

16. AUDIT OF ITEMS OF FINANCIAL STATEMENTS**PART – A – AUDIT OF PROFIT AND LOSS ITEMS**

Q No. 1 Write about assertions used for audit of Profit and Loss, Balance sheet and Presentation and Disclosure?

A. TRANSACTIONS:

- a) **OCCURRENCE:** Ensure that the transactions in the financial statements have occurred and are relate to the entity.
- b) **COMPLETENESS:** All transactions that were supposed to be recorded have been recognized in the financial statements and further, transactions have been recognized in the correct accounting periods (Cut-off).
- c) **MEASUREMENT:** Transactions have been recorded accurately at their appropriate amounts.

B. BALANCES:

- a) **EXISTENCE:** Assets, liabilities and equity balances exist as at the period end.
- b) **COMPLETENESS:** All assets, liabilities and equity balances that were supposed to be recorded have been recognized in the financial statements.
- c) **VALUATION:** Assets, liabilities and equity balances have been valued appropriately.
- d) **RIGHTS & OBLIGATIONS:** Entity has the right to ownership or use of the recognized assets, and the liabilities recognized in the financial statements represent the obligations of the entity.

C. PRESENTATION AND DISCLOSURES:

- a) **OCCURRENCE AND EXISTENCE:** Transactions and events disclosed in the financial statements have occurred and relate to the entity and further, the closing balance does exist as at the period- end.
- b) **COMPLETENESS:** All transactions, balances, events and other matters that should have been disclosed have been disclosed in the financial statements.
- c) **MEASUREMENT AND VALUATION:** Transactions, events, balances and other financial matters have been measured and disclosed correctly at their appropriate values and in a manner that promotes the understandability of information contained in the financial statements.

Q No. 2 Write about understanding Revenue from sales in brief?

A. UNDERSTANDING OF REVENUE CENTERS:

Auditor needs to obtain a clear understanding about the organization and its revenue centers, Specifically the following items:

1. Type of services or products they provide.
2. Major selling products/services.
3. Introduction of new products/service line.
4. Discontinuance of products/services.
5. Major customers.
6. General sales terms and conditions.

B. BRIEF AUDIT PROCEDURE:

1. An auditor needs to identify the control points over sales.
2. An auditor shall test the controls over sales to determine their effectiveness.
3. The auditor selects a random sample of transactions and examines the related customer purchase orders, invoices and customer statements.
4. Performing substantive audit procedures by sales trend analysis, comparison with previous accounting period, category wise sales etc.

Q No. 3 Write about audit procedure for verification of Sales?**A. OCCURENCE:** Recorded sales represent goods shipped/ services performed during the period:

1. Check whether a single sales invoice is recorded multiple times.
2. Whether any fictitious sales has been recorded.
3. Whether any shipments were done without the consent and agreement of the customer.
4. Whether any substantial uncertainty exists about collectability.
5. Review sequence of sales invoices.
6. Review journal entries for unusual transactions.
7. Calculate the ratio of sales return to sales and compare it with previous year and investigate material deviations.
8. Check the sales return with sales invoice, challan, credit note, stock register, reversal of GST etc.

B. COMPLETENESS: All sales made during the period were recorded and there in no understatement or overstatement.1. **Cut-off arrangement:**

- a) Perform cut-off test to ensure that revenues are recognised in the current accounting period.
- b) This arises when companies recognise revenue based on the date of sales invoices rather than the date on which the risks and rewards are transferred to the buyer.
- c) 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.

E.g., Auditor generally focus on year end sale invoices and ensure that the risk is transferred on or before closing date.

2. If credit notes issued after the accounting period immediately for the current year end sales, it may be a case of fictitious sales.
3. Check reconciliation of total sales/goods dispatched as per stock records and financial records and GST invoice.
4. Review the GST and GST returns and ensure that the same are reconciled with revenue reported in the profit and loss account.

C. MEASUREMENT: All sales are accurately measured as per applicable accounting standards and correctly journalized, summarized, and posted.

1. If there are any export sales, consider Exchange gain/ loss arising from the sales.

2. Trace a few transactions from beginning to completion (Audit in Depth).
3. Auditor must understand client's operations and related GAAP issues regarding revenue recognition method.
E.g. Point of sale revenue recognition vs. Percentage of completion.
4. Ensure that the related party sales are properly authorized and the value of such transactions were reasonable and at arm's length.

Q No. 4 Write about audit of Other Incomes?

A. INTEREST INCOME ON FIXED DEPOSITS:

1. Obtain a list 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.
2. Verify the arithmetical accuracy of the interest calculation made by the entity by multiplying the deposit amount with the applicable rate and number of days during the period under audit.
3. For deposits still outstanding as at the period- end, trace the same to the direct confirmation obtained from the respective bank/ financial institution. (Balance confirmation)
4. Obtain a confirmation of interest income from the bank and verify that the interest income as per bank is matching with entity records. (Interest certificate)
5. Obtain a copy of Form 26AS and reconcile the interest reflected therein to the calculation shared by client.

B. DIVIDENDS:

1. Verify that the dividends are recognized only when the entity's right to receive payment of the dividend is established
2. Verify that Gain/(loss) on sale of investment in mutual funds is recorded as other income only on transfer of title from the entity.
3. Obtain the mutual fund statement and trace the gain / loss as recorded in the books of account is matching with the statement.

Q No. 5 Write about understanding of entity's purchase process?

1. An auditor needs to identify the control points over purchases and evaluate the effectiveness thereof. Controls test ensures the auditor to identify the reliability of system of purchases.
2. A typical internal control questionnaire for Purchases are:
 - a) Whether segregation of duties exist.
 - b) Whether competitive quotes are invited.
 - c) Whether a purchase committee exists who authorises purchase price.
 - d) Who issues and authorizes purchase orders.
 - e) Who checks the quality, quantity and specifications of the goods received and prepares goods receipt note (GRN).
 - f) Who approves the vendor invoice.
 - g) Whether a 2 way/ 3 way match process exists (i.e. Tally between purchase order, grn and vendor invoice).
 - h) How the purchases have been recognised in the accounting system.

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 analytical procedures such as trend analysis, comparison with previous accounting period, category wise purchases.
5. 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.

Q No. 6 Write about detailed audit procedure for Purchases?

- A. **OCCURRENCE:** Ensure that the recorded purchases represent the goods received during the year. Ensure that the purchases are not understated or overstated by performing the following procedure:
1. Whether any fictitious vendor and purchase has been recorded by reviewing the vendor selection process followed by the entity. (Web search for vendor name)
 2. Whether the goods were received at the factory gate and ensure that it is recorded in security gate inward register.
 3. Whether quality inspection of goods was done.
 4. Whether a goods receipt note (GRN) was prepared and signed by an appropriate client staff.
 5. Whether the purchase invoice was approved as per delegation of authority and whether a 3 or 2-way match was done.
 6. Whether stock record has been updated by the stores personnel.
 7. Verify the following special items during audit of purchases:
 - a) The purchase invoice received should be the Original copy (and not photocopy/ carbon copy).
 - b) Purchase invoice should have been booked only once risk and reward incidental to ownership has been transferred to the entity.
 - c) Purchase invoice should be in the name of auditee. However, in case of different branches, it should be addressed to the appropriate branch.
 - d) Input tax component should have been booked in the input tax ledger.
 - e) In case of purchases made from related parties, the auditor needs to verify approval from Board and compare arm's length price details and purchase price.
 - f) Review journal entries for unusual transactions.
 - g) Vouch from the purchase journal to the supporting documents.
- B. **COMPLETENESS AND MEASUREMENT:**
1. **CUT-OFF PROCEDURES:**
 - a) Perform cut-off test to ensure that purchases are recognised in the correct accounting period.
 - b) For the purpose, the auditor should examine material inward records for few days say last 5 days prior to closing date to check that all corresponding invoices have been duly entered in the Purchases book and none have been omitted.
 - c) Ensure correct accounting treatment of goods – in – transit as per the agreed terms with the vendor regarding transfer of risk and reward of ownership in goods.

2. PERFORM ANALYTICAL PROCEDURES:

To obtain audit evidence as to overall reasonableness of purchase quantity and price the auditor shall analyse the following:

- a) **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 Management If any significant variations found.
- b) **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.
- c) **Ratios Analysis:** Auditor should compare the creditors turnover ratios and stock turnover ratios of the current year with previous years.
- d) Auditor should review quantitative reconciliation of closing stocks with opening stock, purchases and consumption.

1. While Auditing purchases which type of analytical procedures will be performed by the auditor to obtain audit evidence as to overall reasonableness of purchase quantity and price.	M19-4M
A. Refer point B(2)	

Q No. 7 Write about audit procedure for Employee Benefit expenses?

A. ENTITY HIRING, APPRAISAL AND RETIREMENT PROCESS:

- 1) Verify the controls the entity has set for employee benefit payment process to determine how strong and reliable they are.
- 2) If the controls are strong, the auditor can minimise the amount of transaction testing he must do.
- 3) Generally internal controls over the employee benefit expenses includes-
 - a) Maintaining of attendance records,
 - b) Employee Payroll or Master,
 - c) Authorisation and approval of monthly payroll processing and disbursement,
 - d) Computation of deductions like payroll taxes, provident fund etc.
 - e) Accrual of other benefits like gratuity, leave encashment, bonus etc.
- 4) The auditor selects a random sample of transactions and examines the related appointment letters, appraisal letters, attendance records, HR policies, employee master etc.
- 5) Performing analytical procedures is must. Substantive analytical procedure will consist of:
 - a) Monthly expense reasonability,
 - b) Comparison with previous accounting period and
 - c) Compare the client's business operations and overall trend in the industry.

B. DETAILED AUDIT PROCEDURE:

1. Verify the employee attendance process and related controls and try to Identify any fictitious or ghost workers.
2. Obtain a list of employees as at the period end along with a monthly movement split between new hires, leavers and continuing employees.

3. For a sample 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.
4. For a sample 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.
5. Obtain the monthly salary registers for all 12 months and compare with the previous year. If unusual deviations exist, inquire for such differences.
6. Verify whether provision has been made for all employee benefits and obligations like bonus, gratuity, leave encashment
7. In case Provident fund (PF), Employee state insurance (ESI) are applicable to the entity:
 - a. Re – calculate monthly liability of employer and employee contributions to be paid and compare with actual details.
 - b. Also obtain monthly deposit challans to verify monthly liability deposited with the authorities within the due dates.
8. Perform analytical procedures to obtain audit evidence as to overall reasonableness of employee benefit expense which may include production per employee analysis.

1. While reviewing Employee benefit expenses of the company, how you as an auditor you will evaluate its hiring , appraisal and retirement process ? A. Refer point A above	M19-3M
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Q No. 8 Write about audit of Depreciation and Amortisation?

AUDIT PROCEDURE:

1. Identify the entity's accounting policy related to depreciation and amortization and Ensure that the depreciation methods are as per the relevant provisions of Companies Act, applicable accounting standards.
2. Whether the depreciation has been calculated after making adjustment of residual value from the cost of the assets.
3. Whether depreciation and amortization charges are accurately calculated and recorded:
 - a) Obtain the fixed asset register maintained by the entity.
 - b) Obtain a list of all additions/ deletions along with their authorisation.
 - c) Select the sample of assets from the Fixed Assets Register and verify the rates of depreciation, depreciation calculation.
 - d) Ensure that the revaluation, if any, is considered appropriately.
4. Whether all depreciation and amortization charges are recorded in the proper accounting period.
 - a) Ensure depreciation is charged on the assets from the date when it is ready to use.
 - b) Perform analytical procedures to obtain audit evidence as to overall reasonableness.
5. Ensure the parts (components) of each item of property, plant and equipment that are to be depreciated separately has been properly identified.
6. Whether the most appropriate depreciation method for each separately depreciable component has been used.
7. Also in case of Income tax audit, check the calculations are as per Income tax act, 1961 and verify the value of additions by comparing to books of accounts.

RELEVANT QUESTIONS:

1. Mention any five attributes to be considered by any auditor while verifying for a depreciation and amortization expenses. A. Write any 5 points of above	M18-5M
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Q No. 9 Write about audit of Other expenses?**GENERAL POINTS:**

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

1. Whether the expenditure pertained to current period under audit.
2. Whether the expenditure qualified as a revenue and not capital expenditure.
3. Whether the expenditure had a valid supporting documents, such as bills, tickets etc.
4. Whether the expenditure has been classified under the correct expense head.
5. Whether the expenditure was authorised by proper personnel.
6. Ensure that the expenditure is not personal in nature of management.
7. Also perform Analytical procedure to compare with previous year data and unusual deviations shall be inquired.

RENT EXPENSES:

1. Obtain a month wise expense schedule along with the rent agreements.
2. Ensure that the rent is recorded for all 12 months and whether the rent amount is as per the Rental agreement.
3. Specific consideration should be given to escalation clause to verify if the rent was increased/adjusted during the period under audit.
4. Verify that the agreement is in the name of the entity and whether the expense pertains to premises used for running business operations of the entity.

POWER AND FUEL:

1. Obtain a month wise expense schedule along with the power bills.
2. Ensure that the expense has been recorded for all 12 months.
3. 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.
4. Analyse the monthly power units consumed by linking it to units of finished goods produced and investigate reasons for variance in monthly trends. (Analytical Procedures)

INSURANCE:

1. Obtain a summary of insurance policies taken along with their validity period.
2. Verify if the expense has been correctly classified between prepaid and expense for the period based on number of days.
3. Verify the last premium paid receipt to ensure that the policy is not discontinued.

LEGAL AND PROFESSIONAL EXPENSES:

1. Obtain a month wise and consultant wise summary in case of monthly retainer ship agreements.

2. Verify if the expenditure for all 12 months has been recorded correctly. For non-recurring expenses,
3. Select a sample and vouch for the attributes discussed above.
4. The auditor should be cautious while vouching for legal expenses as the same may highlight a pending dispute which is not being discussed/ highlighted to the auditor for his specific consideration in light of SA – 501.

TRAVEL, REPAIR & MAINTENANCE, PRINTING & STATIONERY:

1. The auditor should select a sample and vouch for the various attributes.
2. Wherever possible, the auditor and try and prepare a summary of expenditure on monthly basis and then analytically compare the trends.

RELEVANT QUESTIONS:

<p>1. An entity in addition to undertaking purchases and incurring employee benefit expenses also spends on other expenditure 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 analyze the monthly trends for expenses like rent, power and fuel, an auditor generally prefers to vouch for other expenses to verify some important attributes. Advise stating clearly those attributes and the audit procedures generally required to be undertaken while auditing other expenses</p> <p>A. Refer GENERAL POINTS above</p>	<p>MTP-II- M18(N)</p>
<p>2. "While the auditor may choose to analyse the monthly trends for expenses like rent, power and fuel but for other expenses, an auditor generally prefers to verify other attributes." Mention those attributes</p> <p>A. Refer GENERAL POINTS above</p>	<p>N18 – 5M</p>

PART – B – AUDIT OF BALANCESHEET ITEMS

Q No. 10 Write about of audit of reserves and surplus or Other equity under Ind AS?

A. MEANING OF PROVISIONS:

- 1) Provisions are amounts charged against revenue to provide for:
 - a) Renewal or diminution in the value of assets; or
 - b) A known liability, the amount whereof could only be estimated and cannot be determined with accuracy; or
 - c) a claim which is disputed.
- 2) Provisions are normally charged to the Statement of Profit and Loss before arriving at the amount of profit Reserves are appropriations out of profits.

B. MEANING OF RESERVES:

1. Reserves are 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.
2. There are two types of reserves, broadly:
 - a) **Revenue Reserves:** Represent profits that are available for distribution to shareholders held for the time being or any one or more purpose.

- b) **Capital Reserve:** represents a reserve which does not include any amount regarded as free for distribution through the Statement of Profit and Loss

C. DIFFERENCE BETWEEN RESERVES AND PROVISIONS:

- 1) Provisions are amounts set aside to meet specific/ identified liabilities or diminution in recoverable value of assets. These must be provided for regardless of the fact whether the Company has earned profit or not.
- 2) Reserves on the other hand, represent amounts appropriated out of profits, held for equalising the dividends of the company from one period to another or for financing the expansion of the company or for generally strengthening the company financially. (E.g., Dividend Equalization reserve, Retained Earnings)

D. AUDIT PROCEDURE FOR RESERVES:

1. Tally the opening balance of reserves and surplus to the previous year audited financial statements For addition/ utilization in current year,
2. **Profit and Loss balance:**
 - a. Trace the movement as disclosed in Statement of changes in Equity to Surplus/ Deficit as per Income Statement for the year under audit.
 - b. 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 declaration of dividend.
3. **Share Premium:**
 - a. It needs to be confirmed that 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.
 - b. The withdrawal from securities premium account could be done only for limited purposes verify whether the same has been complied.

RELEVANT QUESTIONS

<p>1. ABC Ltd. has issued shares for cash at a premium of Rs. 450/-, that is, at an amount in excess of nominal value of shares which is Rs. 10/- for cash. Section 52 of the companies Act,2013 provided that the company shall transfer the amount received by it as securities premium account. Advise the means in which the amount in the account be applied.</p> <p>A. Refer point D(3) above</p>	<p>RTP – M18(N)</p>
<p>2. Explain the difference between reserves and provisions.</p> <p>A. Refer point C above</p>	<p>MTP-I - M19(N)</p>

Q No. 11 Write about audit of Borrowings?

- A. **EXISTANCE:** All borrowings on balance sheet date represents valid claims:
- 1) Review board minutes for approval of new lending agreements and make sure that any new loan agreements or bond issuances are authorized.
 - 2) Verify that borrowing limits not exceeded as authorized by the board and within the limits set by Articles of Association and Companies act.
 - 3) Verify the overdrafts and loans with bank confirmation / confirmation from lenders.

- 4) Verify details of leases and hire purchase creditors recorded as per the agreement.
- 5) When debt is closed, ensure that a dis-charge is received on assets securing the debt.
- 6) If auditor become aware of significant transactions that are outside the normal course of business or appear to be unusual, perform the following procedures:
 - a) Gain an understanding of the business rationale for such significant unusual transaction.
 - b) Consider whether the transactions involve previously unidentified related parties.

B. COMPLTENESS: All borrowings have been accounted for in the books of the entity on timely basis:

- 1) Obtain a schedule of borrowing showing beginning and ending balances, additional borrowings and repayments during the year.
- 2) Consider any evidence of additional debt obtained through examination of minutes of the board, significant contracts, confirmations of bank accounts.
- 3) Review debt activity for a few days before and after end of the reporting period to determine if there are unrecorded liabilities at year-end and the transaction is recorded in the correct period.
- 4) For each lender, Send a confirmation request for the amount(s) owed to the lender, and perform the following:
 - a) Mail the Confirmation request to appropriate selected party.
 - b) Send reminders for non-replies.
 - c) Compare replies to requests.
 - d) Reconciliations of exceptions.
 - e) Trace reconciling items to supporting documents.

C. VALUATION: Ensure that the liability is recorded at correct amount:

1. Ensure the loan balance and loan payables are as per loan agreement.
2. Recalculate the interest accrual, and discount or premium on redemption.
3. Check computation of the amortization of premium or discount.
4. For foreign current loans, Verify the closing exchange rate(s) used and test the translation calculations.

RELEVANT QUESTIONS

<p>1. Ongoing through the financial statements of ABC Ltd, its auditors Deepa Raj and Associates observed that company has taken Loans from banks and financial institutions. Further, the audit team discusses the following about Liabilities:</p>	MTP-II – N18(N)
<p>2. “Liabilities are the financial obligations of an enterprise other than owners’ funds. Liabilities include loans/ borrowings, trade payables and other current liabilities, deferred payment credits and provisions.</p> <p>Verification of liabilities is as important as that of assets, for, if any liability is omitted (or understated) or over stated, the Balance Sheet would not show a true and fair view of the state of affairs of the company.”</p> <p>Advise stating clearly the audit procedures generally required to be undertaken for verification of existence of Borrowings.</p>	MTP-I – M19(N)
<p>A. Refer point A above</p>	

Q No. 12 Write about audit of Trade Receivables?
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I. COMPLIANCE PROCEDURE:

The auditor shall ensure the system of trade receivables shall have the following features:

- a) All sales are only to approved customers.
- b) All such sales are recorded.
- c) Once recorded, the debts can only be eliminated by receipt of cash or on the authority of a responsible official.
- d) Debts are collected promptly.
- e) Balances are regularly reviewed and aged, a proper system of follow up exists.
- f) If necessary adequate provision for bad debt exists.
- g) Clear segregation of duties relating to identification of debt, receipt of income, reconciliations and write off of debts.

II. SUBSTANTIVE AUDIT PROCEDURE:A. EXISTANCE:

- 1) Check controls to ensure that invoices cannot be recorded more than once.
- 2) Ask for a period-end accounts receivable aging report and ensure that they were completely recorded in entity's general ledger.
- 3) Ensure that the total of Receivables report Total is matching with total of General ledgers.
- 4) See 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.
- 5) Verify if the Company has obtained confirmations from debtors.
- 6) **Direct confirmation procedures**
 - 1) 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.
 - 2) 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.
 - 3) The auditor employs direct confirmation procedure with the consent of the entity under audit.
 - a) There may be situations where the management of the entity requests the auditor not to seek confirmation from certain trade receivables.
 - b) In such cases, the auditor should check whether there are valid grounds for such a request.
 - 4) The trade receivables may be requested to confirm the balances either
 - a) as at the date of the balance sheet.
 - b) as at any other selected date which is reasonably close to the date of the balance sheet.
 - c) The date should be decided by the auditor in consultation with the Company.
 - 5) The form of requesting confirmation from the trade receivables may be either use
 - a) the 'positive' form of request, wherein the trade receivable is requested to respond whether or not he is in agreement with the balance shown

- b) the 'negative' form of request, wherein the trade receivable is requested to respond only if he disagrees with the balance shown.
- 6) The use of the positive form is preferable when individual account balances are relatively large, or where the internal controls are weak, or where the auditor has reasons to believe that there may be a substantial number of accounts in dispute or inaccuracies or irregularities.
- 7) It may be appropriate to use the positive form for trade receivables with large balances and the negative form for trade receivables with small balances.
- 8) A list of trade receivables selected for confirmation should be given to the entity for preparing request letters for confirmation.
- 9) Where no reply is received, the auditor should perform additional testing regarding the balances. This testing could include:
 - a) Agreeing the balance to cash received;
 - b) Agreeing the detail of the respective balance to the customer's remittance advice;
 - c) Preparing a detailed analysis of the balance, ensuring it consists of identifiable transactions and confirming that these revenue transactions actually occurred;
 - d) Prepare a final summary of the results to draw the final conclusion.

B. COMPLETENESS:

- 1) The auditor needs to satisfy himself of correct and proper cut-offs. Without a correct cut-off, sales could be understated or overstated, hence, the need to perform the following cut off tests:
 - a) For the invoices issued during the last few days closer to the reporting date/ cut-off date and which have been included in the debtors, the goods should have been dispatched and not lying with the Company and included in closing stock;
 - b) All goods dispatched prior to the period year-end have been invoiced and included in debtors;
 - c) No goods dispatched after the year- end have been invoiced and included in debtors for the period under audit
- 2) 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.
- 3) Match invoice dates to the shipment dates for those 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.
- 4) 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 the customers had authorized.
- 5) Study the system of giving discounts and check the following:
 - a) Whether the same is being given as per the Company policy.
 - b) Whether cash discount is given on the basis of date of realization of cheque which is within reasonable time limit.

C. VALUATION:

- 1) Assess the allowance for doubtful accounts. Review the process followed by the Company.
- 2) Obtain the ageing report of accounts receivable and split between:
 - a) Not currently due,
 - b) 30 days old,

- c) 30-60 days old,
 - d) 60- 180 days old,
 - e) 180- 365 days old and
 - f) More than 365 days old
- 3) Obtain the list of debtors under litigation and compare with previous year.
 - 4) Scrutinize the analysis and identify those debts which appear doubtful; Discuss with management their reasons, if any of these debts are not included in the provision for bad debts; Perform further testing where any disputes exist; Reach a final conclusion regarding the adequacy of the bad debts provision.
 - 5) Assess bad debt write-offs. Prepare schedule of movements on 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.
 - 6) Check that write-offs or other reductions in the receivable balances have been approved by an appropriate and authorized member of senior management.

RELEVANT QUESTIONS

<p>1. "Trade receivable are an essential part of any organization's balance sheet. Often referred to as debtors, these are monies which are owed to an organisation by a customer. The most common form of an account receivable is a sale made on credit, via an invoice, to a customer ." It is important to carry out compliance procedures in the sales audit as part of the debtors' audit procedure. Verify to ensure that the system for receivables has the necessary features.</p> <p>A. Refer Point I above</p>	<p>MTP-II – N18(N)</p>
<p>2. "Until the invoice is paid, the invoice amount is recorded on the organization's balance sheet as accounts receivable. If balances are not recoverable, then these amounts will need to be written off as an expense in the income statement/ profit and loss account."</p> <p>It is important to carry out compliance procedures in the sales audit as part of the debtors' audit procedure.</p> <p>Verify to ensure that the system for receivables has the necessary features.</p> <p>A. Refer Point I above</p>	<p>MTP-I – M18(N)</p>

Q No. 13 Write about audit of Cash and Cash Equivalents?

A. AUDIT PROCEDURE:

1. There should be a verification of cash, to the extent possible, as on the date of reporting period.
2. The cash should be checked not only on the 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 client or to his staff (Surprise check).
3. 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.
4. If the auditor is unable to check the cash balance on the Balance Sheet date, he should arrange with his client for all the cash balance to be banked and where this cannot conveniently be done on the evening of the close of the financial year, it should be deposited the following morning.

5. The practice should also be adopted in the case of balance at the factory, depot or branch where cash cannot be checked at the close of the year.
6. In case it is not possible, the auditor should verify the receipts and payments of cash up to the date he counts the cash. This should be done soon after the cash balances have been counted.
7. The Cash Book on the date of verification should be signed by the auditor to indicate the stage at which the cash balance was checked. If any cheques or drafts are included in cash balance, the total thereof should be disclosed.
8. The auditor needs to obtain bank reconciliation statements for all bank accounts maintained by the entity as at the reporting period and additionally needs to understand the client's process and periodicity of making the BRS.
9. Auditor should request the client to provide BRS signed by the accountant and approved by the Finance Head/authorized senior company official so that he is able to assign responsibility in case of any errors. Verification of BRS shall entail the following:
 - a) Tallying the balance as per bank to the bank confirmation/ statement
 - b) 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 statement of subsequent period and should verify if the cheques issued have subsequently been cleared by bank.
 - c) 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.
 - d) 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.

B. DIRECT CONFIRMATION PROCEDURES:

- a) A significant and important audit activity is to contact banks/ financial institutions directly and ask them to confirm the amounts held in various 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.
- b) 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.
- c) 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.
- d) This testing could include Agreeing the balance to bank statement received by the Company or internet/ online login to account in auditor's personal presence

Q No. 14 Write about audit of Inventory?

A. EXISTANCE: To Ensure inventories are existing as at year end.

- 1) Review client's plan for performing inventory count. Plan should also allocate staff responsible for each class of inventory.

- 2) Observe inventory being counted and personally perform test counts to verify counts. Test counts by auditor should include:
 - a) Ensure that the employees are counting as per managements plan.
 - b) Assuring that all items are properly tagged (E.g., Bar codes or QR Codes).
 - c) Staying alert at all times and specifically being cautious about empty boxes, etc. And obsolete items.
 - d) Establishing cut off by documenting last receiving reports and shipping details for the period.
 - e) Ensuring exclusion of third party stock and damaged or obsolete stock.
 - f) Investigating any significant differences between the physical stock take and the stock records.
- 3) Further, the auditor should ask the client personnel to sign all stock count sheets.
- 4) When control risk is high and/or client uses periodic system - inventory count should be undertaken at end of period. If client uses perpetual system with proper and adequate records, inventory may be counted at interim dates.

B. COMPLETENESS:

- 1) Perform analytical procedures like:
 - a. Compute inventory turnover ratio (COGS/ average inventory)
 - b. Compare budgetary expectations vis-à-vis actuals
- 2) Examine non-financial information related to inventory, such as weights and measures.
- 3) Perform purchase and sales cut-off tests.
- 4) Verify the clerical and arithmetical accuracy of inventory listings.
- 5) Reconcile physical inventory amounts with perpetual records.
- 6) Reconcile physical counts with general ledger control totals.

C. RIGHTS AND OBLIGATION:

- 1) Vouch recorded purchases to underlying documentation.
- 2) Evaluate the consigned goods. Examine client correspondence, sales and receivables records, purchase documents.
- 3) Determine existence of collateral agreements.
- 4) Review material purchase commitment agreements.
- 5) Examine invoices for evidence of ownership.
- 6) In respect 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. (External Confirmation).

D. VALUATION:

Raw materials and consumables:

- a) Ascertain what elements of cost are included e.g. carriage in, duties etc.
- b) If standard costs are used then compare with actual costs.
- c) Test check cost prices used with purchase invoices received in the months prior to counting.

- d) 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:

- a) Ascertain how the various stages of production are measured.
- b) Ascertain what elements of cost are included. Ascertain the basis on which overheads are included and compare such basis with the available costing and financial information maintained by the entity.
- c) Ensure that material costs exclude any abnormal wastage factors.

Finished goods and goods for resale:

Enquire into what costs are included and ensure that the overheads included have been determined based on normal costs.

- a) Ensure that inventories are valued at net realizable value if they are likely to fetch a value lower than their cost.
- b) 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- 385 days old and more than 365 days old
- c) Examine vendor price lists to determine if recorded costs less than current prices.
- d) Calculate inventory turnover ratio. Obsolete inventory may be revealed if ratio is significantly lower.
- e) In manufacturing entities, test overhead allocation rates and ensure that only direct labor, direct material and overhead have been included.

Q No. 15 Write about audit of Fixed Assets?

A. EXISTANCE: To Establish the existence of Fixed assets at year end.

Review client's plan for performing physical verification of PPE and its periodicity. Ensure it is appropriately supervised.

1. Obtain PPE physical verification report backed by the working sheets from the client and perform the following procedures:
 - a. Assess if all items of PPE are properly tagged and carry identification marks/ numbers.
 - b. Reconciliation of items of PPE as physically verified with the fixed asset register maintained by the entity as at the date.
 - c. Specifically verify if the PPE additions up to the date of physical verification have been updated in the fixed asset register.
 - d. Verify the discrepancies noted, based on physical verification undertaken and how such discrepancies have been dealt books of accounts.

Example: Any identified shortages/ assets not in working condition and/ or active use should be accounted for as deletions in the books of accounts. Post approvals by the entity's management and depreciation charge should have ceased to be charged beyond the date of deletion.

B. COMPLETENESS: Additions to PPE during the period under audit have been properly recorded in the financial statements.

1. Verify the movement in the PPE schedule (asset class wise like building, P&M etc.) compiled by the management i.e. Opening + Additions - Deletions= Closing.

2. Check the arithmetical accuracy of the movement in PPE schedule, tally the opening balances to the previous year audited financial statements.
3. Ensure that the assets belongs to third parties are not included in FAR and a separate record is maintained for that.
4. For additions during the period under audit, obtain a list of all additions from the management.
5. For all material additions, verify if such expenditure is to be treated as capital expenditure or revenue expenditure.
6. Verify the installation certificate or report to establish the date of addition, for all additions to PPE during the period under audit.
7. Verify if the PPE additions have been approved by appropriate entity's personnel.
8. Verify if proper internal controls like inviting competitive quotations/ tenders etc. were followed prior to finalizing the vendor for procuring item of PPE.
9. In relation to deletions to PPE:
 - a) understand from the management the reason and rationale for deletion and the manner of disposal.
 - b) Obtain the management approval and discard note authoring discard of the asset from its active use.
 - c) Verify the Internal controls for sale of discarded PPE. (E.g., Tenders)
 - d) Verify that the management has accurately recorded the deletion of PPE.

C. RIGHTS AND OBLIGATIONS:

1. The auditor shall verify that all PPE purchase invoices are in the name of the entity that entitles legal title of ownership to the respective entity.
2. For all additions to land, building in particular, the auditor should obtain copies of conveyance deed/ sale deed to establish whether the entity name is mentioned therein.
3. The auditor should insist and verify the original title deeds for all immoveable properties held.
4. 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.
5. In addition, the auditor should also verify the register of charges, available with the entity to assess the PPE that has been given as security to any third parties.

D. VALUATION: Ensure that PPE has been valued properly and as per GAAP.

1. The auditor should verify that the entity has charged depreciation on all items of PPE.
2. Verify that the depreciation method used is selected by considering consumption pattern.
3. A variety of depreciation methods can be used to allocate the depreciable amount of an asset on a systematic basis over its useful life. These methods:
 - a) Straight-line depreciation results in a constant charge over the useful life if the asset's residual value does not change.
 - b) The diminishing balance method results in a decreasing charge over the useful life.
 - c) The units of production method results in a charge based on the expected use or output.

4. The entity select such method that most closely reflects the expected pattern of consumption of the future economic benefits embodied in the asset.
5. Ensure that method should have been applied consistently from period to period unless there is a change in the expected pattern of consumption of those future economic benefits.
6. The auditor should also verify if the management has undertaken an impairment assessment to determine whether an item of property, plant and equipment is impaired and such impairment shall be appropriately recorded.

Q No. 16 Write the audit procedures to be performed as an auditor for completeness (assertion) of intangible assets.

A. EXISTANCE:

1. 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.

Example- For verifying the existence of 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.

2. 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 to be charged beyond the date of deletion.

B. COMPLETENESS:

- 1) Verify the movement in the Intangible assets schedule (asset class wise like software, designs/ drawings, goodwill etc.) compiled by the management i.e. Opening + Additions - Deletions= Closing and tally the closing balance to the entity's books of account.
- 2) Check the arithmetical accuracy of the movement in intangible asset schedule, tally the opening balances to the previous year audited financial statements.
- 3) For all material additions, verify if such expenditure meets the criterion for recognition of an intangible asset.
- 4) Verify the certificate or report to establish the date of use of the intangible for all additions to intangible assets during the period under audit.
- 5) Verify if the additions have been approved by appropriate entity's personnel.
- 6) In relation to deletions to intangible assets:
 - a) Understand from the management the reason and rationale for deletion and the manner of disposal.
 - b) Obtain the management approval and discard note authoring discard of the asset from its active use.
 - c) Verify that the management has accurately recorded the deletion of intangible asset and the resultant gain/ loss on discard in the entity's books of account.

C. SELF STUDY:

- 7) Intangible asset shall be recognised if, and only if:
 - a) The said asset is identifiable;

- b) The entity controls the asset i.e. The entity has the power to obtain the future economic benefits flowing from the underlying resource.
 - c) It is probable that future economic benefits associated with the asset will flow to the entity;
 - d) The cost of the item can be measured reliably.
- 8) To assess whether an internally generated intangible asset meets the criteria for recognition, an entity classifies the generation of the asset into:
- a) a research phase; and
 - b) a development phase

9) Research phase:

No intangible asset arising from research (or from the research phase of an internal project) shall be recognised. Expenditure on research (or on the research phase of an internal project) shall be recognised as an expense when it is incurred since in the research phase of an internal project, an entity cannot demonstrate that an intangible asset exists that will generate probable future economic benefits.

Examples of research activities are:

- i) Activities aimed at obtaining new knowledge;
- ii) The search for, evaluation and final selection of, applications of research findings or other knowledge;
- iii) The search for alternatives for materials, devices, products, processes, systems or services; and
- iv) The formulation, design, evaluation and final selection of possible alternatives for new or improved materials, devices, products, processes, systems or services.

10) Development phase:

An intangible asset arising from development or from the development phase of an internal project) shall be recognized if, and only if, an entity can demonstrate all of the following:

- a) The technical feasibility of completing the intangible asset so that it will be available for use or sale;
 - b) Its intention to complete the intangible asset and use or sell it;
 - c) Its ability to use or sell the intangible asset;
 - d) How the intangible asset will generate probable future economic benefits.
 - e) The availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset;
 - f) Its ability to measure reliably the expenditure attributable to the intangible asset during its development.
- 11) The cost of an internally generated intangible asset comprises all directly attributable costs necessary to create, produce, and prepare the asset to be capable of Operating.

Examples of directly attributable costs are:

- i) Costs of materials and services used or consumed in generating the intangible asset;
- ii) Costs of employee benefits arising from the generation of the intangible asset;
- iii) Fees to register a legal right; and
- iv) Amortization of patents and licenses that are used to generate the intangible asset.

D. **VALUATION:** Ensure that the Intangibles have been properly valued as per GAAP.

1. The value of intangible assets may diminish due to of time, use and/ or obsolescence.
2. The auditor should:
 - a) Verify that the entity has charged amortization on all intangible assets;
 - b) 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.
 - c) The auditor should also verify if the management has undertaken an impairment assessment to determine whether an intangible asset is impaired.

Q No. 17 Write about audit of Loans and Advances?

A. **EXISTANCE AND COMPLETENESS:**

1. For establishing existence of loans and advances, direct confirmation procedures are to be used.
2. Obtain a list of all advances and other current assets and compare them with balances in the ledger.
3. Inspect loan agreements and acknowledgements of parties in respect of outstanding loans.
4. In addition, the auditor should confirm that the loans advanced were within the competence of persons who had advanced the same.
5. Inspect the minutes of meeting of board of directors to confirm if all material loans and advances were approved by the board of directors.
6. Verify that the loan has been acknowledged by the party and inspect if any security has been deposited against due repayment of the loan.
7. Ascertain if loans are being recovered regularly as per agreed installments.
8. In relation to balances with statutory authorities, verify the balances with external confirmation.
9. Further, the auditor should obtain copies of statutory returns filed with the authorities like GST returns etc. and verify whether the amount recorded as per books of account tallies with the claim made with the authorities.

B. **VALUATION: (Self Study)**

1. 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.
2. 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.
3. Obtain the list of loans and advances under litigation and compare with previous year.
4. Identify those loans and advances that appear doubtful;
5. Ensure the adequacy of the bad and doubtful loans/ advances provision.
6. Check that write-offs or other reductions in the recoverable balances have been approved by an appropriate and authorised member of management.
7. Check that the restatement of foreign currency loans and advances/ other current assets has been done properly.

Q No. 18 Write about audit of Contingencies and Provisions?

1. Obtain a list of all provisions and compare them with balances in the ledger.
2. Inspect the underlying arrangements like appointment agreement with employees to understand the entity's commitment towards defined benefits, agreement with customers to assess warranty commitments, any legal and other claims on the entity i.e. litigations.
3. Obtain the underlying working and the basis for each of the provisions made, from the management and verify whether the same is complete and accurate.
4. Where ever required the auditor may take the help of management expert or auditors expert depending on circumstances.
5. Generally we may take assistance of actuary for determining retirement benefits. Assistance of Legal experts, Lawyers, in respect of determining outcome of pending litigation.
6. 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:
 - a) Evaluate the competence, capabilities and objectivity of that expert:
 - b) Whether the expert is employed by the entity or is engaged by it
 - c) The extent to which management can exercise influence or control over the expert
 - d) Auditor's previous experience of the work of the expert
 - e) Knowledge of the expert's qualification, membership of a professional body or industry association
 - f) Obtain an understanding of the work of that expert.

PRACTICAL QUESTIONS FOR SELF STUDY**Q No. 19 Write about audit of Sales returns?**

- 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.
- See that price of such goods is unloaded from the sales account and the trade receivable's record. Refer to 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.
- Ensure that the goods in respect of which the period of approval has expired at the close of the year either have been received back subsequently or customers' accounts have been debited.

Confirm that the inventory of goods sent out on approval, the period of approval in respect of which had not expired till the close of the year lying with the party, has been included in the closing inventory.

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Q No. 20 Write about audit of Trade Payables and other current liabilities? (SIMILAR ANSWER TO AUDIT OF TRADE RECEIVABLES)

A. EXISTANCE:

1. Check whether there are controls in place to ensure that the same purchase/ expense invoice cannot be recorded more than once and payable balances are automatically recorded in the general ledger at the time of recording of expense.
2. To ensure that trade payable ledger reconciles to general ledger, ask for a period-end accounts payable aging report and trace the grand total to the amount in the accounts payable account in the general ledger.
3. Calculate the accounts payable report total. Add up the expense/ liability items on the accounts payable aging report to verify that the total traced to the general ledger is correct.
4. Investigate reconciling items. If there are journal entries in the accounts payable account in the general ledger, review the justification for larger amounts. This implies that these journal entries should be fully documented.

B. DIRECT CONFIRMATION PROCEDURES:

1. An important audit activity is to contact vendors directly 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.
2. 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.
3. 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.
4. The date should be decided by the auditor in consultation with the Company.
5. The form of requesting confirmation from the trade creditor may be either
 - a) the 'positive' form of request, where the trade creditor is requested to respond whether or not he is in agreement with the balance shown, or
 - b) the 'negative' form of request wherein the trade creditor is requested to respond only if he disagrees with the balance shown.
6. The use of the positive form is preferable when individual account balances are relatively large, or where the internal controls are weak, or where the auditor has reasons to believe that there may be a substantial number of accounts in dispute or inaccuracies or irregularities.
7. The negative form is useful when internal controls are considered to be effective, or when a large number of small balances are involved, or when the auditor has no reason to believe that the trade creditors are unlikely to respond.

8. If the negative rather than the positive form of confirmation is used, the number of requests sent and the extent of the other auditing procedures to be performed should normally be greater so as to enable the auditor to obtain the same degree of assurance with respect to the trade payable balances. In many situations, it may be appropriate to use the positive form for trade creditors with large balances and the negative form for trade creditors with small balances.
9. The method of selection of the trade creditors to be circularized should not be revealed to the Company until the trial balance of the trade payables' ledger is handed over to the auditor. 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 and auditor should insert an identification mark, example- a team member inserting his initials in the letter (without informing the Company) to enable the auditor to continue to maintain unpredictability in audit and to avoid any wrong doing from management side. The auditor should maintain strict control to ensure the correctness and proper dispatch of request letter.
10. 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.
11. 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.
12. Where no reply is received, the auditor should perform additional testing regarding the balances. This testing could include:
 - a) Agreeing the balance to subsequent cash paid;
 - b) Agreeing the detail of the respective balance to the underlying vendor invoices;
 - c) Preparing a detailed analysis of the balance, ensuring it consists of identifiable transactions and confirming that these purchases/ expense transactions actually occurred;
 - d) Prepare a final summary of the results of the circularization and draw the final conclusion.
 - e) Related party payables. 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.
 - f) Trend analysis. 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 and document the same in audit work papers.

C. COMPLETENESS:

1. The auditor needs to satisfy himself of correct and proper cut-off s. Without a correct cut-off , purchases and expenses could be understated or overstated, hence, the need to perform the following cut off tests:
2. For the invoices received/ recorded during the last few days closer to the reporting date/ cutoff 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 favor of the entity;
3. All good received prior to the period/ year end should have been booked in the form of purchases and included in trade creditors;

4. No goods received/ risk and rewards of ownership in goods transferred in favour of the entity after the year- end should have been recorded as purchases and included in trade creditors for the period under audit.
5. Test purchase/ expense vouchers listed in account payable report. Select few purchase/ expense vouchers from the accounts payable ageing report and compare them to supporting documentation to see if the purchases were recorded with the correct amounts and correct vendors and on the correct dates.
6. Match purchase/ expense vouchers to gate entry (inward) register/ log. Match purchase invoice dates to the gate entry (inward) dates for those items in the log, to see if 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.
7. Search for unrecorded liability- 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.
8. 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.
9. 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.
10. As part of subsequent events review procedures, verify if advances have been adjusted subsequently post sale of goods/ rendering of services.
11. In relation to statutory dues liability like Tax withholding (TDS) payable, excise duty payable, VAT payable, service tax payable, luxury tax payable, professional tax payable, PF and ESI dues payable etc., prepare a reasonability with respect to sales/ purchases/ employee benefit expenses.

VALUATION:

1. Assess old outstanding liability balances- 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.
2. 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.
3. 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 the financial controller or finance director.
4. Check that the restatement of foreign currency trade payables has been done properly.
5. Understand management's process to identify the principal amount and the interest due thereon remaining unpaid to any Micro, Small and Medium
6. Enterprises supplier at the end of accounting year.
7. Test check the management process to assess if the auditor could rely on the management process.

RELEVANT QUESTIONS

<p>1. Verification of liabilities is as important as that of assets, considering if any liability is omitted (or understated) or overstated, the Balance Sheet would not show a true and fair view of the state of affairs of the entity. Explain stating also criteria for a liability to be classified as current liability</p> <p>A. Refer VALUATION point above</p>	<p>MTP-II- M19(N)</p>
<p>2. Liabilities 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 Balance Sheet would not show a true and fair view of the state of affairs of the entity.</p> <p>Advise stating clearly the audit procedure to establish the existence of trade payables and other current liabilities as at the period-end.</p> <p>A. Refer Point A above</p>	<p>MTP-I- N18(N)</p>

Q No. 21 Expenses which are of essentially revenue in nature, if incurred for creating an asset or adding to its value for higher productivity are regarded as expenses of a capital nature. Explain such expenses.

- 1) **Material and wages-** capital expenditure when expended on the construction of a building or erection of machinery
- 2) **Legal expenses-** capital expenditure when incurred in connection with the purchase of land or building.
- 3) **Freight-** capital expenditure when incurred in respect of purchase of plant and machinery
- 4) **Repair-** Major repairs of a fixed asset that increases its productivity
- 5) **Wages-** Wages paid on installation costs incurred in Plant & machinery
- 6) **Interest-** Interest incurred during the eligible period as defined under Ind AS 23 i.e. during the period of construction of the asset.

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The End