing to the amount recorded in books and analyse reasons for variance, if any. Also, obtain monthly deposit challans to verify if the month on month liability was subsequently deposited with the authorities and within the defined timelines. • Perform analytical procedures to obtain audit evidence as to overall reasonableness of employee benefit expenses which may include production per employee analysis. Auditor should analyse units produced per employee and compare the same with previous years and prevent industry trends and ask for the reasons from the management, if any significant variations are found.
Required disclosures for employee benefit expenses have been appropriately made	<p>Ensure whether the following disclosures as required under Schedule III (Part 1) to Companies Act, 2013 have been made:</p> <p>Whether employee benefit expense has been classified as:</p> <ul style="list-style-type: none"> • Salaries and wages. • Contributions to provident and other funds. • Staff welfare expenses.

4.5 Depreciation and Amortisation

One of the key principles of accrual basis of accounting requires that an asset's cost is proportionally expensed based on the period over which the asset is expected to be used. Both depreciation and amortization are methods that are used to prorate the cost of a specific type of asset over its useful life. Depreciation represents systematic allocation of the depreciable value of an item of PPE over its useful life while amortisation represents systematic allocation of the depreciable amount of an intangible asset over its useful life.

Depreciation and amortisation generally constitute an entity's significant part of overall expenses and have direct impact on the profit/ loss of the entity, hence auditors need to verify and ensure that such expenditure is appropriate, accurately calculated and has been accounted as per applicable provisions of Companies Act or other statutes, to the extent applicable on the respective industry and as per generally accepted accounting principles.

Auditor needs to consider the following attributes while verifying for depreciation and amortisation expenses:

- Obtain the understanding of entity's accounting policy related to depreciation and amortisation.
- Ensure the Company policy for charging depreciation and amortisation is as per the relevant provisions of Companies Act/ applicable accounting standards.
- Whether the depreciation has been calculated after making adjustment of residual value from the cost of the assets.
- Whether depreciation and amortisation charges are valid.
- Whether depreciation and amortisation charges are accurately calculated and recorded.
- Whether all depreciation and amortisation charges are recorded in the appropriate period.
- Ensure the parts (components) of each item of property, plant and equipment that are to be depreciated separately have been properly identified.
- Whether the most appropriate depreciation method for each separately depreciable component has been used.

The below table summarises the audit procedures generally required to be undertaken while auditing depreciation and amortization expense:

Brief description	Audit procedures
<p>Depreciation and amortization expenses pertaining to the period have been recorded appropriately and there is no understatement/overstatement.</p> <p>Depreciation and amortisation expenses have been measured appropriately. Recorded depreciation and amortisation expenses were actually incurred during the period.</p>	<p>Obtain an understanding of entity's process of charging depreciation and amortization. Obtain the fixed asset register maintained by the entity. There is always a risk that an entity could capitalize expense of revenue nature to increase its profit or charge capital expenditure directly in income and expense statement to reduce its profit. To address this risk, the auditor may choose to check the nature of asset from fixed asset register and further, there is always a risk that fake asset has been capitalized in the books and to mitigate this risk, auditors should physically verify the fixed assets, at least the ones that are material in value.</p> <p>Obtain a list of all additions/ deletions along with their proper approval from the authorised person for the same.</p> <p>Select the sample of assets from the Fixed Assets Register, on materiality considerations and verify the rates of depreciation, depreciation calculation.</p> <ul style="list-style-type: none"> ▪ Obtain the list of all the components identified by the management. ▪ Ensure Intangible assets like patents, goodwill, copy rights have been properly amortized over the period. ▪ Ensure depreciation is charged on the assets from the date when it is ready to use. ▪ Ensure depreciation on revalued amount has been properly accounted from revaluation reserve. ▪ Depreciation computation as per Income tax Act, 1961- Ensure that additions are tallying with the additions as per Companies Act and the opening

	WDV to the Tax audit schedule for the assessment year preceding the previous year under audit.
	<ul style="list-style-type: none"> Perform analytical procedures to obtain audit evidence as to overall reasonableness of depreciation and amortisation expense - check the arithmetical accuracy of records and perform independent calculations. For ex-Re-compute the depreciation expense for the year (Refer the format below that could be used for compiling reasonability of the expenditure for the year). Ensure that the depreciation and amortization has been charged as per the useful lives of PPE and intangible assets. Ensure that residual values have been properly verified as that impacts the computation of depreciation. Ensure that the depreciation and amortization has been computed prospectively whenever there is any change in useful lives of PPE and intangible assets.
Required disclosures for depreciation and amortisation have been appropriately made	<p>Ensure whether the following disclosures as required have been made:</p> <ul style="list-style-type: none"> Accounting policy for depreciation and amortization. Useful lives of assets as per Schedule II to the Companies Act, 2013. Residual value of assets. Depreciation method.

Book Value			Useful life	Computation of Depreciation/ amortisation on the basis of useful life and residual value	Actual Depreciation/ amortisation as per books	Variance	Reasons for Variance
Opening Balance	Closing Balance	Average Balance	%				
A	B	$C = (A + B)/2$ #	D	E	F	$G = F - E$	H

Alternatively, any other most accurate number/ estimate can also be used

4.6 Other Expenses like Power and Fuel, Rent, Repair to Building, Plant and Machinery, Insurance, Travelling, Legal and Professional, Miscellaneous Expenses

An entity in addition to making purchases and incurring employee benefit expenses, also incurs other expenditures like rent, power and fuel, repairs and maintenance, insurance, travelling, miscellaneous expenses etc., that are essential and incidental to running of business operations.

While the auditor may choose to analyse the monthly trends for expenses like rent, power and fuel, an auditor generally prefers to vouch for other expenses to verify following attributes:

- ◆ Whether the expenditure pertained to current period under audit;
- ◆ Whether the expenditure qualified as a revenue and not capital expenditure;
- ◆ Whether the expenditure had a valid supporting like travel tickets, insurance policy, third party invoice etc.;
- ◆ Whether the expenditure has been classified under the correct expense head;
- ◆ Whether the expenditure was authorised as per the delegation of authority matrix;
- ◆ Whether the expenditure was in relation to the entity's business and not a personal expenditure.

The below table summarises the audit procedures generally required to be undertaken while auditing other expenses:

Brief description	Audit procedures
Recorded other expenses were actually incurred during the period	<ul style="list-style-type: none"> • Rent expense- Obtain a month wise expense schedule along with the rent agreements. Verify if expense has been recorded for all 12 months and whether the rent amount is as per the underlying
Other expenses	

<p>pertaining to the period have been recorded appropriately and there is no understatement or overstatement</p> <p>Other expenses have been measured appropriately</p>	<p>agreement. Specific consideration should be given to escalation clause in the agreement to verify if the rent was required to be recorded on a straight-line basis during the period under audit. Also, verify if the agreement is in the name of the entity and whether the expense pertains to premises used for running business operations of the entity.</p> <ul style="list-style-type: none"> • Power and fuel expense - Obtain a month wise expense schedule along with the power bills. Verify if expense has been recorded for all 12 months. Also, compile a month wise summary of power units consumed and the applicable rate and check the arithmetical accuracy of the bill raised on monthly basis. In relation to the units consumed, analyse the monthly power units consumed by linking it to units of finished goods produced and investigate reasons for variance in monthly trends.
	<ul style="list-style-type: none"> • Insurance expense - Obtain a summary of insurance policies taken along with their validity period. Verify whether the expense has been correctly classified between prepaid and expense for the period based on number of days. • Legal and professional expenses - Obtain a month-wise and consultant-wise summary. In case of monthly retainerhip agreements, verify whether the expenditure for all 12 months has been recorded correctly. For non- recurring expenses, select a sample and vouch for the attributes discussed above. The auditor should be cautious while vouching for legal expenses as the same may highlight a dispute for which the entity may not have made any provision and the matter may also not have been discussed/ highlighted to the auditor for his specific consideration. • Travel, repair and maintenance, printing and stationery, miscellaneous expenses - The auditor should select a sample and vouch for the

	<p>attributes discussed above. Wherever possible, the auditor should try to prepare a summary of expenditure on monthly basis and then analytically compare the trends.</p> <ul style="list-style-type: none"> • Perform analytical procedures to obtain audit evidence as to overall reasonableness of other expense which may include expenditure per unit of production analysis. Auditor should analyse expense per unit produced and compare the same with previous years and prevent industry trends and ask for the reasons from the management, if any significant variations are found.
Required disclosures for other expenses have been appropriately made	<p>Ensure other expense have been classified under:</p> <ul style="list-style-type: none"> • Rent. • Insurance. • Power and fuel. • Repairs and maintenance- Building, Plant and machinery, others. • Legal and professional. • Printing and stationary. • Travel expenses. • Miscellaneous expenses.

SUMMARY

Companies prepare their financial statements in accordance with the framework of **generally accepted accounting principles**. A **financial statement audit** comprises the examination of an entity's **financial statements** by an independent **auditor**. The result of this examination is a report by the **auditor**. In preparing financial statements, Company's management makes implicit or explicit claims (i.e. assertions) regarding the completeness, cutoff, existence/ occurrence, valuation/ measurement, rights and obligations and presentation and disclosure of assets, liabilities, equity, income, expenses and disclosures in accordance with the applicable accounting standards. The auditor then needs to draw an audit programme to verify and obtain sufficient and appropriate audit evidence for each of the assertions made by the management.

TEST YOUR KNOWLEDGE

MCQs

1. Which assertion is common among the statement of profit and loss and balance sheet captions:
 - (a) Existence
 - (b) Valuation
 - (c) Completeness
 - (d) Measurement
2. Direct confirmation procedures are performed during audit of accounts receivable balances to address the following balance sheet assertion:
 - (a) Rights and obligations
 - (b) Existence
 - (c) Valuation
 - (d) Completeness
3. Where no reply is received during the performance of direct confirmation procedures as part of audit of accounts receivable balances, the auditor should perform:
 - (a) No additional testing
 - (b) Additional testing including subsequent collections testing and agreeing the detail of the respective balance to the customer's remittance advice.
 - (c) Additional testing including preparing a detailed analysis of the balance, ensuring it consists of identifiable transactions and confirming that these revenue transactions actually occurred.
 - (d) Both (b) and (c)
4. Obtaining trade receivables ageing report and analysis and identification of doubtful debts is performed during audit of accounts receivable balances to address the following balance sheet assertion:
 - (a) Valuation
 - (b) Rights and obligations
 - (c) Existence

- (d) Completeness
5. Observing inventory being counted and personally performing test counts to verify counts is performed during audit of inventory balances to address the following balance sheet assertion:
- (a) Rights and obligations
 - (b) Valuation
 - (c) Completeness
 - (d) Existence
6. Wages paid to workers would qualify as:
- (a) Revenue expenditure
 - (b) Capital expenditure
 - (c) Revenue or capital expenditure depending upon facts and circumstances.
 - (d) None of the above
7. During the course of audit of intangible assets, expenditure incurred during following phase is not capitalised:
- (a) Development phase
 - (b) Research phase
 - (c) None of the above
 - (d) Both (a) and (b)
8. Search for unrecorded liability is performed during audit of current liabilities to address the following balance sheet assertion:
- (a) Valuation
 - (b) Rights and obligations
 - (c) Existence
 - (d) Completeness
9. Cut-off testing is performed during audit of sales to address the following assertion:
- (a) Occurrence
 - (b) Measurement

- (c) Cut-off
- (d) All of the above
10. ABC's investee company- XYZ declares final dividend for financial year 2016-17 in the meeting of board of directors held on April 10, 2017. In which financial year should ABC account for the dividend income:
- (a) Proportionately i.e. considering 10 days of financial year 2017-18 and 355 days of financial year 2016-17
- (b) Financial year 2016- 17
- (c) Financial year 2017- 18
- (d) Equally between financial year 2016-17 and financial year 2017-18
11. All inventory units held by the audit entity and that should have been recorded, have been recognized in the financial statements. The assertion involved is :
- (a) Existence
- (b) Completeness
- (c) Rights and Obligations
- (d) Valuation
12. Which of the following is not an example of revenue expenditure -
- (a) Salaries and wages of employees engaged directly or in-directly in production
- (b) Repairs, maintenance and renewals of fixed assets
- (c) Legal and professional expenses
- (d) development expenditure on land

Correct/Incorrect

State with reasons (in short) whether the following statement is correct or incorrect:

1. Employee benefits expenses represent the sum an entity pays to its employees for their labour/ efforts only.
2. Dividends are recognised in the statement of profit and loss only when the entity's right to receive payment of the dividend is established.
3. "Sweat Equity Shares" means equity shares issued by the company to employees or directors at a premium or for consideration other than cash for

providing know-how or making available right in the nature of intellectual property rights or value additions, by whatever name called.

4. Capital reserves represent profits that are available for distribution to shareholders held for the time being or any one or more purpose.
5. A capital reserve, generally, can be utilised for writing down fictitious assets or losses or (subject to provisions in the Articles) for issuing bonus shares if it is realised.
6. If Company X's balance sheet shows building with carrying amount of ₹ 100 lakh, the auditor shall assume only one point that the management has only asserted that the building recognized in the balance sheet exists as at the period-end.
7. The securities premium account may only be applied by the Company towards the issue of unissued shares of the company to the members of the company as fully paid bonus shares.

Theoretical Questions

1. How will you vouch and/or verify the following:
 - (a) Goods sent out on Sale or Return Basis.
 - (b) Borrowing from Banks.
2. How will you vouch/verify the following:
 - (a) Goods sent on consignment.
 - (b) Foreign travel expenses.
 - (c) Receipt of capital subsidy.
 - (d) Provision for income tax.
3. How will you vouch and/or verify payment of taxes?
4. How would you vouch/verify the following:
 - (a) Advertisement Expenses.
 - (b) Sale of Scrap.

ANSWERS/SOLUTIONS

Answers to MCQs

1. (c) 2. (b) 3. (b) 4. (a) 5. (d) 6. (c)

7. (b) 8. (d) 9. (c) 10. (c) 11. (b) 12. (d)

Answers to Correct/Incorrect

1. **Incorrect:** Employee benefits expenses, commonly called payroll expenses, represent the aggregate sum an entity pays to its employees for their labour/ efforts, as well as associated expenses such as perquisites/ benefits, post-employment benefits like gratuity, superannuation, leave encashment, provident fund contribution etc. as well as towards their hiring, their welfare and training.
2. **Incorrect:** Dividends are recognised in the statement of profit and loss only when:
 - (i) the entity's right to receive payment of the dividend is established;
 - (ii) it is probable that the economic benefits associated with the dividend will flow to the entity; and
 - (iii) the amount of the dividend can be measured reliably.
3. **Incorrect:** "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 right in the nature of intellectual property rights or value additions, by whatever name called.
4. **Incorrect:** Revenue reserves represent profits that are available for distribution to shareholders.
5. **Correct:** A capital reserve, generally, can be utilised for writing down fictitious assets or losses or (subject to provisions in the Articles) for issuing bonus shares if it is realised. But the amount of share premium or capital redemption reserve account can be utilised only for the purpose specified in Sections 52 and 55 respectively of the Companies Act, 2013.
6. **Incorrect:** If Company X's balance sheet shows building with carrying amount of ₹ 100 lakh, the auditor shall assume that the management has claimed/ asserted that:
 - The building recognized in the balance sheet exists as at the period-end (existence assertion);
 - Company X owns and controls such building (Rights and obligations assertion);
 - The building has been valued accurately in accordance with the measurement principles (Valuation assertion);

All buildings owned and controlled by Company X are included within the carrying amount of ₹ 100 lakh (Completeness assertion).

7. **Incorrect:** The securities premium account may be applied by the Company:
- (a) towards the issue of unissued shares of the company to the members of the company as fully paid bonus shares;
 - (b) in writing off the preliminary expenses of the Company;
 - (c) in writing off the expenses of, or the commission paid or discount allowed on, any issue of shares or debentures of the company;
 - (d) in providing for the premium payable on the redemption of any redeemable preference shares or of any debentures of the company; or
 - (e) for the purchase of its own shares or other securities under section 68.

Answer to Theoretical Questions

1. (a) **Goods Sent Out on Sale or Return Basis:**

- (i) Check whether a separate memoranda record of goods sent out on sale or return basis is maintained. The party accounts are debited only after the goods have been sold and the sales account is credited.
 - (ii) Verify that price of such goods is unloaded from the sales account and the trade receivables record. Check the memoranda record to confirm that on the receipt of acceptance from each party, his account has been debited and the sales account correspondingly credited.
 - (iii) Ensure that the goods in respect of which the period of approval has expired at the end of the year, have either been received back or customers' accounts have been debited.
 - (iv) Confirm that the inventory of goods sent out on approval, the period of approval in respect of which had not expired till the end of the year lying with the party, has been included in the closing inventory.
- (b) **Borrowing from Banks:** Borrowing from banks may be either in the form of overdraft limits or term loans. In each case, the borrowings should be verified as follows-
- (i) Reconcile the balances in the overdrafts or loan accounts with that shown in the pass book(s) and confirm the last mentioned balance

by obtaining a certificate from the bank showing the balance in the accounts as at the end of the year.

- (ii) Obtain independent balance confirmation from the bank showing balances, particulars of securities deposited with the bank as security for the loans or of the charge created on an asset and confirm that the same has been correctly disclosed and duly registered with Registrar of Companies and recorded in the Register of charges.
- (iii) Verify the authority under which the loan or draft has been raised. In the case of a company, only the Board of Directors is authorised to raise a loan or borrow from a bank.
- (iv) Confirm, in the case of a company, that the restraint contained in Section 180 of the Companies Act, 2013 as regards the maximum amount of loan that the company can raise has not been contravened.

Ascertain the purpose for which loan has been raised and the manner in which it has been utilised and that this has not prejudicially affected the entity.

2. (a) **Goods Sent on Consignment:**

- (i) Verify the accounts sales submitted by the consignee showing goods sold and inventory of goods in hand.
- (ii) Reconcile the figure of the goods on hand, as given in the last accounts sales, with the Performa invoices and accounts sales received during the year. If any consignment inventory was in the hands of the consignee at the beginning of the year, the same should be taken into account in the reconciliation.
- (iii) Obtain confirmation from the consignee for the goods held on consignment on the balance sheet date. Verify the terms of agreement between the consignor and the consignee to check the commission and other expenses debited to the consignment account and credited to the consignee's account. The accounts sales also must be correspondingly checked.
- (iv) Ensure that the quantity of goods in hand with the consignee has been valued at cost plus proportionate non-recurring expenses, e.g., freight, dock dues, customs due, etc., unless the value is lower. In case net realisable value is lower, the inventory in hand

of the consignee should be valued at net realisable value. Also see that the allowance has been made for damaged and obsolete goods in making the valuation.

- (v) See that goods in hand with the consignee have been shown separately under the head inventories.

(b) Foreign Travel Expenses:

- (i) Examine Travelling Allowance bills submitted by the employees stating the details of tour, details of expenses, etc.
- (ii) Verify that the tour programme was properly authorised by the competent authority.
- (iii) Check the T.A. bills along with accompanying supporting documents such as air tickets, travel agents bill and hotel bills with reference to the internal rules for entitlement of the employees and also make sure that the bills are properly passed.
- (iv) See that the tour report accompanies the T.A. bill. The tour report will show the purpose of the tour. Satisfy that the purpose of the tour as shown by the tour report conforms to the authorisation for the tour.
- (v) Check Reserve Bank of India's permission, if necessary, for withdrawing the foreign exchange. For a company the amount of foreign exchange spent is to be disclosed separately in the accounts as per requirement of Schedule III to the Companies Act, 2013 and Accounting Standard 11 "The Effects of Changes in Foreign Exchange Rates".

(c) Receipt of Capital Subsidy:

- (i) Check the application made for the claim of subsidy to ascertain the purpose and the scheme under which the subsidy has been made available.
- (ii) Examine documents for the grant of subsidy and note the conditions attached with the same relating to its use, etc.
- (iii) Ensure that the conditions to be fulfilled and other terms especially whether the same is for a specific asset or is for setting up a factory at a specific location.
- (iv) Check relevant entries for receipt of subsidy.
- (v) Check compliance with requirements of AS 12 on "Accounting for

Government Grants" i.e. whether it relates to specific amount or in the form of promoters' contribution and accordingly accounted for as also compliance with the disclosure requirements.

(d) Provision for Income Tax:

- (i) Obtain the computation of income and income tax prepared by the entity and verify whether it is as per the Income-tax Act, 1961 and Rules made thereunder.
- (ii) Review adjustments, expenses, disallowed special rebates, etc. with particular reference to the last available completed assessment.
- (iii) Examine relevant records and documents pertaining to advance tax, self-assessment tax and other demands.
- (iv) Compute tax payable as per the latest applicable rates in the Finance Act.
- (v) Ensure that overall provisions on the date of the balance sheet is adequate having regard to current year provision, advance tax paid, assessment orders, etc.
- (vi) Ensure that the requirements of AS 22 on Accounting for Taxes on Income have been appropriately followed for the period under audit.

3. Vouching of Payment of Taxes:

- (i) Payment on account of income-tax and other taxes consequent upon a regular assessment should be verified by reference to the copy of the assessment order, assessment form, notice of demand and the receipted challan.
- (ii) Payments or advance payments of income-tax should also be verified with the notice of demand and the receipted challan acknowledging the amount paid.
- (iii) The interest allowed on advance payments of income-tax should be included as income and penal interest charged for non-payment should be debited to the interest account.
- (iv) Nowadays, electronic payment of taxes is also in trend. Electronic payment of taxes means payment of taxes by way of internet banking facility or credit or debit cards.
- (v) The entity can make electronic payment of taxes also from the account of any other person. However, the challan for making such payment

must clearly indicate the Permanent Account Number (PAN) of the assessee on whose behalf the payment is made. This should be checked by the auditor.

- (vi) It is not necessary for the entity to make payment of taxes from his own account in an authorized bank. While vouching such e-payment, the auditor should cross verify the payments of taxes through the receipted challan along with PAN No /TAN No. etc.

4. (a) **Advertisement Expenses:**

- (i) Verify the bills/invoices from advertising agency to ensure that rates charged for different types of advertisement are as per the contract.
- (ii) See that the advertisement relates to client's business.
- (iii) Inspect the receipt issued by the agency.
- (iv) Ascertain the nature of expenditure – revenue or capital expenditure and see that it has been recorded properly.
- (v) Ascertain the period for which payment is made and see that prepaid amount, if any, is carried to the balance sheet.
- (vi) See that all outstanding advertisement bills have been provided for.

(b) **Sale of Scrap:**

- (i) Review the internal control as regards generation, storage and disposal of scrap.
- (ii) Check whether the organization is maintaining reasonable record for generation of scrap.
- (iii) Analyze the raw material used, production and generation pattern of scrap and compare the same with figures of earlier year.
- (iv) Check the rates at which scrap has been sold and compare the rate with previous year.
- (v) Vouch sales, with invoices raised, advertisement for tender, rate contract with scrap dealers.
- (vi) Ensure that there exists a proper control procedure to identify scrap and good units and they are not mixed up and sold as scrap.
- (vii) Make an overall assessment of the value of realization from scrap as to its reasonableness.