CHAPTER 9

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 captions.
- The specific procedures for auditing common balance sheet and Income statement captions.
- The presentation and disclosure in financial statements comprising balance sheet, income statement, Statement of Comprehensive Income and Statement of Changes in Equity

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 or financial reporting standards (Ind 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 the completeness, existence/ occurrence, valuation/ measurement, rights and obligations and presentation and disclosure of assets, liabilities, equity, income, expenses and disclosures in accordance with the applicable financial reporting standards/ 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 and further, transactions have been recognized in the correct accounting periods.	Employee benefit expense in respect of all personnel has been fully accounted for and such cost recognized during the period relates to the current accounting period. Any accrued and prepaid expenses have also been accounted for correctly in the financial statements.

Measurement	Transactions have been recorded accurately at their appropriate amounts and further, transactions have been classified and presented fairly in the financial statements.	Employee benefit cost has been measured/ calculated accurately and has been fairly allocated between: — Operating expenses incurred in production activities; — General and administrative expenses; and — Cost of personnel relating to any self-constructed assets other than inventory. Any adjustments such as tax deduction at source have been correctly reconciled and accounted for.

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 audit entity and that should have been recorded, has been recognized in the financial statements. Any inventory held by a third party on behalf of the audit entity has been included as part of the inventory balance.

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 Ind 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 has been excluded from the cost of inventory. An acceptable valuation basis (eg. FIFO, Weighted average etc.) has been used to value inventory cost as at the period-end
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.	Audit entity owns or controls the inventory recorded in the financial statements. Any inventory held by the audit entity on behalf of another entity has not been recognized as part of inventory of the audit entity.

3. PRESENTATION AND DISCLOSURE

Assertions	Explanation	Examples: Related party disclosures
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	Transactions with related parties disclosed in the notes of financial statements have occurred during the period and relate to the audit entity. The closing balance of such related parties does exist as at the period- end.
Completeness	All transactions, balances, events and other matters that should have been disclosed have been disclosed in the financial statements.	All related parties, related party transactions and balances that should have been disclosed have been disclosed in the notes forming part of financial statements.

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.	Related party transactions, balances and events related thereto have been disclosed accurately at their appropriate valuation. The nature of related party transactions, balances and events has been clearly disclosed in the notes of financial statements to enable users of financial statements assess and determine the financial statement captions affected by the related party transactions and balances and can easily ascertain their financial effect.

Following section defines the various procedures an auditor should design to perform around various common balance sheet captions:

4. BALANCE SHEET CAPTIONS

4.1 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 also 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:

Assertions	Explanation	Audit procedures
Existence	To establish the existence of share capital as at the period-end	**As per section 2(8) of the Companies Act, 2013. "Authorised capital" or "Nominal capital"** means such capital as is authorised by the memorandum of a company to be the maximum amount of share capital of the company. Thus, it is the sum stated in the memorandum as the capital of the company with which it is to be registered being the maximum amount which it is authorised to raise by issuing shares, and upon which it pays the stamp duty. It is usually fixed at the amount, which, it is estimated, the company will need, including the working capital and reserve capital, if any.
Completeness	Equity balances that were supposed to be recorded have been recognized in the financial statements.	**As per Section 2(50) of the Companies Act, 2013, "issued capital"** means that part of authorised capital which is offered by the company for subscription and includes the shares allotted for consideration other than cash.
Valuation	Equity balances have been valued appropriately.	**Audit procedures** ● 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

Assertions	Explanation	Audit procedures
		● In case there is any change, obtain the certified copies of relevant resolutions passed at the meetings of board of directors, shareholders authorising the increase/ decrease in authorised and 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 alongwith the issue price. ● Verify whether the paid up capital as at the period- end is within the limits of authorised capital ● In case there was increase in authorised share capital, verify whether the Company has accurately calculated the fee and stamp duty payable to MCA and obtain a copy of the receipt in support of the payment made **Shares Issued at Premium:** 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 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. As per the section, where a company issues shares at a premium, whether for cash or otherwise, a sum equal to the aggregate amount of the premium received on those shares shall be transferred to a "securities premium account" and 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.

Assertions	Explanation	Audit procedures
		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 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.

Assertions	Explanation	Audit procedures
		The auditor needs to 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" 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. 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: (a) the issue is authorised 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.

Assertions	Explanation	Audit procedures
		The rights, limitations, restrictions and provisions as are for the time being 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 shareholder held to pass the special resolution was properly convened and that the proposal was circularised in advance among all the shareholders; (ii) Verify that the Articles of Association authorises reduction of capital; (iii) Examine the order of the Tribunal confirming the reduction and verify that a copy of the order and the minutes have been registered and filed with the Registrar of Companies; (iv) Inspect the Registrar's Certificate as regards to reduction of capital; (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; (vi) Confirm whether the revaluation of assets has been properly disclosed in the Balance Sheet;

Assertions	Explanation	Audit procedures
		(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 have been altered or new certificates have been issued in lieu of the old, and the old ones have been cancelled; (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. (ix) Verify that the Memorandum of Association of the company has been suitably amended.
Presentation and Disclosure	Required disclosures for equity have been appropriately made	• Ensure whether the following disclosure requirements of Ind AS compliant Schedule III to Companies Act, 2013 have been complied with: **Issued and subscribed share capital** (Number of shares and value) • Balance at the beginning of the reporting period • Changes in equity share capital during the year • Balance at the end of the reporting period **For each class of capital** • Rights attached • Preferences • Restrictions, including o Restrictions on the distribution of dividends o Restrictions on the repayment of capital **Shares held in Company by the following entities:** • Holding company • Ultimate holding company • Subsidiaries of the holding company • Associates of the holding company

Assertions	Explanation	Audit procedures
		• Subsidiaries of the ultimate holding company • Associates of the ultimate holding company **Shares held in the company held by each shareholder holding more than 5% shares specifying the number of shares held** **Aggregate number and class of shares for:** • 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 Above disclosure should have been made for a period of five years immediately preceding the balance sheet date

4.2 Reserve and Surplus (Other Equity under Ind AS)

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.

On the contrary, provisions are amounts charged against revenue to provide for:

(i) Renewal or diminution in the value of assets; or

(ii) a known liability, the amount whereof could only be estimated and cannot be determined with accuracy; or

(iii) a claim which is disputed.

Amounts contributed or transferred from profits to make good the diminution in value of assets due to the fact that some of them have been lost or destroyed as a result of some natural calamity or debts have proved to be irrecoverable are also described as provisions. Provisions are normally charged to the Statement of Profit and Loss before arriving at the amount of profit. Reserves are appropriations out of profits.

Difference between Reserves and Provisions

The difference between the two is that 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.

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.

If we examine the Balance Sheet of a company, at a given time, and deduct the total liabilities to outside trade payables from the value of assets shown therein, the difference between the two figures will represent the net worth of the company based on the book values of assets as on that date. The same shall include the capital contributed by the shareholders as well as total undistributed profit held either to the credit of the Statement of Profit and Loss or to reserves; the reserves again will be segregated as revenue or capital reserves.

Revenue reserves represent profits that are available for distribution to shareholders held for the time being or any one or more purpose.

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, on the other hand represents a reserve which does not include any amount regarded as free for distribution through the Statement of Profit and Loss

Example

Share 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 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.

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

Assertions	Explanation	Audit procedures
Existence Completeness Valuation	To establish the existence of reserves and surplus as at the period- end Reserves and Surplus balances that were supposed to be recorded have been recognized in the financial statements. Reserves and Surplus balances have been valued appropriately.	**Audit procedures** Tally the opening balance of reserves and surplus to the previous year audited financial statements. For addition/ utilisation in current year, in case of: **Profit and Loss balance-** trace the movement as disclosed in Statement of changes in Equity to Surplus/ Deficit as per Income Statement 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 declaration of dividend. Students should note that as per Ind AS 10 and 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. Share Premium- 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. As already discussed under the caption- share capital", the withdrawal from securities premium account could be done only for limited purposes like issue of fully paid bonus shares, writing off preliminary expenses/ expenses, commission on issue of shares or debentures of the company; adjustment of premium payable on redemption of redeemable preference shares/ debentures, purchase of own shares or other securities under section 68. **Other Equity-** understand the underlying reason for the transaction, example the same could be on account of equity debt portion split of a compound financial instrument.

Assertions	Explanation	Audit procedures
Presentation and Disclosure	Required disclosures for reserves and surplus have been appropriately made	Ensure whether the following disclosure requirements of Ind AS compliant Schedule III to Companies Act, 2013 have been complied with: Has the company sub-classified other equity into the following: • Share application money pending allotment • Equity component of compound financial instruments • Capital reserve • Securities premium reserve • Other reserves (Specify nature) • Retained earnings • Debt instruments through other comprehensive income • Equity instruments through other comprehensive income • Effective portion of cash flow hedges • Revaluation surplus • Exchange difference of translation of financial statements of foreign operation • Other items of other comprehensive income (specify nature) • Money received against share warrants For each component of other equity, whether the company has disclosed the following (to the extent applicable): (i) Balance at the beginning of the reporting period (ii) Changes in accounting policy or prior period error (iii) Restated balance at the beginning of the reporting period (iv) Total Comprehensive Income for the year (v) Dividends (vi) Transfer to retained earnings (vii) Any other change (to be specified) (viii) Balance at the end of reporting period

4.3 Borrowings

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.

Verification of liabilities is as important as that of assets, for, 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 company.

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

Assertions	Explanation	Audit procedures
Existence	All borrowings on the balance sheet represent valid claims by banks or other third parties.	• Review board minutes for approval of new lending agreements. During review, make sure that any new loan agreements or bond issuances are authorized. Ensure that significant debt commitments should be approved by the board of directors. • Agree details of loans recorded (interest rate, nature and repayment terms) to the loan agreement. Verify that borrowing limits imposed by agreements are not exceeded. • Agree overdrafts and loans recorded to bank confirmation / confirmation to lenders. • Agree details of leases and hire purchase creditors recorded to underlying agreement. • 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. • If we become aware of significant transactions that are outside the normal course of business or that otherwise appear to be unusual given our understanding of the entity and its environment, perform the following procedures:

Assertions	Explanation	Audit procedures
		(a) Gain an understanding of the business rationale for such significant unusual transaction. (b) Consider whether the transactions involve previously unidentified related parties or parties that do not have the substance or the financial strength to support the transaction without assistance from the entity we are auditing.
Completeness	That all borrowings have been accounted for in the books of the company on a timely basis.	• Obtain a schedule of short term and long term borrowing (including debt outstanding at the end of the prior year, as well as any new debt or renewal of debt) showing beginning and ending balances and borrowings and repayments during the year, and perform the following: (a) Consider any evidence of additional debt obtained through examination of minutes of the board, significant contracts, confirmations of bank accounts, support for subsequent cash disbursements (when testing payables), and other documents. (b) Test the summarization and trace the ending balances to the general ledger. • 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. **Direct confirmation procedures** • For each lender (or, in some circumstances, selected lenders) with which the client had debt outstanding at the prior year end or during the current year, prepare, or have the client prepare, a confirmation request for the amount(s) owed to the lender, and perform the following: (a) Ascertain that the confirmation asks for all information likely to be relevant to our tests of debt and related interest balances (e.g., applicable interest rates, due dates, the date to which interest has been paid, collateral and security interests).

Assertions	Explanation	Audit procedures
		(b) Mail the requests under our control to a person within the lending institution who would be expected to be knowledgeable about the client's obligations, including any contingent liabilities, guarantees, letters of credit, security agreements, or similar matters with which the lender may be involved. (c) Send reminders for non-replies. (d) Compare replies to requests. Prepare, or have the client prepare, reconciliations of exceptions. Trace reconciling items to supporting documents.
Valuation	That liability is recorded at the correct amount.	• 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. • Recalculate the interest accrual, and discount or premium on redemption. • Check computation of the amortization of premium or discount. • For foreign current loans, agree the closing exchange rate(s) used and test the translation calculations.
Presentation and Disclosure	That borrowings have been presented, classified and disclosed in the financial statements in accordance with the requirements of applicable financial reporting framework i.e. Companies Act, 2013 and applicable Indian GAAP	• Determine that the following items, if any, are properly recorded, classified, and/or disclosed, as appropriate: (a) Debt owed to related parties. (b) Debt callable by the creditor (e.g., due to loan covenant violations). (c) Short-term obligations expected to be refinanced. (d) Discounts or premiums and related amortization. (e) Unconditional purchase obligations. • Read the provisions in loan and debt agreements and perform the following: (a) Test that the client is in compliance with loan covenants and other significant provisions of the agreements.

Assertions	Explanation	Audit procedures
		(b) If there are any provisions with which the client is not in compliance, determine whether the debt should be classified as current. If enforcement of the provisions has been waived by the lender, obtain confirmation of the waiver from the lender. • Examine the due dates on loans for proper classification between long-term and current. Analyse relevant details of interest rates, amounts due (e.g. between current and non-current payables), dates and terms of redemption or conversion to ensure completeness and accuracy. • 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. • Review debt for related parties' transactions or borrowings from major shareholders. • 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.

Assertions	Explanation	Audit procedures
		• 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. Future, instalments under hire purchase agreements for the purchase of assets may be shown as secured loans. • Verify whether liabilities to bank towards bills discounted, bills negotiated, cheques discounted, etc. are correctly reflected and disclosed in the accounts. • 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, on the borrowings of the company. Also, check compliance of section 185 and 186 of Companies Act, 2013. • Examine the purpose for which the amount is borrowed and the amount is not used against the interest of the company. • Check compliance of Section 2(22)(e) of Income Tax Act,1961 and ensure that payment by way of advance or loan to a shareholder holding not less than 10% of voting power or any concern in which such shareholder is a member or a partner and in which he has substantial interest, shall be treated as dividend. • 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.

Assertions	Explanation	Audit procedures
		Ensure whether the following disclosures as required under Ind AS compliant Schedule III to Companies Act, 2013 are made regarding each amount disclosed under the heading 'long term borrowings' have been complied with: • 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). For a default in repayment of borrowing and/ or interest on the balance sheet date, following disclosures should have been made separately for each case: • Period of default. • Amount of default.

4.4 Trade Receivables

Trade receivable are an essential part of any organisation'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. 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, then these amounts will need to be written off as an expense in the income statement/ profit and loss account.

It is important to carry out compliance procedures in the sales audit as part of the debtors' audit procedure. In summary, check to ensure that the system for receivables has the following features:

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

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

Assertions	Explanation	Audit procedures
Existence	To establish the existence of trade receivables as at the period- end	• 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. • To ensure that trace receivables ledger reconciles to general ledger. Ask for a period-end accounts receivable aging report and trace the grand total to the amount in the accounts receivable account in the general ledger. • Calculate the receivable report total. Add up the invoices on the accounts receivable aging report to verify that the total traced to the general ledger is correct.

Assertions	Explanation	Audit procedures
		• Investigate reconciling items. If there are journal entries in the accounts receivable account in the general ledger, review the justification for larger amounts. This implies that these journal entries should be fully documented. • 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, verify if the Company has obtained confirmations from debtors. **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 trade receivables may be either (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, or (b) the 'negative' form of request wherein the trade receivable is requested to respond only if he disagrees with the balance shown. The use of the positive form is preferable.

Assertions	Explanation	Audit procedures
		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. 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 receivables are unlikely to respond. 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 receivable balances. In many situations, 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. • 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 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 despatch 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 receivables 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. • 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

<table>
<tr><th>Assertions</th><th>Explanation</th><th>Audit procedures</th></tr>
<tr><td></td><td></td><td>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 receivables taken as a whole.
• Where no reply is received, the auditor should perform additional testing regarding the balances. This testing could include:
— Agreeing the balance to cash received;
— Agreeing the detail of the respective balance to the customer's remittance advice;
— Preparing a detailed analysis of the balance, ensuring it consists of identifiable transactions and confirming that these revenue transactions actually occurred;
— Prepare a final summary of the results of the circularization and draw the final conclusion
• Related party receivables. If there are any related party receivables, 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.
• Check that receivables for other than sales or services are not included in the list.
• Trend analysis. Review a trend line of sales and accounts receivable, or a comparison of the two over time, to see if there are any unusual trends. Another possible comparison is of receivables to current assets. 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.</td></tr>
<tr><td>Completeness</td><td>Trade receivable balances that were supposed to be recorded have been recognized in the financial statements.</td><td>• 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:
— For the invoices issued during the last few days (say 5 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;
— All good dispatched prior to the period/ year-end have been invoiced and included in debtors;</td></tr>
</table>

Assertions	Explanation	Audit procedures
		— No goods dispatched after the year- end have been invoiced and included in debtors for the period under audit • 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 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. • 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. • Review receiving log. 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 • Study the system of giving discounts and check the following: (a) Whether the same is being given as per the Company policy/ general industry trends; (b) Whether cash discount is given on the basis of date of realization of cheque or on the basis of date of receipt of cheque. If the same is on the basis of date of receipt of cheques, verify that the cheque has been realized within a reasonable time. • Review credit memos. Review a selection of the credit memos issued during the audit period to see if they were properly authorized, whether they were issued in the correct period, and whether the circumstances of their issuance indicate other problems. Also, review credit memos issued after the period being audited, to see if they relate to transactions from within the audit period. Where any deduction has been made against a bill, check the reason and correspondence for the same.

Assertions	Explanation	Audit procedures
Valuation	Trade receivable balances have been valued appropriately.	• 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 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.  • 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. • 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. • Check that write-offs or other reductions in the receivable balances have been approved by an appropriate and authorised member of senior management, for example the financial controller or finance director.

Assertions	Explanation	Audit procedures
Presentation and Disclosure	Required disclosures for trade receivables have been appropriately made	• Check that the restatement of foreign currency trade receivables has been done properly. • Companies must prepare and present their financial statements according to a financial reporting framework. Auditors, therefore, determine that the accounting policies and procedures related to accounts receivables are appropriate and are applied consistently according to GAAP. They also validate that the Company presents and discloses its accounts receivable balances in the balance sheet and its accompanying notes properly. • Verify that the split between more than 6 months and less than 6 months has been done from the due date instead of sales invoice date. • Check classification of amount due is properly disclosed as: — Secured, considered good — Unsecured, considered good — Doubtful • Verify that proper disclosure of amounts due from the following parties has been made: — By directors — By other officers of the company — By any of them either severally — By jointly with any other person — By firms — By private companies respectively in which any director is a partner or director or member. • Note down the transactions with parties under section 189 of Companies Act, 2013 and ensure that the same is reported properly in CARO.

4.5 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:

Assertions	Explanation	Audit procedures
Existence	To establish the existence of cash and cash equivalent balances as at the period- end.	• Special care is necessary in regard to verification of cash balances for 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 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. 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 othe₹ 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.
Completeness	Cash and cash equivalent balances that were supposed to be recorded have been recorded in the financial statements.	

Assertions	Explanation	Audit procedures
		• If the auditor is unable to check the cash balance on the date of the Balance Sheet, 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. 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. In case this 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. The Cash Book of the day on which the balance is verified 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. • 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 have them initialled by a responsible official and debited to Appropriate Accounts. • The auditor should also perform a cash sensitivity analysis by compiling a summary of total cash receipts and payments each month and analyse the trends to see if there have been variations in any specific month and request explanations from the management. • 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 The

Assertions	Explanation	Audit procedures
		auditor should request the client to provide BRS signed by the accountant and approved by the Finance Head/ authorised senior company official so that he is able to assign responsibility in case of any errors. • Verification of BRS shall entail the following: — Tallying the balance as per books to the Company's books of account and trial balance — Tallying the balance as per bank 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 statement of subsequent period and should verify if the cheques issued have subsequently been cleared by bank. For all cases where cheques have become stale i.e. 3 months or more has lapsed since the issue date, the same should not appear in the BRS and should have instead been clubbed under 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 explanations from the management and in case such explanations are found to be unsatisfactory, the auditor should verify of the revenue recognition related to such parties was in order and as per the Company's normal revenue recognition accounting policy.

Assertions	Explanation	Audit procedures
		— 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 insist the management to record adjustments for the same in its books of account or else, the auditor should qualify his opinion with respect to cash and cash equivalents **Direct confirmation procedures** • 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 were no reply is received, the auditor should perform additional testing regarding the balances. 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; — Prepare a final summary of the results of the circularization and draw the final conclusion

Assertions	Explanation	Audit procedures
Valuation	Cash and cash equivalent balances have been valued appropriately.	In addition to the procedures performed above, the auditor should ensure that all bank account holding foreign currency have been restated at the closing exchange rates.
Presentation and Disclosure	Required disclosures for cash and cash equivalents have been appropriately made	Ensure whether the following disclosures as required under Ind AS compliant Schedule III to Companies Act, 2013 have been made: Cash and cash equivalents (i) Cash and cash equivalents shall be classified as: (a) Balances with banks; (b) Cheques, drafts on hand; (c) Cash on hand; (d) Others (specify nature) (ii) Earmarked balances with banks (for example, for unpaid dividend) shall be separately stated. (iii) Balances with banks to the extent held as margin money or security against the borrowings, guarantees, other commitments shall be disclosed separately. (iv) Repatriation restrictions, if any, in respect of cash and bank balances shall be separately stated. (v) Bank deposits with more than 12 months' maturity shall be disclosed separately.

4.6 Inventories

Inventories are a form of current asset held for sale in the ordinary course of business or in the process of production for such sale or for consumption in the production of goods or service for sale or in the form of materials or supplies to be consumed in the production process or in the rendering of services As per generally accepted accounting principles under AS 2- 'Valuation of Inventories' and IND AS 2- 'Ínventoríes", inventory is valued at lower of cost and net realisable value. This general principle applies to valuation of all inventories except inventories of the following to which special considerations apply.

(a) Work-in-progress arising under construction contracts, including directly related service contracts (refer Accounting Standard (AS) 7, "Construction Contracts");

(b) Shares, debentures and other financial instruments held as inventory (refer AS 2- 'Valuation of Inventories' and IND AS 2- 'Ínventoríes"); and

(c) Producers' inventories of livestock, agricultural and forest products, and mineral oils, ores and gases to the extent that they are measured at net realisable value in accordance with well-established practices in those industries (refer AS 2- 'Valuation of Inventories') and biological assets as defined under IND AS 41- ''Agriculture" and part of exclusions under IND AS 2- 'Ínventoríes").

The inventories referred to in (c) above are measured at net realisable value at different stages of production. This occurs, for example, when agricultural crops have been harvested or mineral oils, ores and gases have been extracted and sale is assured under a forward contract or a Government guarantee, or when a homogenous market exists and there is a negligible risk/ uncertainty of failure to sell. Such inventories are accordingly, excluded from the scope.

Following the fundamental accounting assumption of consistency, whatever basis of valuation is adopted; it should be applied consistently from one period to another to prevent distortion of operational results disclosed in the financial statements. Accordingly, any change in the accounting policy relating to inventories (including the basis of comparison of historical cost with net realisable value and the cost formulae used) which has a material effect in the current period or which is reasonably expected to have a material effect in later periods should be disclosed. In the case of a change in accounting policy which has a material effect in the current period, the amount by which items/ captions in the financial statements are affected by such change should also be disclosed to the extent ascertainable. Where such amount is not ascertainable, wholly or in part, the fact should be indicated.

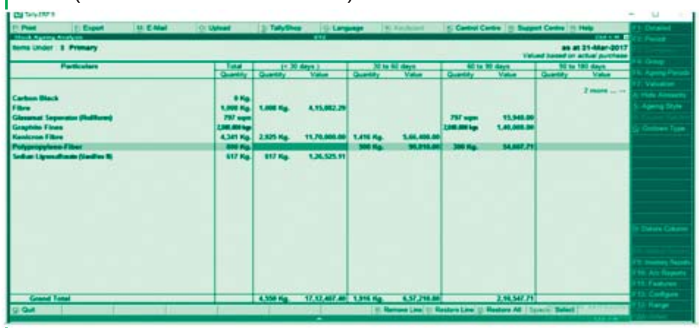
Period end closing inventory is adjusted in "change in inventories" in the Statement of Profit and Loss for giving effect to the adjustment required in the Profit or Loss. To reflect a true and fair view of the accounts, the correctness, appropriateness and consistency of the verification and valuation bases and methods are of great significance in relation to inventories.

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

Assertions	Explanation	Audit procedures
Existence	To establish the existence of Inventories as at the period- end.	• Review client's plan for performing inventory count. Plan should include procedures relating to shipments and receipts during count and should also allocate staff responsible for each class of inventory. • Ensure that consigned goods have been segregated. • Evidence of appropriate supervision for those performing count should be examined. • Observe inventory being counted and personally perform test counts to verify counts. Test counts by auditor should include: — observing employees are adhering to the agreed plan. — assuring that all items are properly tagged. — observing that proper amounts are shown on tags. — 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. — Establishing cut off by documenting last receiving reports and shipping documents for the period. — 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. Further, the auditor should ask the client personnel to sign all stock count sheets and also agree the variances observed, if any to avoid any conflicts/ difference of opinion at the time of reporting. • 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. • Confirm or investigate public warehouse inventory of client and also, any inventory of client lying with a third party (specifically relevant for cases where the clients get job work done in its process of production).

Assertions	Explanation	Audit procedures
Completeness	Only the inventories held by entity have been recorded in the financial statements and do not include any inventories that belong to third parties but does include inventories owned by the entity and lying with a third party	• Perform analytical procedures (comparison tests with industry averages, budgets, prior years, trend analysis, etc.). — Compute inventory turnover ratio (COGS/ average inventory) — Perform vertical analysis (inventory/ total assets) — Compare budgetary expectations vis-à-vis actuals • Examine non-financial information related to inventory, such as weights and measures. • 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.
Rights and Obligations	The entity has valid legal ownership rights over the inventories claimed to be held by the entity and recorded in the financial statements	• Vouch recorded purchases to underlying documentation (purchase requisition, purchase order, receiving report, vendor invoice, and cancelled check 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

Assertions	Explanation	Audit procedures
Valuation	Inventories have been valued appropriately and as per generally accepted accounting policies and practises	• Depending on how the business operates, the management may value inventory using "first-in first-out," "last-in first-out," or a weighted average system. First-in first-out, called FIFO, values inventory at close to its current replacement cost. Last-in first-out, called LIFO, values inventory at close to its original purchase cost. A weighted average system values inventory according to an average cost of all inventory items bought during the period. • **Raw materials and consumables** ▫ Ascertain what elements of cost are included e.g. carriage in, 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** ▫ 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** ▫ Enquire into 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 draft 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 have also been written down.

Assertions	Explanation	Audit procedures
		□ 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 (refer screenshot below)  □ 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.
Presentation and Disclosure	Required disclosures for inventories have been appropriately made	Ensure whether the following disclosures as required under Ind AS compliant Schedule III to Companies Act, 2013 have been made: • Whether mode of valuation has been stated separately for each class of inventory • Whether inventory has been classified as: — Raw materials — Work-in-progress — Finished goods — Stock-in-trade (goods acquired for trading) — Stores and spares — Loose tools — Others (specify nature) • Whether goods-in-transit have been disclosed separately under each sub-head of inventory

4.7 Fixed Assets-Tangible Assets Comprising Land, Buildings, Plant & Equipment, Furniture & Fixtures, Vehicles, Office Equipment, Computers etc. [referred to as "Property, Plant and Equipment" ("PPE") under Ind AS

Before we proceed to understand what constitutes fixed assets, it is essential to understand the difference between revenue expenditure and capital expenditure.

Revenue Expenditure

An expenditure, the benefits of which shall get expended or exhausted in the process of earning revenue within a short span of time, maximum period being one year, for example on purchase of goods for sale, on their movement from one place to another, on maintenance of assets, etc.

Example

Examples of Revenue expenditure include:

(i) Cost of raw material and stores consumed in the process of manufacture/ production;

(ii) Salaries and wages of employees engaged directly or in-directly in production;

(iii) Rent, rates and taxes;

(iv) Power and fuel;

(v) Repairs, maintenance and renewals of fixed assets;

(vi) Legal and professional expenses;

(vii) Advertisement and sales promotion;

(viii) Communication;

(ix) Printing and Stationery;

(x) Insurance.

Capital Expenditure

An expenditure incurred for the below mentioned purposes:

(i) Acquiring fixed assets, i.e., assets of a permanent or a semi-permanent nature, which are held not for resale but for use within the business with a view to earning profits and the benefit whereof is expected to last for more than one year;

(ii) Making additions/ enhancements to the existing fixed assets with the intent to increasing earning capacity of the business;

(iii) Minimising the cost of production;

(iv) Acquiring a benefit of enduring nature in the form of a valuable right like patent, trademarks etc.

The different forms of capital expenditure are: (i) land; (ii) building; (iii) plant and equipment; (iv) furniture and fixtures; (v) office equipment; (vi) electric installations; (vii) vehicles/ motor cars; (viii) premium paid for the lease of a building; (ix) development expenditure on land; and (x) goodwill; etc.

Expenses which are essentially of a revenue nature, if incurred for creating an asset or adding to its value for achieving higher productivity, are also regarded as expenditure of a capital nature.

Example

Examples of such capital expenditure are:

(i) **Material and wages-** capital expenditure when expended on the construction of a building or erection of machinery;

(ii) **Legal expenses-** capital expenditure when incurred in connection with the purchase of land or building;

(iii) **Freight-** capital expenditure when incurred in respect of purchase of plant and machinery;

(iv) **Repair-** Major repairs of a fixed asset that increases its productivity;

(v) **Wages-** Wages paid on installation costs incurred in Plant & machinery;

(vi) **Interest-** Interest incurred during the eligible period as defined under Ind AS 23 i.e. during the period of construction of the asset.

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

Assertions	Explanation	Audit procedures
Existence	To establish the existence of tangible fixed assets (PPE) as at the period- end	• Review client'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 client and perform the following procedures: — Assess if all items of PPE are properly tagged and carry identification marks/ numbers and physical verification work papers do capture the asset identification numbers for assets physically verified. — 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

Assertions	Explanation	Audit procedures
		management and depreciation charge should have ceased to be charged beyond the date of deletion.
Completeness	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	• 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 and 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 undertake the following procedures: — For all material additions, verify if such expenditure meets the capital expenditure test vis-à-vis revenue expenditure. Students should note that the cost of an item of property, plant and equipment shall be recognised as an asset if, and only if: (a) it is probable that future economic benefits associated with the item will flow to the entity; and (b) the cost of the item can be measured reliably. 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. In particular, the cost of an item of property, plant and equipment as per Ind AS 16 should comprise:

Assertions	Explanation	Audit procedures
		(a) its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates; (b) any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management, examples being costs of employee benefits (as defined in Ind AS 19, Employee Benefits) arising directly from the construction or acquisition of the item of property, plant and equipment, costs of site preparation, initial delivery and handling costs; installation and assembly costs; costs of testing whether the asset is functioning properly, after deducting the net proceeds from selling any items produced while bringing the asset to that location and condition (such as samples produced when testing equipment); and professional fees.; Students should note that following costs do not qualify as costs of an item of property, plant and equipment: (i) costs of opening a new facility; (ii) costs of introducing a new product or service (including costs of advertising and promotional activities); (iii) costs of conducting business in a new location or with a new class of customer (including costs of staff training); and (iv) administration and other general overhead cost.

Assertions	Explanation	Audit procedures
		(c) the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located, the obligation for which an entity incurs either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period. Items such as spare parts, stand-by equipment and servicing equipment are recognised as property, plant and equipment, when they meet the definition of capital expenditure. Otherwise, such items are classified as inventory. Items of property, plant and equipment may be acquired for safety or environmental reasons. The acquisition of such property, plant and equipment, although not directly increasing the future economic benefits of any particular existing item of property, plant and equipment, may be necessary for an entity to obtain the future economic benefits from its other assets. Such items of property, plant and equipment qualify for recognition as assets because they enable an entity to derive future economic benefits from related assets in excess of what could be derived had those items not been acquired. For example, a chemical manufacturer may install new chemical handling processes

Assertions	Explanation	Audit procedures
		to comply with environmental requirements for the production and storage of dangerous chemicals; related plant enhancements are recognised as an asset because without them the entity is unable to manufacture and sell chemicals. o On the contrary, an entity should not recognise in the carrying amount of an item of property, plant and equipment the costs of the day-to-day servicing of the item. Rather, these costs are recognised in profit or loss as incurred. Costs of day-to-day servicing are primarily the costs of labour and consumables, and may include the cost of small parts. The purpose of these expenditures is often described as for the 'repairs and maintenance' of the item of property, plant and equipment. o Parts of some items of property, plant and equipment may require replacement at regular intervals. For example, a furnace may require relining after a specified number of hours of use, or aircraft interiors such as seats and galleys may require replacement several times during the life of the airframe. Items of property, plant and equipment may also be acquired to make a less frequently recurring replacement, such as replacing the interior walls of a building, or to make a nonrecurring replacement. Under the recognition principle as defined in paragraph 7 of Ind

Assertions	Explanation	Audit procedures
		AS 16, an entity recognises in the carrying amount of an item of property, plant and equipment the cost of replacing part of such an item when that cost is incurred if the recognition criteria are met. The carrying amount of those parts that are replaced is derecognised in accordance with the derecognition provisions of Ind AS 16. o Verify the installation certificate or report or other similar documentation maintained by the entity to establish the date of addition, for all additions to PPE during the period under audit. o Verify if the PPE additions have been approved by appropriate entity's personnel and is as per the capital expenditure budget approved by the board of directors at the start of the financial year. o Verify if proper internal processes and procedures like inviting competitive quotations/ floating tenders etc. were followed prior to finalizing the vendor for procuring item of PPE/ awarding of work contract for capital project. • 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 manner of disposal. Obtain the management approval and discard note authoring discard of the asset

Assertions	Explanation	Audit procedures
		from its active use. Verify the process followed for sale of discarded PPE, 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 discard in the entity's books of account.
Valuation	PPE have been valued appropriately and as per generally accepted accounting policies and practises	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: • Verify that the entity has charged depreciation on all items of PPE unless any item of PPE is non-depreciating like freehold land; • Verify that the depreciation method used reflects the pattern in which the asset's future economic benefits are expected to be consumed by the entity. 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 include the straight-line method, the diminishing balance method and the units of production method. Straight-line depreciation results in a constant charge over the useful life if the asset's residual value does not change. The diminishing balance method results in a decreasing charge over the useful

Assertions	Explanation	Audit procedures
		life. The units of production method results in a charge based on the expected use or output. The entity should have selected the method that most closely reflects the expected pattern of consumption of the future economic benefits embodied in the asset. 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. • 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. For the purpose, the auditor needs to verify if the entity has applied Ind AS 36, Impairment of Assets for determining the manner of reviewing the carrying amount of its PPE, determining the recoverable amount of the PPE to determine impairment loss, if any.
Rights and Obligations	The entity has valid legal ownership rights over the PPE claimed to be held by the entity and recorded in the financial statements	• 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 name of the entity that entitles legal title of ownership to the respective entity. For all additions to land, building in particular, the auditor should obtain copies of conveyance deed/ sale deed to establish whether the entity is mentioned to be the legal and valid owner. • The auditor should insist and verify the original title deeds for all immoveable properties held as at

Assertions	Explanation	Audit procedures
		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 the PPE that has been given as security to any third parties.
Presentation and Disclosure	Required disclosures for PPE have been appropriately made	Ensure whether the following disclosures as required under Ind AS compliant Schedule III to Companies Act, 2013 have been made: • Whether all items of property, plant and equipment have been classified as: o Land o Buildings o Plant and equipment o Furniture and fixtures o Vehicles o Office equipment o 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 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: o Opening balance of gross carrying amount

Assertions	Explanation	Audit procedures
		o Additions o Acquisitions through business combinations o Disposals o Disposals through demergers o Other adjustments ❑ Borrowing costs capitalized o Closing balance of gross carrying amount • For each class of property, plant and equipment, whether the entity has disclosed: o Opening accumulated depreciation o Charge for the year o Deduction/ other adjustments for depreciation o Closing accumulated depreciation • For each class of property, plant and equipment, whether the entity has disclosed: o Opening accumulated impairment losses o Impairment losses o Impairment reversals o Closing accumulated impairment losses

4.8 Fixed Assets - 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 expend resources, or incur liabilities, on the acquisition, development, maintenance or enhancement of intangible resources 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 is internally generated.

If an item covered does not meet the definition of an intangible asset, expenditure to acquire it or generate it internally is recognised as an expense when it is incurred. However, if the item is acquired in a business combination, it forms part of the goodwill recognised at the date of the amalgamation.

Some intangible assets may be contained in or on a physical substance such as a compact disk (in the case of computer software), legal documentation (in the case of a license or patent) or film (in the case of motion pictures). The cost of the physical substance containing the intangible assets is usually not significant. Accordingly, the physical substance containing an intangible asset, though tangible in nature, is commonly treated as a part of the intangible asset contained in or on it.

In some cases, an asset may incorporate both intangible and tangible elements that are, in practice, inseparable. In determining whether such an asset should be treated under AS 10/ Ind AS-16- Accounting for Fixed Assets, or as an intangible asset, judgement is required to assess as to which element is predominant. For example, computer software for a computer controlled machine tool that cannot operate without that specific software is an integral part of the related hardware and it is treated as a fixed asset. The same applies to the operating system of a computer. Where the software is not an integral part of the related hardware, computer software is treated as an intangible asset.

As per AS-26 and Ind AS- 38, 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:

Assertions	Explanation	Audit procedures
Existence	To establish the existence of intangible fixed assets as at the period- end	• 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. **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. 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.
Completeness	Additions to Intangible assets during the period under audit have been recorded appropriately in the financial statements	• 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. • Check the arithmetical accuracy of the movement in intangible asset schedule, tally the opening balances to the previous year

Assertions	Explanation	Audit procedures
		audited financial statements. For additions during the period under audit, obtain a listing of all additions from the management and undertake the following procedures: ❑ For all material additions, verify if such expenditure meets the criterion for recognition of an intangible asset. Students should note that an 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 and to restrict the access of others to those benefits; (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. ❑ 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 ***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

Assertions	Explanation	Audit procedures
		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. ***Development phase*** An intangible asset arising from development or from the development phase of an internal project) shall be recognised if, and only if, an entity can demonstrate all of the following: (i) the technical feasibility of completing the intangible asset so that it will be available for use or sale; (ii) its intention to complete the intangible asset and use or sell it; (iii) its ability to use or sell the intangible asset; (iv) how the intangible asset will generate probable future economic benefits. Among other things, the entity can demonstrate the existence of a market for the output of the

Assertions	Explanation	Audit procedures
		intangible asset or the intangible asset itself or, if it is to be used internally, the usefulness of the intangible asset; (v) the availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset; (vi) its ability to measure reliably the expenditure attributable to the intangible asset during its development. Students should note that Internally generated brands, mastheads, publishing titles, customer lists and items similar in substance cannot be recognised as intangible assets. 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 in the manner intended by management. 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 (as defined in Ind AS 19) arising from the generation of the intangible asset; (iii) fees to register a legal right; and (iv) amortisation of patents and licences that are used to generate the intangible asset. Goodwill recognised in a business combination is an asset representing the future

Assertions	Explanation	Audit procedures
		economic benefits arising from other assets acquired in a business combination that are not individually identified and separately recognised. The future economic benefits may result from synergy between the identifiable assets acquired or from assets that, individually, do not qualify for recognition in the financial statements. ▫ Verify the certificate or report or other similar documentation maintained by the entity to establish 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 if the additions have been approved by appropriate entity's personnel and is as per the capital expenditure budget approved by the board of directors at the start of the financial year. ▫ Verify if proper internal processes and procedures like inviting competitive quotations/ floating tenders etc. were followed prior to finalizing the vendor for procuring item of intangible assets. • In relation to deletions to intangible assets, understand from the management the reason and rationale for deletion and the manner of disposal. Obtain the management approval and discard note authoring discard 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

Assertions	Explanation	Audit procedures
		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 discard in the entity's books of account.
Valuation	Intangible have been valued appropriately and as per generally accepted accounting policies and practices	The value of intangible assets may diminish due to efflux of time, use and/ or 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 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: • 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 if the management has undertaken an impairment assessment to determine whether an intangible asset is impaired. For the purpose, the auditor needs to verify if the entity has applied Ind AS 36, 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.
Rights and Obligations	The entity has valid legal ownership rights over the PPE claimed to be held by the entity and recorded in the financial statements	• In addition to the procedures undertaken for verifying completeness of additions to intangible assets during the period under audit, the auditor while performing testing of

Assertions	Explanation	Audit procedures
		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 respective entity.
Presentation and Disclosure	Required disclosures for PPE have been appropriately made	Ensure whether the following disclosures as required under Ind AS compliant Schedule III to Companies Act, 2013 have been made: • For Goodwill, 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: □ Opening balance of gross carrying amount □ Additions □ Disposals □ Impairments □ Other adjustments • Whether all items of intangible assets have been classified as: □ 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 assets**, 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:

Assertions	Explanation	Audit procedures
		◻ Opening balance of gross carrying amount ◻ Additions ◻ Acquisitions through business combinations ◻ Disposals ◻ Disposals through demergers ◻ Other adjustments ◻ Borrowing costs capitalized ◻ Closing balance of gross carrying amount • For each class of intangible assets, whether the entity has disclosed: ◻ Opening accumulated amortization ◻ Charge for the year ◻ Deduction/ other adjustments for amortization ◻ Closing accumulated amortization • For each class of intangible assets, whether the entity has disclosed: ◻ Opening accumulated impairment losses ◻ Impairment losses ◻ Impairment reversals ◻ Closing accumulated impairment losses

4.9 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 Balance Sheet would not show a true and fair view of the state of affairs of the entity.

Further, a liability is classified as current if it satisfies any of the following criteria:

- It is expected to be settled in the entity's normal operating cycle
- It is held primarily for the purpose of being traded
- It is due to be settled within twelve months after the reporting period

- The entity does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting period. Terms of a liability that could, at the option of the counterparty, result in its settlement by the issue of equity instruments does not affect its classification.

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

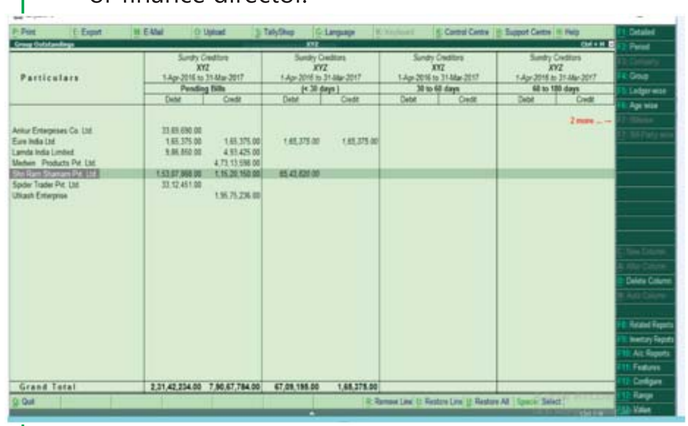
Assertions	Explanation	Audit procedures
Existence	To establish the existence of trade payables and other current liabilities as at the period-end	• Check whether there are controls in place to ensure that the same purchase/ expense invoice cannot be recorded more than once and payable balances are automatically recorded in the general ledger at the time of recording of expense. • 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. • 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. • 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. **Direct confirmation procedures** • 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

Assertions	Explanation	Audit procedures
		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. • 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 'positive' form of request, wherein 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. 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. 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. 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 payabl

Assertions	Explanation	Audit procedures
		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. • 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. 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 despatch of request lette₹ 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. • 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: ◻ Agreeing the balance to subsequent cash paid; ◻ Agreeing the detail 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; ◻ Prepare a final summary of the results of the circularization and draw the final conclusion.

Assertions	Explanation	Audit procedures
		• 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. • 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.
Completeness	Trade payables and liability balances that were supposed to be recorded have been recognized in the financial statements.	• The auditor needs to satisfy himself of correct and proper cut-offs. Without a correct cut-off, purchases and expenses could be understated or overstated, hence, the need to perform the following cut off tests: ◻ For the invoices received/ recorded during the last few days (say 5 days) closer to 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 good received prior to the period/ year-end should have been booked in the form of purchases and included in trade creditors; ◻ 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. • 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. • 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.

Assertions	Explanation	Audit procedures
		• 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. • 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. As part of subsequent events review procedures, verify if advances have been adjusted subsequently post sale of goods/ rendering of services. • 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. Example- VAT liability for last month may be calculated by applying the applicable rate to the sales made and in case of any variance with the VAT 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.

Assertions	Explanation	Audit procedures
Valuation	Trade payables and other liability balances have been valued appropriately.	• 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. • 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 the financial controller or finance director.  • 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 Enterprises supplier at the end of accounting year. Test check the management process to assess if the auditor could rely on the management process.

Assertions	Explanation	Audit procedures
Presentation and Disclosure	Required disclosures for trade payables and other liabilities have been appropriately made	Ensure whether the following disclosures as required under Ind AS compliant Schedule III to Companies Act, 2013 have been made: • 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 enterprises and small enterprises in the notes: ◻ 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 under section 23 of the Micro, Small and Medium Enterprises Development Act, 2006. • Whether the amount disclosed under other current liabilities are classified as below: ◻ Revenue received in advance. ◻ Other advances (specify nature). ◻ Others current liabilities (specify nature).

4.10 Loans and Advances; and Other Current Assets

In general, loans (and advances) are another form of current assets, to a large extent similar to trade receivables. While loans could be understood in normal parlance to mean money advanced to related or other parties, with or without interest clause, advances include amounts recoverable either 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 accrued interest on loans/ fixed deposits held, 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:

Assertions	Explanation	Audit procedures
Existence	To establish the existence of loans and advances and other current assets as at the period- end	• For establishing existence of loans and advances, direct confirmation procedures, similar to those performed for ''Accounts receivable" balances are undertaken with the only difference that while undertaking circularisation of direct confirmations, in addition to the principal amount, interest received/ receivable, if any, as per the agreed terms between the parties, may also be included as part of the balance to be confirmed.
Completeness	Loans and advances and other current asset balances that were supposed to be recorded have been recognized in the financial statements.	• Obtain a list of all advances and other current assets and compare them with balances in the ledger. • Inspect loan agreements and acknowledgements of parties in respect of outstanding loans. A loan or an advance, if material, can be granted only if authorised by the Memorandum and

Assertions	Explanation	Audit procedures
		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. • 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. • Related party loans and advances- 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 service tax/ VAT/ excise 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 client and in case found satisfactory, the same should be maintained as part of audit documentation. • Further, the auditor should obtain copies of statutory returns filed with the authorities like excise returns/ VAT returns etc. and verify whether the amount recorded as per books of account tallies with the claim made with the authorities.

Assertions	Explanation	Audit procedures
Valuation	Loans and advances and other current asset balances have been valued appropriately.	• 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 their reasons, if any of these loans/ advances are not included in the provision for bad recoverable; Perform further testing where any disputes exist; Reach a final conclusion regarding the adequacy of the bad and doubtful loans/ advances provision. • 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 an appropriate and authorised member of senior management, for example the financial controller or finance director. • Check that the restatement of foreign currency loans and advances/ other current assets has been done properly.
Presentation and Disclosure	Required disclosures for loans and advances and other current assets have been appropriately made	Ensure whether the following disclosures as required under Ind AS compliant Schedule III to Companies Act, 2013 have been made: • Whether loans have been classified as: ▫ Security deposits

Assertions	Explanation	Audit procedures
		▫ Loans to related parties (giving details thereof) ▫ Other loans (specify nature) • Whether all the above loans have been further sub-classified as: ▫ 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: ▫ 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 **Other current assets** • Does the entity classify current assets that do not fit into any other asset category as other current assets? • Whether other current assets are classified as: ▫ Advances other than capital advances which are further sub-classified as: ❍ Security Deposits ❍ Advances to related parties (giving details thereof) ❍ Other advances (specify nature) ▫ Other current assets (specify nature) • For advances, whether separate disclosure has been made for amounts due by: ▫ Director(s) of the company ▫ Director(s) of the company jointly with other persons

Assertions	Explanation	Audit procedures
		▫ 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

4.11 Provisions and Contingent Liabilities

Provisions are amounts charged against revenue to provide for:

(i) a known liability, the amount whereof cannot be determined with substantial accuracy; or

(ii) a claim which is disputed.

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 employee post- employment defined benefit plan, provision for litigation, provision for warranties etc.

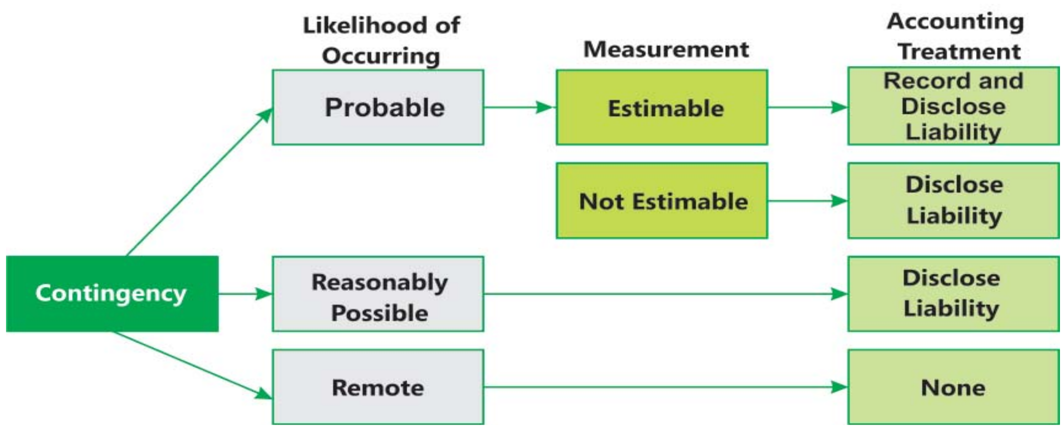
A contingent liability is:

(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.

Accounting Treatment of Contingent Liabilities



In a general sense, all provisions are contingent because they are uncertain in timing or amount. However, as per Ind AS 37- Provisions, Contingent Liabilities and Contingent Assets, the term 'contingent' is used for liabilities and assets that are not recognized because their 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. In addition, the term 'contingent liability' is used for liabilities that do not meet the recognition criteria.

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

Assertions	Explanation	Audit procedures
Existence Completeness Valuation	To establish the existence of provisions as at the period- end Provisions that were supposed to be recorded have been recognized in the financial statements. Provision balances have been valued appropriately.	• Obtain a list of all provisions and compare them with balances in the ledger. • 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. • 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 experts report, calculation and underlying working for the provision amount, example for employee defined benefit provision, the auditor may request the management to share the

Assertions	Explanation	Audit procedures
		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. • 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: ◻ Evaluate the competence, capabilities and objectivity of that expert: ▪ Whether the expert is employed by the entity or is engaged by it ▪ The extent to which management can exercise influence or control over the expert ▪ Auditor's previous experience of the work of the expert ▪ Knowledge of the expert's qualification, membership of a professional body or industry association ◻ Obtain an understanding of the work of that expert: ▪ Whether the auditor has expertise to evaluate the work of the expert ▪ Whether any professional or other standards, and regulatory or legal requirements apply ▪ Evaluating the assumptions and methods used by the management ▪ Evaluating the nature of internal or external data used by the Expert

<table>
<tr><th>Assertions</th><th>Explanation</th><th>Audit procedures</th></tr>
<tr><td></td><td></td><td>
Evaluate the appropriateness of his work as audit evidence for the relevant assertion
Relevance and reasonableness of the Expert's findings or conclusions
Evaluating the relevance, completeness and accuracy of the source data used by the Expert
</td></tr>
<tr><td>Presentation and Disclosure</td><td>Required disclosures for provisions have been appropriately made</td><td>
Ensure whether the following disclosures as required under Ind AS compliant Schedule III to Companies Act, 2013 have been made:

Whether current and non- current portions have been split for
Provision for employee benefits
Others (specify nature)
Whether for each class of provision, disclosure has been made for:
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; and
the increase during the period in the discounted amount arising from the passage of time and the effect of any change in the discount rate
Whether for each class of provision, disclosure has been made for:
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

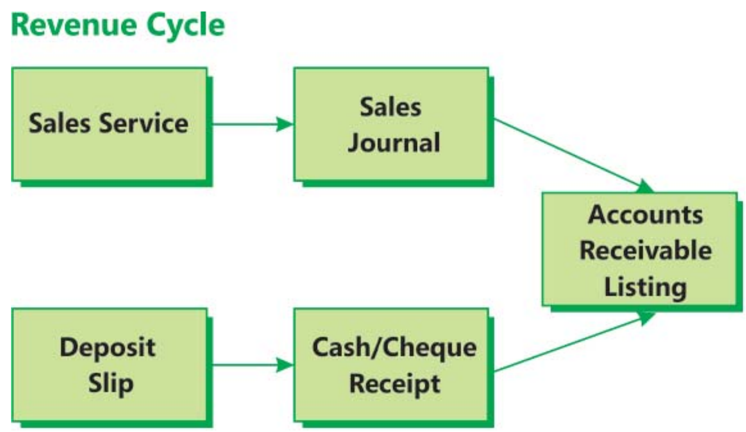
</td></tr>
</table>

Assertions	Explanation	Audit procedures
		▫ the amount of any expected reimbursement, stating the amount of any asset that has been recognised 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: ▫ 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. • Whether Contingent liabilities have been classified as: ▫ Claims against the company not acknowledged as debts; ▫ Guarantees; ▫ Other money for which the entity is contingently liable. • Whether the amount of any guarantees given by the entity on behalf of directors or other officers of the entity has been stated and where practicable, the general nature of each such contingent liability, if material has also been specified.

5. INCOME STATEMENT CAPTIONS

5.1 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 for the purchase. As part of the year-end audit of an entity's financial statements, external accountants (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.



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

Example

Type of services or products they provide, demand of the service 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 identify the control points over sales

   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 risk and reward 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 amount of transaction testing he must do.

   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 must. Substantive analytical procedure will consist of sales trend analysis, comparison with previous accounting period, category wise sales, any analysis the auditor may find relevant and most important of all building a sales expectation and compare 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:

Assertions	Explanation	Audit procedures
Occurrence	Recorded sales represent goods shipped/ services performed during the period	• Ensure revenue is not overstated by performing following audit procedures: □ Check whether a single sales invoice is recorded twice or a cancelled sales invoice could also be recorded. □ Whether any fictitious customer and sale has 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.).

		• Review sequence of sales invoices • Review journal entries for unusual transactions • Vouch from the sales journal to the supporting documents • Calculate the ratio of sales return to sales and compare it with previous year and note down the reason for increase/ decrease • Check the sales return with sales invoice, challan, credit note, stock register, reversal of excise duty and sales tax etc.
Completeness	All sales made during the period were recorded and there in no understatement or overstatement.	• Perform cut-off test 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 buye` 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 will also have to see "Credit notes" issued after the accounting period. Sometimes sales team or sales personnel can make fictitious/ ghost sales before the year-end to meet performance target and cancel out the sale 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 excise records • Review the sales tax and service tax returns and ensure that the same are reconciled with revenue reported in the profit and loss account. Prepare a reasonability say of VAT by applying the applicable rate to the gross sales value and compare the amount of VAT as per statutory returns and analyze the reasons for variance, if any.

Measurement	All sales are accurately measured as per applicable accounting standards and correctly journalized, summarized, and posted	• If there are any export sales, consider calculating/reviewing "Exchange gain/ loss" arising from the sales. • Recalculate prices and extensions on sales invoice • Trace a few transactions from inception to completion • Auditor must understand client's operations and related GAAP issues e.g. point of sale revenue recognition vs. percentage of completion • 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.

Presentation and Disclosure	Required disclosures for sales have been appropriately made	Ensure whether the following disclosures as required under Ind AS compliant Schedule III to Companies Act, 2013 have been made:
		• 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:
		    □ Sale of products (including excise duty)
		    □ Sale of services
		    □ Other operating revenues
		• Whether brokerage and discount on sales, other than the usual trade discount has been disclosed
		• Whether the transactions with related parties are appropriately disclosed in notes to accounts

5.2 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, common examples being excess funds parked in fixed deposits with banks (the entity not being a bank or financial institution), loans given to third parties/ within the group, 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.

Under Ind AS, interest income from debt instruments is recognized using the effective interest rate method. The effective interest rate is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset to the gross carrying amount of a financial asset. When calculating the effective interest rate, the entity should estimate the expected cash flows by considering all the contractual terms of the financial instrument (for example: repayment, extension, call and similar options) but does not consider the expected credit losses.

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.

Assertions	Explanation	Audit procedures
Occurrence Completeness Measurement	Recorded other income was earned during the period Other income earned during the period was appropriately recorded and there in no understatement or overstatement. Other income has been measured appropriately as per the applicable accounting standards	• For verifying interest income on fixed deposits: ▫ 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 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 confirmation 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.

Assertions	Explanation	Audit procedures
		• 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, provided it is probable that the economic benefits associated with the dividend will flow to the entity and the amount of the dividend can be measured reliably. • 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.
Presentation and Disclosure	Required disclosures for other income have been appropriately made	Ensure whether the following disclosures as required under Ind AS compliant Schedule III to Companies Act, 2013 have been made: • Whether 'other income" has been classified as: ◻ Interest income ◻ Dividend income ◻ Other non-operating income (net of expenses directly attributable to such income)

5.3 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, external accountants (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, who 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 how strong and reliable they are. If they are strong, the auditor can reduce the amount of transaction testing he must do. Common internal controls over the purchase cycle include inviting of competitive quotations for shortlisting the vendor, 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:

Assertions	Explanation	Audit procedures
Occurrence	Recorded purchases represent goods actually received/ services availed during the period	• Ensure purchases are not understated/ overstated by performing following audit procedures: • Whether any fictitious vendor and purchase has been recorded by reviewing the vendor selection process followed by the entity and also doing a search on web for ascertaining the existence of the vendor. • Whether the goods were received at the factory gate and whether there exists an entry in the security gate inward register

		• 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 **Special considerations during audit of purchases** • The purchase invoice received should be the "Original" copy (and not photocopy/ carbon copy) against which the auditee 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 auditee. However, in case of different branches, it should be addressed to the appropriate branch. • Input tax component should have been booked in the input tax ledger, the auditor should obtain a copy of the input tax returns filed with the authorities and tally the input tax as reflected in the books to the amount disclosed in the returns. • Appropriate ledger should have been debited as per the nature of goods/ services purchased to ensure proper classification of purchase/ expense. • In case of purchases made from related parties or allied and associated concerns, the auditor needs to verify if requisite approval from Board 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

		• 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 • Vouch from the purchase journal to the supporting documents
Completeness Measurement	All purchases made during the period were recorded and there in no understatement or overstatement. All purchases have been measured appropriately	In addition to the procedures for establishing occurrence of purchases as discussed above, the auditor should: • 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 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. • 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. • Perform analytical procedures to obtain audit evidence as to overall reasonableness of purchase quantity and price which may include: ▫ **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. ▫ **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.

		▫ **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
Presentation and Disclosure	Required disclosures for purchases have been appropriately made	Ensure whether the following disclosures as required under Ind AS compliant Schedule III to Companies Act, 2013 have been made: • Whether purchases of stock-in-trade has been specifically disclosed • Whether changes in inventories of finished goods, stock–in-trade and work-in-progress has been specifically disclosed • Whether the transactions with related parties are appropriately disclosed in notes to accounts

5.4 Employee Benefits Expense

Employee benefits expense or commonly called payroll represents 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 benefit 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 strong and reliable they are. If they are strong, the auditor can minimise the amount of transaction testing he must do. 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 expense:

Assertions	Explanation	Audit procedures
Occurrence Completeness Measurement	Recorded employee benefit expenses were actually incurred during the period Employee benefit expenses pertaining to the period have been recorded appropriately and there in no understatement or overstatement. Employee benefit expenses have been measured appropriately	• 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 be physically present at the entry gate at any given date and himself count the employees entering the premises and also, understand the manner of recording/ capturing their time. 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. • 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

Assertions	Explanation	Audit procedures
		preceding month and analyse the reasons for variance which could be attributable to annual increments, an employee at senior level joining/ leaving the entity, bonus pay-out etc. • Verify if accrual/ provision has been made for all employee benefits and obligations like bonus, gratuity, leave encashment • 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 expense 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 Management If any significant variations are found.
Presentation and Disclosure	Required disclosures for employee benefit expenses have been appropriately made	Ensure whether the following disclosures as required under Ind AS compliant Schedule III to Companies Act, 2013 have been made: Whether employee benefit expense has been classified as: • Salaries and wages. • Contributions to provident and other funds. • Staff welfare expenses.

5.5 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 asset 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 has 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:

Assertions	Explanation	Audit procedures
Completeness Measurement Occurrence	Depreciation and amortisation expenses pertaining to the period have been recorded appropriately and there in no understatement/ overstatement. Depreciation and amortisation expenses have been measured appropriately Recorded depreciation and amortisation expenses were actually incurred during the period	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, atleast the ones that are material in value. Obtain a list of all additions/ deletions along with their proper approval from the authorised person for the same. Select the sample of assets from the Fixed Assets Register, on materiality considerations and verify the rates of depreciation, depreciation calculation. ▪ 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.

		▪ 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 example- compute or 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).
Presentation and disclosure	Required disclosures for depreciation and amortisation have been appropriately made	Ensure whether the following disclosures as required under Ind- AS compliant Schedule III to Companies Act, 2013 have been made: ▪ Accounting policy for depreciation and amortization ▪ Useful lives of assets as per schedule II ▪ Residual value of assets ▪ Depreciation method

Book Value			**Rate of Deprecia-tion/ amortisa-tion**	**Analytical Deprecia-tion/ amor-tisation**	**Actual De-preciation/ amortisa-tion as per books**	**Variance**	**Reasons for Variance**
Opening Balance	**Closing Balance**	**Aver-age Balance**	**%**				
A	B	C= (A + B)/2#	D	E=C*D	F	G=F-E	H

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

5.6 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 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 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:

Assertions	Explanation	Audit procedures
Occurrence Completeness Measurement	Recorded other expenses were actually incurred during the period Other expenses pertaining to the period have been recorded appropriately and there in no understatement or overstatement Other expenses have been measured appropriately	• **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 agreement. Specific consideration should be given to escalation clause in the agreement to verify if the rent was to be increased/ adjusted 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. • **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.

Assertions	Explanation	Audit procedures
		• **Insurance expense**- Obtain a summary of insurance policies taken along with their validity period. Verify if 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 retainer ship agreements, verify if 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 attributes discussed above. Wherever possible, the auditor and try and prepare a summary of expenditure on monthly basis and then analytically compare the trends. • Perform analytical procedures to obtain audit evidence as to overall reasonableness of other expense which may include **expenditure per unit produced 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 Management If any significant variations are found.

Assertions	Explanation	Audit procedures
Presentation and Disclosure	Required disclosures for other expenses have been appropriately made	**Ensure other expense have been classified under:** • 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, existence/ occurrence, valuation/ measurement, rights and obligations and presentation and disclosure of assets, liabilities, equity, income, expenses and disclosures in accordance with the applicable financial reporting standards/ 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 income statement 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 agreeing the balance to cash received; 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 always 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 generally 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 income statement assertion:
   (a) Occurrence
   (b) Measurement
   (c) Completeness
   (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, has 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 expense or commonly called payroll represents 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. There is no difference between reserves and provision.

5. **Capital reserves** represent profits that are available for distribution to shareholders held for the time being or any one or more purpose.

6. 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.

7. If Company X's balance sheet shows building with carrying amount of ₹ 100 lakh, the auditor shall assume that the management has only asserted that the building recognized in the balance sheet exists as at the period-end.

8. **Authorised capital** is the sum stated in the memorandum as the capital of the company with which it is to be registered being the maximum amount which it is authorised to raise by issuing shares, and upon which it pays the stamp duty.

9. 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.** (d)	**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 expense or commonly called payroll represents 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 :** The difference between the two is that 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.

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.

5. **Incorrect : Revenue reserves** represent profits that are available for distribution to shareholders held for the time being or any one or more purpose.

6. **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.

7. **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).

8. **Correct : As per section 2(8) of the Companies Act, 2013. "Authorised capital" or "Nominal capital" means such capital as is authorised by the memorandum of a company to be the maximum amount of share capital of the company.** Thus, it is the sum stated in the memorandum as the capital of the company with which it is to be registered being the maximum amount which it is authorised to raise by issuing shares, and upon which it pays the stamp duty. It is usually fixed at the amount, which, it is estimated, the company will need, including the working capital and reserve capital, if any.

9. **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) 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.

(iii) 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.

(iv) 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.

(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 overdraft or loan account 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 a certificate from the bank showing particulars of securities deposited with the bank as security for the loans or of the charge created on an asset or assets of the concern 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 distinctly under 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) Refer to 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) See that 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 prepared by the auditee 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 assessee 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.

(vi) It is not necessary for the assessee 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 bill/invoice from advertising agency to ensure that rates charged for different types of advertisement are as per contract.

(ii) See that advertisement relates to client's business.

(iii) Inspect the receipt issued by the agency.

(iv) Ascertain the nature of expenditure – revenue deferred and see that it has been recorded properly.

(v) Ascertain the period for which payment is made and see that pre-paid is carried forward to balance sheet.

(vi) Compare the statement of account with the ledger account.

(vii) 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.