

AUDIT OF ITEMS OF FINANCIAL STATEMENTS

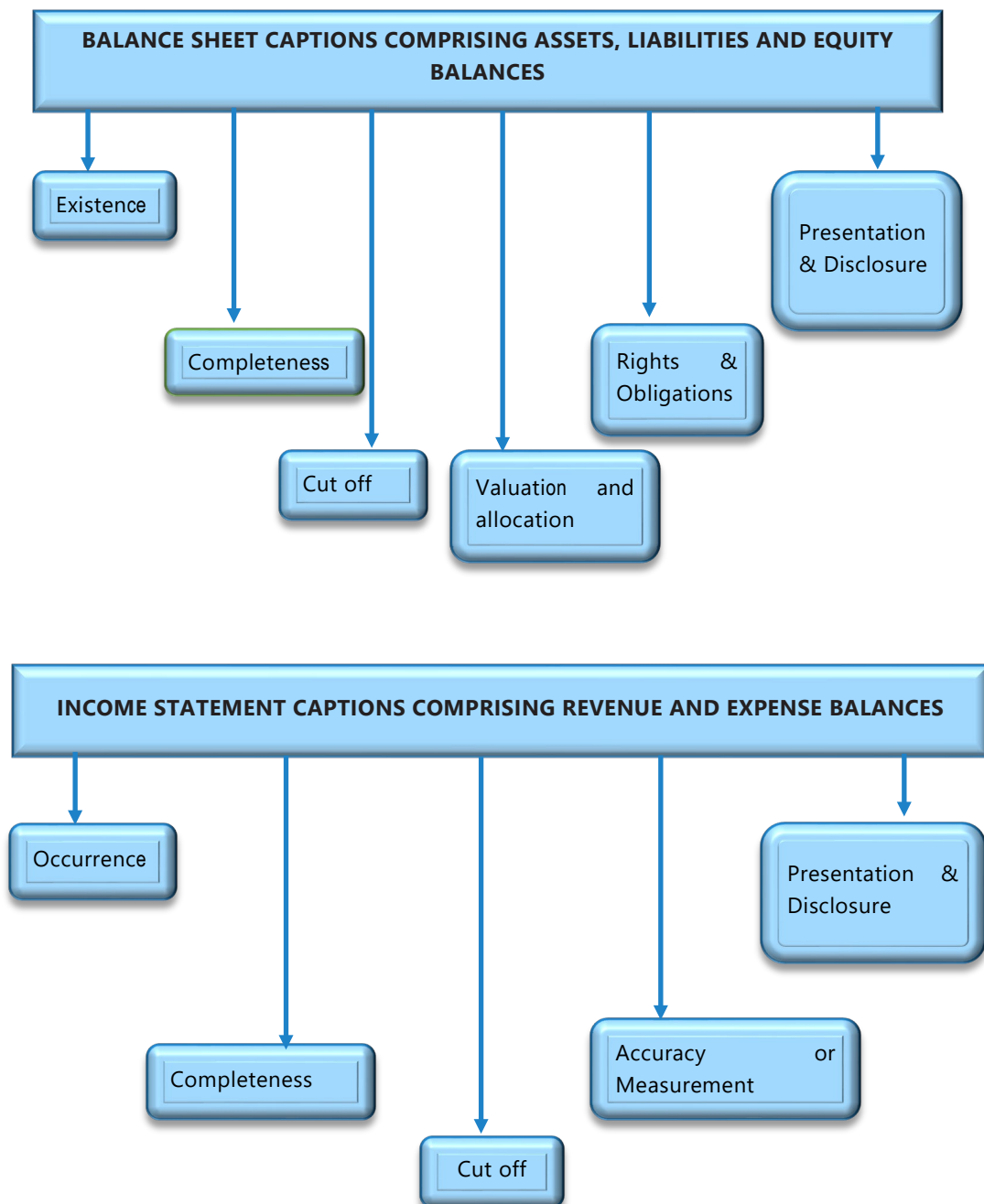


LEARNING OUTCOMES

After studying this chapter, you would be able to understand-

- ◆ The general considerations in an audit of financial statements.
- ◆ The specific procedures for auditing heads of balance sheet and statement of profit or loss.
- ◆ Audit procedures in respect of certain disclosures in the financial statements.
- ◆ Practicality of above concepts using examples and case studies.

CHAPTER OVERVIEW



Full import of "Substantive audit procedures" was already ingrained by Sameer. However, he wanted to know how such procedures are actually applied. How such detailed checking is carried out by team carrying out audit? Are there separate yardsticks for verifying "transactions" and "balances"? And what is logic behind detailed checking of "transactions" and "balances"? Recalling the basic premise of preparation of financial statements by the management, it flowed to him logically that such preparation of financial statements ought to involve expressly stated or implied statements. While carrying out detailed checking, auditor basically tries to verify these assertions.

Shekhar had told him that while verifying transactions and balances of the manufacturing company they were auditing, all assertions backing up these were verified. For example, while verifying sales of the company, it was verified that sales pertaining to the company have, in fact, taken place. It was also verified that data in respect of these transactions was recorded correctly. Nonetheless, it was made sure to verify recording of transactions in correct accounting period. And there were others too!

Similarly, while verifying trade receivables, procedures were applied to confirm existence of these balances. It was also checked that money represented by trade receivables was, in fact, recoverable. Were some balances under litigation or under dispute? All such aspects were gone through to obtain assurance that the balances were properly valued. And how can disclosure requirements be left behind? Whether all disclosures have been made in respect of such balances which were required to be made in accordance with applicable financial reporting framework? Besides this, analytical procedures also needed to be performed to bring out variations and fluctuations.

Gathering that transactions and balances reflected in financial statements convey so many things, both stated and understood, he found such a framework quite logical. In this context, requirements of applicable financial reporting framework become too important to be taken lightly. Schedule III of the Companies Act, 2013 came to his mind instantaneously in context of their talks pertaining to a manufacturing company.

Performing audit procedures to verify such assertions provides evidence to auditor which is evaluated in light of overall circumstances. Such procedures are indeed bedrock which help auditor to crystallize his opinion in form of audit report. Wanting to learn comprehensively about such procedures particularly in context of companies, he scrolled mouse to next page.



INTRODUCTION

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

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

Further, every financial statement contains an overall representation in addition to various specific assertions. Each financial statement purports to present something as a whole in addition to its component details. For example, an income statement purports to present "the results of operations" a balance sheet purports to present "financial position". The auditor's opinion is typically directed to these overall representations. But to formulate and offer an opinion on the overall truth of these statements he has first to inquire into the truth of many specific assertions that makes up each of these statements. Out of his individual judgements of these specific assertions he arrives at a judgement on the financial statement as a whole. In this chapter, we will be discussing in detail about the various audit procedures that an auditor can perform in order to verify the various assertions appearing in the financial statements. Before discussing about the audit procedures that an auditor can perform to verify the various assertions appearing in the financial statements, let us have a look at the meaning of the term assertion.

DEFINITION OF ASSERTION: It refers to the representations by management, explicit or otherwise, that are embodied *in the financial statements*, as used by the auditor to consider the different types of potential misstatements that may occur.

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

- completeness;
- cut-off;
- existence/ occurrence;

- valuation and allocation/ accuracy or measurement;
- rights and obligations; and
- presentation and disclosure

of **Assets, Liabilities, Equity, Income, Expenses and Disclosures** in accordance with the applicable accounting standards.

Example

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

- The building recognized in the balance sheet exists as at the period- end (existence assertion);
- Company X owns and controls such building (Rights and obligations assertion);
- The building has been valued accurately in accordance with the measurement principles (Valuation and allocation 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 the assertions made by the management by obtaining sufficient and appropriate audit evidence for each of the claims made on Account Balances, Class of Transactions and Related Disclosures.

ASSERTIONS MAY BE BROADLY CLASSIFIED INTO THE FOLLOWING TYPES

1. INCOME STATEMENT CAPTIONS COMPRISING REVENUE AND EXPENSE BALANCES

Assertions	Explanation	Example: Employee benefit expenses and sales
Occurrence	Transactions recognized in the financial statements have occurred and relate to the entity.	(i) 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. (ii) Recorded Sales represent goods which were ordered by valid customers and were despatched and invoiced in the period.
Completeness	All transactions that were supposed to be recorded have been recognized in the financial statements. Transactions have not been omitted.	(i) Employee benefit expenses in respect of all personnel have been fully accounted for. (ii) All genuine Sales have been recorded.
Cut-off	Whether all income and expenses are reported in the-correct accounting period. Cut-off is a separate assertion because the substantive procedures to verify it are typically different from those applied to the other components of completeness.	(i) Employee benefit expenses recognized during the period relates to the current accounting period only. (ii) Sales shall include the despatch of goods made at the year end as they belong to the relevant period.
Accuracy or Measurement	Transactions have been recorded accurately at their appropriate amounts in the financial statements. There have been no errors while preparing documents or in posting transactions to ledger. The figures and explanations are not misstated.	(i) Employee benefit expense has been measured/ calculated accurately. Any adjustments such as tax deduction at source have been correctly reconciled and accounted for. (ii) Sales are recorded correctly in the books based on the invoices. Discounts have been

		properly adjusted or accounted for.
Presentation and Disclosure	Transactions have been classified and presented fairly in the financial statements. Transactions and events are appropriately segregated or disaggregated. Presentation and disclosure assertions are considered during the course of the audit to determine that the disclosures are complete and accurate. The disclosures that are most susceptible to material misstatement are those that require significant judgement and qualitative assessments. Audit teams assess the completeness and accuracy of disclosures by determining that the disclosures provide information in a manner that does not materially omit, distort or mislead the user. The description and disclosure of transactions are relevant and easy to understand.	(1) A Company shall disclose by way of notes additional information regarding aggregate expenditure and income on the following items:— Employee Benefits Expense [showing separately (i) salaries and wages, (ii) contribution to provident and other funds, (iii) expense on <u>Employee Stock Option Scheme (ESOP)</u> and <u>Employee Stock Purchase Plan (ESPP)</u>, (iv) staff welfare expenses]. (2) In respect of a company other than a finance company revenue from operations shall disclose separately in the notes revenue from— (a) Sale of products; (b) Sale of services; (ba) Grants or donations received (relevant in case of section 8 companies only),] (c) Other operating revenues; Less: (d) Excise duty



2. BALANCE SHEET CAPTIONS COMPRISING ASSETS, LIABILITIES AND EQUITY BALANCES

Assertions	Explanation	Example: Inventory balance
Existence	Assets, liabilities and equity balances exist as at the period end.	Inventory recognized in the balance sheet actually existed as at the period end.
Completeness	All assets, liabilities and equity balances that were supposed to be recorded have been recognized in the financial statements.	All inventory units held by the entity that should have been recorded, have been recognized appropriately in the financial statements. Any inventory held by a third party on behalf of the entity has been included as part of the inventory balance. Inventory held by the entity as a Consignee (on behalf of third party i.e. Consignor) shall be excluded.
Cut-off	Whether all assets and liabilities are reported in the appropriate period.	Inventory balance as at the year-end does not include any element of next financial year. All items of inventory pertaining to the relevant year shall be included regardless of the location.
Valuation and allocation	Assets, liabilities and equity balances have been valued appropriately i.e. the amounts at which they are recorded are appropriate. There has been no overstatement or understatement.	Inventory has been recognized at the lower of - cost and - net realizable value in accordance with AS 2 - Inventories. Any costs that could not be reasonably allocated to the cost of production (e.g. general and administrative costs) and

		any abnormal wastage have been excluded from the cost of inventory. An acceptable valuation basis (eg. FIFO, Weighted average etc.) has been used to value inventory as at the period-end.
Rights & Obligations	Entity has the right to assets i.e. (whether the entity has ownership and legal title to assets) and the liabilities recognized in the financial statements represent all the entity's obligations to repayment as at a given date.	The entity owns or controls the inventory recorded in the financial statements i.e. the purchase invoices have been made in the name of client. Any inventory held by the entity on behalf of another entity has not been recognized as part of inventory of the entity. (Eg: Consignment agreements can be checked).
Presentation and Disclosure	Whether particular items in the financial statements are properly classified, described and disclosed. Presentation and disclosure assertions are considered during the course of the audit to determine that disclosures are complete and accurate. The disclosures that are most susceptible to material misstatement are those that require significant judgement and qualitative assessments. Audit teams assess the completeness and accuracy of disclosures by determining that the	Example 1 Inventories (i) Inventories shall be classified as: (a) Raw materials; (b) Work-in-progress; (c) Finished goods; (d) Stock-in-trade (in respect of goods acquired for trading); (e) Stores and spares; (f) Loose tools; (g) Others (specify nature). (ii) Goods-in-transit shall be disclosed under the relevant sub-head of inventories. (iii) Mode of valuation shall be stated. Example 2: For Share capital, a

	disclosures provide information in a manner that does not materially omit, distort or mislead the user. The balances have been appropriately segregated or disaggregated. The related disclosures are understandable in accordance with applicable Financial Reporting framework.	reconciliation of the number of shares outstanding at the beginning and at the end of the reporting period is required to be disclosed in the notes to accounts of the company.
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An overview of Assertions in financial statements

Checkbox	Assertions relating to Income Statement captions
✓	Occurrence
✓	Completeness
✓	Cut Off
✓	Accuracy or Measurement
✓	Presentation and Disclosure

Checkbox	Assertions relating to Balance Sheet captions
✓	Existence
✓	Completeness
✓	Cut Off
✓	Valuation and allocation
✓	Rights & Obligations
✓	Presentation and Disclosure

Test Your Understanding 1

A company is engaged in manufacturing of fabrics from yarn purchased from different suppliers. Occasionally, it also manufactures fabrics tailor made in accordance with requirements of certain mills from yarn received from these mills. The company raises bill of its labour charges only on mills for converting yarn into fabrics. The auditor of company tries to ensure that stocks of the company as at year end do not include stocks pertaining to these mills. Which assertion auditor tries to verify in above situation? How he can ensure that?

Following section defines the various procedures an auditor should design to perform around certain Balance Sheet captions:



3. BALANCE SHEET CAPTIONS

3.1 Share Capital

Every company's lifecycle starts with raising of capital. Other than a private company, every other company issues a prospectus, which may be in the abridged form, or a Statement in lieu of Prospectus, before it proceeds towards allotment of share capital. The Prospectus defines the conditions on which allotment will be made (like minimum subscription), 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 the matter of purchase of shares. These, therefore, should receive a



careful attention of the auditor. He must verify that each party, has performed his part of the contract, within the allotted time. For issue of shares, the companies also enter into certain underwriting contracts which become an important part of verification by the auditor.

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

Brief description	Audit procedures
To establish the EXISTENCE of share capital as at the period-end Equity balances that were supposed to be Recorded have been Recognized in the financial statements. (COMPLETENESS) 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. • In case there is any change, verify whether the paid up capital as at the period-end is within the limits of authorised capital. Authorized capital should be verified by examining MOA. • Obtain the certified copies of relevant resolutions passed at the meetings of board of directors, shareholders authorising the increase/ decrease in authorised share capital, if required, or paid up share capital. • In case of Fresh issue made in the current year, check with compliance of the Companies Act 2013 with regard to Return of Allotment, Minimum Subscription, minimum application money to be collected, maintenance of separate Bank account, payment of underwriting commission as per Sec 40 etc.

- No shares have been issued at Discount (Sec. 53 of the Companies Act, 2013)
- Check if Shares are issued for cash or for Consideration other than cash. (Eg: To promoters for their services, underwriters for commission payable to them etc.)
- Compliance with SEBI regulations and Guidelines.
- Also, obtain and verify copies of forms filed with Ministry of Corporate Affairs (MCA) (Form SH-7, notice to Registrar of any alteration of share capital, Form PAS 3 company making allotment of shares/ securities required to file a return of allotment to the Registrar) and with Reserve Bank of India (Form FCGPR in case of Foreign Direct Investment (FDI) by a Non-resident shareholder) and verify the number of securities issued along with the issue price.
- In case there was increase in share capital, verify whether the Company has accurately calculated the required fee and stamp duty payable to MCA.

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 as premium to securities premium account and state the purpose for which the amount in the account can be applied.

There is no restriction or conditions prescribed in the Act for issue of shares at premium.

	The provisions of this Act relating to reduction of share capital of a company shall apply as if the securities premium account were the paid-up share capital of the company.
	Application of securities premium account: The securities premium account may be applied by the Company for the following purposes: (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. (Buyback) Prescribed Class of Companies are permitted to apply Securities Premium Account: The securities premium account may be applied by such class of companies, as may be prescribed and whose financial statement comply with the accounting standards prescribed for such class of companies under Section 133: (a) in paying up unissued equity shares of the company to be issued to members of the company as fully paid bonus shares; or (b) in writing off the expenses of or the commission paid or discount allowed on

	any issue of equity shares of the company; or (c) for the purchase of its own shares or other securities under section 68. The auditor needs to verify (i) whether the premium received on shares, if any, has been transferred to a "securities premium account" and (ii) whether the application of any amount out of the said "securities premium account" is only for the purposes mentioned above. Shares issued at a discount: According to Section 53 of the Companies Act, 2013, (1) 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. (2) any share issued by a company at a discounted price shall be void. (2A) Notwithstanding anything contained in sub-sections (1) and (2), a company may issue shares at a discount to its creditors when its debt is converted into shares in pursuance of any statutory resolution plan or debt restructuring scheme in accordance with any guidelines or directions or regulations specified by the Reserve Bank of India under the Reserve Bank of India Act, 1934 or the Banking (Regulation) Act, 1949. (3) Where any company fails to comply with the provisions of this section, such company and every officer who is in default shall be liable to a penalty which may extend to an amount equal to the amount raised through the issue of
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	shares at a discount or five lakh rupees, whichever is less, and the company shall also be liable to refund all monies received with interest at the rate of twelve per cent. per annum from the date of issue of such shares to the persons to whom such shares have been issued. The auditor needs to check (i) the movement in share capital during the year and wherever there is any issue, (ii) he should verify that the Company has not issued any of its shares at a discount by reading the minutes of meeting of its directors and shareholders authorizing issue of share capital and the issue price. (iii) Further, auditor should also verify that whether the company has issued shares at a discount to its creditors when its debt is converted into shares in pursuance of any statutory resolution plan or debt restructuring scheme in accordance with any guidelines or directions or regulations specified by the Reserve Bank of India under the Reserve Bank of India Act, 1934 or the Banking (Regulation) Act, 1949.
	Issue of Sweat Equity Shares: According to Section 54 of the Companies Act, 2013, the employees may be compensated in the form of 'Sweat Equity Shares'. "Sweat Equity Shares" mean equity shares issued by the company to employees or directors at a i. discount or ii. for consideration other than cash

	for providing know-how or making available right in the nature of intellectual property rights or value additions, by whatever name called. The auditor needs to verify that the Sweat Equity Shares issued by the company are of a class of shares already issued and following conditions have been complied with (as per Section 54): (a) the issue is authorized by a special resolution passed by the company; (b) the resolution specifies the number of shares, the current market price, consideration, if any, and the class or classes of directors or employees to whom such equity shares are to be issued; (c) omitted (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. Further, the rights, limitations, restrictions and provisions as applicable to equity shares shall be applicable to the sweat equity shares issued under this section and the holders of such shares shall rank pari passu with other equity shareholders.
	Reduction of Capital As a principle of sound financial management, a company is required to keep its capital intact. At times, however, it may become necessary for the company to bring about a reduction in

its capital. Accumulated business losses, assets of reduced or doubtful value like unsound investments proving bad or having paidup capital in excess of the requirements of the company or surplus capital which cannot be employed gainfully, require corrective measures to be taken to keep the financial health of the company in a reasonably well position. Accordingly, the company may find it necessary to reduce its share capital.

Section 66 deals with the reduction of share capital.

For verifying reduction of capital, the auditor needs to examine whether the company has followed the specific requirements as required by Section 66 of the Companies Act, 2013. The auditor shall undertake the following audit procedures:

- (i) Verify that the meeting of the shareholders held to pass the special resolution was properly convened and that the proposal was circularized in advance to all the shareholders;
- (ii) Verify that the Articles of Association authorises reduction of capital;
- (iii) Examine that there has been no default w.r.t repayment of deposits accepted by company or payment of interest on such deposits. Reduction of capital shall not be affected if such default exists.
- (iv) 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;
- (v) Check the Registrar's Certificate as regards to reduction of capital;
- (vi) Vouch the accounting entries recorded

	to reduce the capital and to write down the assets by reference to the resolution of shareholders and other documentary evidence; also check whether the requirements of Schedule III, Part I, have been complied with in relation to presentation; (vii) Confirm whether the revaluation of assets has been properly disclosed in the Balance Sheet;
	(viii) The company may reduce the capital by reduction in unpaid capital or cancellation of lost capital or paying off excess paid up capital. Verify the adjustment made in the members' accounts in the Register of Members and confirm that either the paid-up amount shown on the old share certificates has been altered or new certificates have been issued in lieu of the old, and the old ones have been cancelled; (ix) 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. (x) Check if the company have complied with all the terms and conditions imposed by the tribunal while confirming reduction of share capital. (xi) Verify that the Memorandum of Association of the company has been suitably altered. Exemption to Buy-Back: According to Section 66 (6), nothing in this section shall apply to buy-back of its own securities by a company under Section 68.

	If the Company has made any buyback of securities, ensure compliance of specific requirements as given under section 68 of the Companies Act 2013.
Required DISCLOSURE for equity have been appropriately made	Ensure whether the following disclosure requirements of Schedule III (Part I) to the Companies Act, 2013 have been complied with: Share Capital For each class of share capital (different classes of preference shares to be treated separately): (a) the number and amount of shares authorised; (b) the number of shares issued, subscribed and fully paid, and subscribed but not fully paid; (c) par value per share; (d) a reconciliation of the number of shares outstanding at the beginning and at the end of the reporting period; (e) the rights, preferences and restrictions attaching to each class of shares including restrictions on the distribution of dividends and the repayment of capital; (f) shares in respect of each class in the company held by its holding company or its ultimate holding company including shares held by or by subsidiaries or associates of the holding company or the ultimate holding company in aggregate; (g) shares in the company held by each shareholder holding more than 5 per cent. shares specifying the number of shares held; (h) shares reserved for issue under options and contracts/commitments for the sale of shares/disinvestment, including the

- terms and amounts;
- (i) for the period of five years immediately preceding the date as at which the Balance Sheet is prepared:
- (A) Aggregate number and class of shares allotted as fully paid-up pursuant to contract(s) without payment being received in cash.
- (B) Aggregate number and class of shares allotted as fully paid-up by way of bonus shares.
- (C) Aggregate number and class of shares bought back.
- (j) terms of any securities convertible into equity/preference shares issued along with the earliest date of conversion in descending order starting from the farthest such date;
- (k) calls unpaid (showing aggregate value of calls unpaid by Directors and officers);
- (l) forfeited shares (amount originally paid-up).
- (m) A company shall disclose Shareholding of Promoters* as below:

Shares held by promoters at the end of the year				% Change during the year***
S. No.	Promoter Name	No. of shares	% of total shares**	
Total				

* Promoter here means promoter as defined in the Companies Act, 2013.

** Details shall be given separately for each class of shares

	*** percentage change shall be computed with respect to the number at the beginning of the year or if issued during the year for the first time then with respect to the date of issue.] Where in respect of an issue of securities made for a specific purpose, the whole or part of the amount has not been used for the specific purpose at the balance sheet date, there shall be indicated by way of note how such unutilised amounts have been used or invested.
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Notes:

To be disclosed as Additional Regulatory Information

Utilisation of Borrowed funds and share premium:

- (A) Where company has advanced or loaned or invested funds (either borrowed funds or share premium or any other sources or kind of funds) to any other person(s) or entity(ies), including foreign entities (Intermediaries) with the understanding (whether recorded in writing or otherwise) that the Intermediary shall
- (i) directly or indirectly lend or invest in other persons or entities identified in any manner whatsoever by or on behalf of the company (Ultimate Beneficiaries) or
 - (ii) provide any guarantee, security or the like to or on behalf of the Ultimate Beneficiaries;
- the company shall disclose the following:-
- (I) date and amount of fund advanced or loaned or invested in Intermediaries with complete details of each Intermediary.
 - (II) date and amount of fund further advanced or loaned or invested by such Intermediaries to other intermediaries or Ultimate

Beneficiaries along with complete details of the ultimate beneficiaries.

- (III) date and amount of guarantee, security or the like provided to or on behalf of the Ultimate Beneficiaries
 - (IV) declaration that relevant provisions of the Foreign Exchange Management Act, 1999 (42 of 1999) and Companies Act has been complied with for such transactions and the transactions are not violative of the Prevention of Money-Laundering act, 2002 (15 of 2003);
- (B) Where a company has received any fund from any person(s) or entity(ies), including foreign entities (Funding Party) with the understanding (whether recorded in writing or otherwise) that the company shall
- (i) directly or indirectly lend or invest in other persons or entities identified in any manner whatsoever by or on behalf of the Funding Party (Ultimate Beneficiaries) or
 - (ii) provide any guarantee, security or the like on behalf of the Ultimate Beneficiaries, the company shall disclose the following:-
 - (I) date and amount of fund received from Funding parties with complete details of each Funding party.
 - (II) date and amount of fund further advanced or loaned or invested other intermediaries or Ultimate Beneficiaries along with complete details of the other intermediaries or ultimate beneficiaries.
 - (III) date and amount of guarantee, security or the like provided to or on behalf of the Ultimate Beneficiaries
 - (IV) declaration that relevant provisions of the Foreign Exchange Management Act, 1999 (42 of 1999) and Companies Act has been complied with for such transactions and the transactions are not violative of the Prevention of Money-Laundering act, 2002 (15 of 2003).]

3.2 Reserves and Surplus

Reserves are the amounts appropriated out of profits that are not intended

- to meet any liability,
- contingency,
- commitment or
- diminution in the value of assets known to exist as at the date of the Balance Sheet.

Reserves are a vital source of financing by internal means. The company utilizes the reserves according to the nature and type of such reserve. The reserves can be segregated as **revenue or capital reserves**.

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

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

Capital Reserve represents a reserve which does not include any amount regarded as free for distribution. They can be utilized only for certain limited purposes.

Example

Securities premium, capital redemption reserve.

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

Capital Reserve is created from capital profits earned through sale of capital assets such as sale of fixed assets, profit on sale of shares.

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



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

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

Brief description	Audit procedures
To establish the EXISTENCE of reserves and surplus as at the period-end	Audit procedures Trace and tally the opening balance of reserves and surplus to the previous year audited financial statements. For addition/utilization in current year, in case of:
Reserves and Surplus balances that were supposed to be recorded have been recognized in the financial statements. (COMPLETENESS)	• Profit and Loss balance – • Trace the movement to surplus/ deficit as per the Statement of profit and loss for the year under audit. • The movement should be traced in the Statement of Changes in Equity.
Reserves and Surplus balances have been VALUED appropriately (VALUATION AND ALLOCATION).	• Verify the resolution passed by the board of directors regarding the recommendation of dividend, resolution passed by shareholders declaring the dividend. • Students should note that as per AS-4 (Revised) or IND AS 10, 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. • Securities Premium - It needs to be

	confirmed that the company has issued shares in excess of the nominal value of the shares and for the same, the auditor should obtain and verify the resolution passed by the board of directors. As already discussed under the caption - 'share capital', the utilisation of securities premium account could be done only for limited purposes; auditor needs to ensure the same. (Sec 52 of the Companies Act 2013)
Required DISCLOSURES for reserves and surplus have been appropriately made	Ensure whether the following disclosure requirements of Schedule III (Part I) to the Companies Act, 2013 have been complied with: - Reserves and Surplus shall be classified as: - Capital Reserves; - Capital Redemption Reserve; - Securities Premium 8 [Omitted]; - Debenture Redemption Reserve; - Revaluation Reserve; - Share Options Outstanding Account; - Other Reserves– (specify the nature and purpose of each reserve and the amount in respect thereof); - Surplus i.e., balance in Statement of Profit and Loss disclosing allocations and appropriations such as dividend, bonus shares and transfer to/ from reserves, etc.; (Additions and deductions since last balance sheet to be shown

	under each of the specified heads); (ii) A reserve specifically represented by earmarked investments shall be termed as a "fund". (iii) Debit balance of statement of profit and loss shall be shown as a negative figure under the head "Surplus". Similarly, the balance of "Reserves and Surplus", after adjusting negative balance of surplus, if any, shall be shown under the head "Reserves and Surplus" even if the resulting figure is in the negative.
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3.3 Borrowings

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



Verification of liabilities is as important as that of assets, for, if any liability is omitted or understated or overstated, the financial statements would not show a true and fair view of the state of affairs of the company. Borrowings are monies made available using external sources like bank loans, debentures, public fixed deposits etc.

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

Brief description	Audit procedures
All borrowings on the balance sheet represent valid claims by banks or other third parties. (EXISTENCE)	Review board minutes for approval of new lending agreements. During review, ensure that new loan agreements or bond issuances were authorized. Ensure that significant debt commitments were approved by the board of directors.

	Agree details of loans recorded (interest rate, nature and repayment terms) to the loan agreement. Verify that borrowing limits, if any, imposed by agreements are not exceeded.
	Roll out and obtain independent balance confirmations (SA 505) in respect of all the borrowings from the lender (banks/ financial institutions etc.).
	Agree details of leases and hire purchase creditors recorded to underlying contracts/agreements.
	In case of Debentures, examine trust deed for terms and dates of redemption, borrowing restrictions and compliance with covenants.
	- When debt is retired, ensure that a discharge is received on assets securing the debt. - Obtain Written Representation that all the liabilities which have been recorded represent a valid claim by the lenders.
That all borrowings have been accounted for in the books of the company on a timely basis. (COMPLETENESS)	- Obtain a schedule of short term and long term borrowings (including debts outstanding at the end of the previous year, as well as any new debt or renewal of debt) showing beginning and ending balances and borrowings taken and repaid during the year, and perform the following: (a) Consider any evidence of additional debt obtained through examination of minutes of the board of directors, significant contracts, confirmations from banks/ lenders, support for

	subsequent cash disbursements (when testing payables) etc. (b) Trace the closing balances as per the schedules to the general ledger.
	Review subsequent transactions after the end of the reporting period to determine if there are unrecorded liabilities at year-end and the transactions are recorded in the correct period. (Eg: Fresh loan taken near the balance sheet date)
	Direct confirmation procedures - Roll out and obtain independent balance confirmations in respect of all the borrowings from the lender (banks/ financial institutions etc.) and perform the following: (a) Ascertain that the confirmation asks for all information likely to be relevant to the tests of debt and related interest balances (e.g., applicable interest rates, due dates, collateral and security interests). (b) Send reminders for non-replies. (c) Compare the balances as per the confirmations obtained to the books of the accounts. Ask for reconciliations, if there are any differences and test the supporting documents for the reconciling items on a test check basis.
That liability is recorded at the correct amount. (VALUATION AND ALLOCATION)	Determine that the accounting policies and methods of recording debt are appropriate and applied consistently.

	• Agree loan balance and loan payables to the loan agreement. • Recompute the interest and discount or premium on redemption, if any. • Check computation of the amortization of premium or discount, if any. • For foreign currency loans, check the closing exchange rate(s) used and verify the computations of the restatements of foreign currency balances outstanding at year end. (As per AS 11)
	• Read the provisions in loan and debt agreements and perform the following: (a) Test that the entity is in compliance with loan covenants and other significant provisions of the agreements. (b) If there are any provisions with which the entity is not in compliance, determine whether the debt should be classified as current. If enforcement of the provisions has been waived by the lender in case of breach of any covenant by the entity, obtain confirmation of the waiver from the lender. • Examine the due dates on loans for proper classification between long-term and short-term. • Where instalments of long-term loans falling due within the next twelve months have been disclosed in the financial statements (e.g. in parentheses or by way of a footnote), verify the correctness of the amount of such instalments.

	Examine the debt agreements for any restrictive covenants. Review restrictive covenant and provisions relating to default and ensure disclosure thereof in the financial statements.
	- Examine the important terms in the loan agreements and the documents, if any, evidencing charge in respect of such loans and advances. Examine whether the requirements of the applicable statute regarding creation and registration of charges have been complied with including disclosure of the same to the extent mandated by statute and considered necessary for proper understanding of the user of financial statements. - In case the value of the security falls below the amount of the loan outstanding, examine whether the loan is classified as secured only to the extent of the market value of the security.
	- Examine the hire purchase agreements for the purchase of assets by the entity and ensure the correctness of the amounts shown as outstanding in the accounts, and also examine the security aspect. - He should carefully review the borrowings from related parties and ensure compliance with AS 18 or IND AS 24. - Verify whether liabilities towards bank in respect of bills discounted, bills negotiated, cheques discounted, etc. are correctly reflected and disclosed in the financial statements.

	- The auditor should also verify that the amount borrowed is within the borrowing powers of the company as laid down by the Articles of Association and Memorandum of Association. - Verify that the company has not contravened the restrictions laid down by Section 180 (related to Restrictions on Powers of Board) of the Companies Act, 2013 in respect of the borrowings of the company. Also, check compliance of Sections 185 (related to Loans to Directors, etc.) and 186 (related to Loan and Investment by company) of the Companies Act, 2013. - Examine the purpose for which the amount is borrowed and ensure that the amount is not used against the interest of the company.
	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.
That borrowings have been presented, classified and DISCLOSED in the financial statements in accordance with the requirements of applicable financial reporting framework i.e. the Companies Act, 2013 and applicable Indian GAAP	Ensure whether the following disclosures as required under Schedule III (Part I) to the Companies Act, 2013 are made for each amount disclosed under each of the following headings: Long- Term Borrowings (i) Long-term borrowings shall be classified as: (a) Bonds/debentures; (b) Term loans: (A) from banks. (B) from other parties. (c) Deferred payment liabilities;

	(d) Deposits; (e) Loans and advances from related parties; (f) Long term maturities of finance lease obligations; (g) Other loans and advances (specify nature). (ii) Borrowings shall further be sub-classified as secured and unsecured. Nature of security shall be specified separately in each case. (iii) Where loans have been guaranteed by directors or others, the aggregate amount of such loans under each head shall be disclosed. (iv) Bonds/debentures (along with the rate of interest and particulars of redemption or conversion, as the case may be) shall be stated in descending order of maturity or conversion, starting from farthest redemption or conversion date, as the case may be. Where bonds/debentures are redeemable by instalments, the date of maturity for this purpose must be reckoned as the date on which the first instalment becomes due. (v) Particulars of any redeemed bonds/debentures which the company has power to reissue shall be disclosed. (vi) Terms of repayment of term loans and other loans shall be stated. (vii) Period and amount of continuing default as on the balance sheet date in repayment of loans and interest, shall be specified separately in each case. Other Long term Liabilities Other Long term Liabilities shall be classified as: (a) Trade Payables;
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	(b) Others Short Term Borrowings (i) Short-term borrowings shall be classified as: (a) Loans repayable on demand; (A) from banks. (B) from other parties. (b) Loans and advances from related parties; (c) Deposits; (d) Other loans and advances (specify nature). (ii) Borrowings shall further be sub-classified as secured and unsecured. Nature of security shall be specified separately in each case. (iii) Where loans have been guaranteed by directors or others, the aggregate amount of such loans under each head shall be disclosed. (iv) Period and amount of default as on the balance sheet date in repayment of loans and interest, shall be specified separately in each case. (v) current maturities of Long term borrowings shall be disclosed separately. Where the company has not used the borrowings from banks and financial institutions for the specific purpose for which it was taken at the balance sheet date, the company shall disclose the details of where they have been used.
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Notes:

To be disclosed as Additional Regulatory Information

1. Where the Company has borrowings from banks or financial institutions on the basis of security of current assets, it shall disclose the following:-

- (a) whether quarterly returns or statements of current assets filed by the Company with banks or financial institutions are in agreement with the books of accounts.
- (b) if not, summary of reconciliation and reasons of material discrepancies, if any to be adequately disclosed.

2. Wilful Defaulter*

Where a company is a declared wilful defaulter by any bank or financial institution or other lender, following details shall be given:

- (a) Date of declaration as wilful defaulter,
- (b) Details of defaults (amount and nature of defaults),

* wilful defaulter" here means a person or an issuer who or which is categorized as a wilful defaulter by any bank or financial institution (as defined under the Act) or consortium thereof, in accordance with the guidelines on wilful defaulters issued by the Reserve Bank of India.

3. Registration of charges or satisfaction with Registrar of Companies

Where any charges or satisfaction yet to be registered with Registrar of Companies beyond the statutory period, details and reasons thereof shall be disclosed.

4. Utilisation of Borrowed funds and share premium:

- (A) Where company has advanced or loaned or invested funds (either borrowed funds or share premium or any other sources or kind of funds) to any other person(s) or entity(ies), including foreign entities (Intermediaries) with the understanding (whether recorded in writing or otherwise) that the Intermediary shall
 - (i) directly or indirectly lend or invest in other persons or entities identified in any manner whatsoever by or on behalf of the company (Ultimate Beneficiaries) or

- (ii) provide any guarantee, security or the like to or on behalf of the Ultimate Beneficiaries;

the company shall disclose the following:-

- (I) date and amount of fund advanced or loaned or invested in Intermediaries with complete details of each Intermediary.
 - (II) date and amount of fund further advanced or loaned or invested by such Intermediaries to other intermediaries or Ultimate Beneficiaries alongwith complete details of the ultimate beneficiaries.
 - (III) date and amount of guarantee, security or the like provided to or on behalf of the Ultimate Beneficiaries
 - (IV) declaration that relevant provisions of the Foreign Exchange Management Act, 1999 (42 of 1999) and Companies Act has been complied with for such transactions and the transactions are not violative of the Prevention of Money-Laundering act, 2002 (15 of 2003).;
- (B) Where a company has received any fund from any person(s) or entity(ies), including foreign entities (Funding Party) with the understanding (whether recorded in writing or otherwise) that the company shall:
 - (i) directly or indirectly lend or invest in other persons or entities identified in any manner whatsoever by or on behalf of the Funding Party (Ultimate Beneficiaries) or
 - (ii) provide any guarantee, security or the like on behalf of the Ultimate Beneficiaries, the company shall disclose the following:-
 - (I) date and amount of fund received from Funding parties with complete details of each Funding party.
 - (II) date and amount of fund further advanced or loaned or invested other intermediaries or Ultimate Beneficiaries alongwith complete details of the other intermediaries' or ultimate beneficiaries.

- (III) date and amount of guarantee, security or the like provided to or on behalf of the Ultimate Beneficiaries
- (IV) declaration that relevant provisions of the Foreign Exchange Management Act, 1999 (42 of 1999) and the Companies Act, 2013 has been complied with for such transactions and the transactions are not violative of the Prevention of Money-Laundering act, 2002 (15 of 2003).]

Test Your Understanding 2

A company has availed cash credit facility of ₹ 2 crore (O/s balance ₹ 2 crore as at year end) from a bank for meeting its working capital requirements against security of stocks and debtors and guaranteed by directors of the company. Discuss, how the above cash credit facility, would be classified and disclosed in financial statements of company.

3.4 Trade Receivables

Trade receivable are an essential part of any organisation's balance sheet, often referred to as debtors. Typically, an invoice is raised and issued to the customer with the invoice amount being recorded as a debtor balance. Until the invoice is paid, the invoice amount is recorded in the organization's balance sheet as accounts receivable. If these balances are not recoverable later on, then these amounts need to be written off as bad and charged in the statement of profit and loss.

It is important to carry out Test of Controls for checking the effectiveness of internal control over sales as a part of the debtors' audit procedure. Following points need to be considered in respect of trade receivables:

- Only bona fide sales lead to trade receivables.
- All such sales are made to approved customers.
- All such sales are properly recorded in the books of accounts.
- Once recorded, the debtors can be settled only by receipt of cash or on the authority of a responsible official.
- Segregation of duties at every point in sales transaction. (accounting for debtors, collecting the payments, sending reminders etc.)

- Debtors are collected on time.
- In case debtors are not collected in time, sending reminders and taking legal actions if required.
- Balances are regularly reviewed.
- A proper system of follow up exists and if necessary, adequate provision for bad debt should be made by preparing adequate ageing schedule of the debtors.



After performing Test of Controls over sales, the auditor will decide upon the audit procedure to be applied to verify debtors balance.

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

Brief description	Audit procedures
To establish the EXISTENCE of trade receivables as at the period- end	• Check whether there are controls in place to ensure that invoices cannot be recorded more than once and receivable balances are automatically recorded in the general ledger from the original invoice. • Ask for a period-end accounts receivable ageing report and trace the balance as per the report to the general ledger. • Check whether realization is recorded invoice-wise or not. If not, check that money received from debtors is adjusted chronologically invoice-wise and on FIFO basis i.e. previous bill is adjusted first. If

	realization is made on account, verify whether the Company has obtained confirmations from debtors in respect of the same. • If any large balance is due for a long time, auditor should ask for reasons and justification for the same. Direct confirmation procedures • A significant and important audit activity is to contact customers directly and ask them to confirm the amounts of unpaid accounts receivable as of the end of the reporting period under audit. This should necessarily be done for all significant account balances as at the period- end while certain random customers having smaller outstanding invoices should also be selected. • The auditor employs direct confirmation procedure with the consent of the entity under audit. There may be situations where the management of the entity requests the auditor not to seek confirmation from certain trade receivables. In such cases, the auditor should consider whether there are valid grounds for such a request. In appropriate cases, the auditor may also need to reconsider the nature, timing and extent of his audit procedures including the degree of planned reliance on management's representations. • The trade receivables may be requested to confirm the balances either (a) as at the date of the balance sheet, or (b) as at any other selected date which is reasonably close to the date of the balance sheet. The date should be decided by the auditor in consultation with the Company.
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	The form of requesting confirmation from the trade receivables may be either (a) the form with balance outstanding amount as per the company, wherein the trade receivable is requested to respond whether or not he is in agreement with the balance shown, or (b) the form without any balance mentioned therein, wherein the trade receivable is requested to respond with the balance outstanding as per his records. The use of the form without any balance is preferable.
	- The method of selection of the trade receivables to be circularised should not be revealed to the Company until the trial balance of the trade receivables' ledger is handed over to the auditor. A list of trade receivables selected for confirmation should be given to the entity for preparing request letters for confirmation which should be properly addressed. The auditor should maintain strict control to ensure the correctness and proper despatch of request letters. It should be ensured that confirmations as well as any undelivered letters are returned to the auditor and not to the client. - Any discrepancies revealed by the confirmations received or by the additional tests carried out by the auditor may have a bearing on other accounts not included in the original sample. The Company should be asked to investigate and reconcile the discrepancies, if any.
	Where no reply is received, the auditor should perform alternate procedures regarding the balances. This could include:

	— Agreeing the balance to cash received subsequently; — Preparing a detailed analysis of the balance, ensuring it consists of identifiable transactions and confirming that these revenue transactions actually occurred. (examination in depth for those balances) • 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 the receivables for other than sales or services are not included in the list. • Review a trend line of sales and accounts receivable, or a comparison of the two over time, to check if there are any unusual trends i.e perform analytical procedures. This will enable the auditor to check the reasonableness of balances. Also, measure the average collection period. Make inquiries about reasons for changes in trends with the management and document the same in audit work papers.
All Trade receivable balances that were supposed to be recorded have been recognized in the financial statements. (COMPLETENESS)	• The auditor needs to satisfy himself of the cut-offs. Without a cut-off, sales could be understated or overstated, hence there is a need to perform the following cut off procedure: — For the invoices issued during the last few days (last 5 days of the reporting year) i.e. cut-off date and which have been included in the debtors; check that the goods should have been dispatched and not lying with the Company;

	— Ensure that all goods dispatched prior to the period/ year-end have been invoiced and included in debtors on a test check basis; — Ensure that no goods dispatched after the year- end have been invoiced and included in debtors for the period under audit.
	• 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 or not. • Review the receiving log to see if the Company has recorded an inordinately large amount of customer returns after the audit period, which would suggest that the Company may have shipped more goods near the end of the audit

	period than what the customers had authorized to inflate the profits of the company; • Review the process of giving discounts/incentives and check whether the same were given as per the Company's policy/general industry trends. • Review credit memos, on a sample basis, issued during the audit period to see if they were properly authorized and whether they were issued in the correct period. Also, review credit memos issued after the period end to see if they relate to transactions belonging to the period under audit. Where any deduction has been made against a bill, check the reason and correspondence for the same.
Trade receivable balances have been VALUED appropriately.	• 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). • Also, obtain the list of debtors under litigation and compare with previous year. • Scrutinize the analysis and identify those debtors which appear doubtful; discuss with management about reasons as to why these debtors are not included in the provision for bad debts. Perform further testing where any disputes exist. • He should check if provisions are made at appropriate rates considering the recoverability of amounts due.

	• Prepare schedule of movements of bad debts – Provision accounts and debts written off and compare the proportion of bad debt expense to sales for the current year in comparison to prior years to see if the current expense appears reasonable. • Check that write-offs of the receivable balances have been approved by an appropriate authority i.e. the Board of Directors in case of a company.																												
Required DISCLOSURE for trade receivables have been appropriately made	• Check that the restatement of foreign currency trade receivables has been done properly in accordance with AS 11. • Proper disclosure of Related Party Transactions regarding receivables have been made as per AS 18 or IND AS 24. • Ensure that the transactions with parties covered under Section 189 (Register of Contracts or Arrangements in which Directors are interested) of the Companies Act, 2013 are reported properly in Companies Auditors’ Report Order (CARO), 2020. Ensure whether the following disclosures as required under Schedule III (Part I) to the Companies Act, 2013 are made for each amount disclosed under the heading “Trade Receivables”. <i>(i) Trade Receivables ageing schedule</i> <table><tr><th></th><th></th><th></th><th></th><th></th><th></th><th>(Amount in ₹)</th></tr><tr><th>Particulars</th><th colspan="5">Outstanding for following periods from due date of payment#</th><th></th></tr><tr><th></th><th>Less than 6 months</th><th>6 months-1 year</th><th>1-2 years</th><th>2-3 years</th><th>More than 3 years</th><th>Total</th></tr><tr><td>(i) Undisputed Trade receivables–considered good</td><td></td><td></td><td></td><td></td><td></td><td></td></tr></table>							(Amount in ₹)	Particulars	Outstanding for following periods from due date of payment#							Less than 6 months	6 months-1 year	1-2 years	2-3 years	More than 3 years	Total	(i) Undisputed Trade receivables–considered good						
						(Amount in ₹)																							
Particulars	Outstanding for following periods from due date of payment#																												
	Less than 6 months	6 months-1 year	1-2 years	2-3 years	More than 3 years	Total																							
(i) Undisputed Trade receivables–considered good																													

	(ii) <i>Undisputed Trade Receivable-considered doubtful</i>						
	(iii) <i>Disputed Trade Receivables considered good</i>						
	(iv) <i>Disputed Trade Receivables considered doubtful</i>						
# similar information shall be given where no due date of payment is specified, in that case disclosure shall be from the date of the transaction. Unbilled dues shall be disclosed separately. <u>(ii) Trade receivables shall be sub-classified as:</u> (a) Secured, considered good; (b) Unsecured, considered good; (c) Doubtful. (iii) Allowance for bad and doubtful debts shall be disclosed under the relevant heads separately. (iv) Debts due by • directors or other officers of the company or any of them either severally or jointly with any other person or • firms or private companies respectively in which any director is a partner or a director or a member should be separately stated.							

3.5 Cash and Cash Equivalents

Cash and cash equivalents 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 i.e. readily convertible into cash and subject to insignificant value risk. Utmost professional skepticism needs to be exercised while auditing such balances as they are prone to misappropriation.



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

Brief description	Audit procedures
To establish the Existence of cash and cash equivalent balances as at the period- end. Cash and cash equivalent balances that were supposed to be recorded have been recorded in the financial statements. (COMPLETENESS)	• Special care is necessary in regard to verification of cash balances. Unless they are checked by surprise, there can be no certainty that the cash produced for inspection was in fact held by the custodian. For this reason, the cash should be checked not only on the last day of the year, but also checked again sometime after the close of the year without giving notice of the auditor's visit either to the entity or to his staff. (Surprise check) • If there are more than one cash balances, e.g., when there is a cashier, a petty cashier, a branch cashier and, in addition, there are imprest balances with employees, all of them should be checked simultaneously, as far as practicable so that the shortage in one balance is not made good by transfer of amount from the others. • It is desirable for the cashier to be present while cash is being counted and he should be made to sign the statement prepared

	containing details of the cash balance counted along with denomination of cash. 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.
	• If there is any rough Cash Book or details of daily balance are separately kept, the auditor should test entries from the rough Cash Book with those in the Cash Book to prove that entries in the Cash Book are correct. • If the auditor finds any slip, chit or I.O.U.s in respect of temporary advances paid to the employees included as part of the cash balance, he should check whether those are approved by an authorized official and recorded in the appropriate accounts. • The auditor should also perform a cash sensitivity analysis by compiling a summary of total cash receipts and payments each month and analyzing the trends to see if there have been variations in any specific month and request brief descriptions from the management. • The auditor needs to obtain bank reconciliation statements (BRS) for all bank accounts maintained by the entity as at the reporting period and additionally need to understand the client's process and periodicity of making the BRS.
	The auditor should ensure that BRS is signed by the authorized personnel so that he is able to assign responsibility in case of any errors. • Verification of BRS shall entail the following: — Tallying the balance as per bank book to the bank confirmation/ statement. — Checking of all material reconciling items included under <i>cheques issued but presented</i> for payment to the

	underlying bank book forming part of books of account. In addition, the auditor should request for bank statements of subsequent period and should verify if the cheques issued have subsequently been cleared by the bank. For all cases where cheques have become stale i.e. 3 months or more have lapsed since the issue date, the same should not appear in the BRS and should instead be taken back to liabilities. — Checking of all material reconciling items included under <i>cheques deposited but not credited</i> by bank by requesting for bank deposit slips, duly acknowledged by bank and verifying if the balances were credited by bank subsequently by tallying to the bank statement of subsequent period. For any instances related to cheques not cleared beyond reasonable time, the auditor should seek brief descriptions from the management and in case such explanations are found to be unsatisfactory, the auditor should verify the revenue recognition related to such parties was in order and as per the Company's revenue recognition policy. — Checking of all material reconciling items included under amounts or charges debited/ credited by bank but not accounted for by requesting for bank statements for the period under audit and tallying the same. If the amounts are found to be material, the auditor should ensure that the management records the adjustments for the same in its books of account. If
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	management does not adjust, the auditor shall consider to qualify his report.
	Direct confirmation procedure • A significant and important audit activity is to contact banks/ financial institutions directly and ask them to confirm the amounts held in current accounts, deposit accounts, EEFC account, cash credit accounts, restrictive use accounts like dividend, escrow accounts as of the end of the reporting period under audit. This should necessarily be done for all account balances as at the period-end. • The Company should be asked to investigate and reconcile the discrepancies, if any, including seeking written explanations/ clarifications from the banks/ financial institutions on any unresolved queries. • The auditor should emphasize for confirmation of 100% of bank account balances. In remote situations, where no reply is received, the auditor should perform additional testing regarding the balances. This testing could include: — Agreeing the balance to bank statement received by the Company or internet/ online login to account in auditor's personal presence; — Sending the audit team member to the bank branch along with the entity's personal to obtain balance confirmation from the bank directly.
Cash and cash equivalent balances have been VALUED appropriately.	In addition to the procedures performed above, the auditor should ensure that all bank accounts holding foreign currency have been restated at the closing exchange rates as per applicable Financial Reporting Framework.

Required DISCLOSURES for cash and cash equivalents have been appropriately made	Ensure whether the following disclosures as required under Schedule III (Part I) to the 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.
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3.6 Inventories

Inventories are assets:

- (a) held for sale in the ordinary course of business;
- (b) in the process of production for such sale; or
- (c) in the form of materials or supplies to be consumed in the production process or in the rendering of services.



As per AS 2 – “Valuation of Inventories”, Inventory is valued at lower of cost and net realisable value. The basis for valuation shall be applied consistently year on year. Any change in accounting policy shall have adequate disclosures in financial statements.

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

Brief description	Audit procedures
To establish the EXISTENCE of Inventories as at the period- end.	• Review entity's plan for performing inventory count. • Ensure that consigned goods have been segregated. • Auditor should participate in the inventory count with the management. • Test counts of inventory by auditor should include: — observing employees are adhering to the agreed plan. — assuring that there is appropriate supervision on the count procedure. — 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. — performing cut-off testing by documenting last 5-10 receiving reports and shipping documents as of the period end.

	— ensuring exclusion of third party stock and damaged or obsolete stock. — ensuring the accounting of all stock sheets. — investigating any significant differences between the physical stock take and the stock records as per books. Further, the auditor should ask the entity's personnel to sign all stock count sheets and also agree the variances observed, if any, to avoid any conflicts. • When the entity uses periodic system for inventory count, it should be undertaken at the end of the period. If the entity uses perpetual system with proper and adequate records, inventory may be counted at interim dates. • Confirm or investigate any inventory of the entity lying with a third party (specifically relevant for cases where the entity gets job work done in its process of production).
Only the inventories held by entity have been recorded in the financial statements and do not include any inventories that belong to third parties but does include inventories owned by the entity and lying with a third party (COMPLETENESS)	• 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 other measurements.

	• Perform purchase and sales cut-off tests. Trace shipping documents (bills of lading and receiving reports, warehouse records, and inventory records) to accounting records immediately before and after year-end. • With respect to tagged inventory, perform tests for omitted transactions and tests for invalid transactions. • Verify the clerical and arithmetical accuracy of inventory listings. • Reconcile physical inventory amounts with perpetual records. • Reconcile physical counts with general ledger control totals. • Reconcile inventories which belong to client but are held with third parties like transporters, warehouses, port authorities etc. • Goods received on consignment basis have been properly segregated from other items of inventory.
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 cheque or payment file). • Evaluate the consigned goods. • Examine client correspondence, sales and receivables records, purchase documents. • Determine existence of collateral agreements. • Review consignment agreements. • Review material purchase commitment agreements.

	• Examine invoices for evidence of ownership i.e. the invoices shall be in the name of the client. • Auditor shall obtain confirmation for significant items of inventory. • For instances of inventory held by third party, the auditor should insist on obtaining declaration from the third party on its business letterhead and signed by an authorized personnel of that third party confirming that the items of inventory belong to the entity and are being held by such third party on behalf of and for the benefit of the entity under audit.
Inventories have been VALUED appropriately and as per generally accepted accounting policies and practices	• Depending on how the business operates, the management may value inventory using First-in first-out (FIFO) or weighted average basis. Consider the reasonableness of the method adopted. • For Raw materials and consumables □ Ascertain what elements of cost are included e.g. carriage inward, non-refundable duties etc. □ If standard costs are used, enquire into basis of standards; how these are compared with actual costs and how variances are analyzed and accounted for/ treated in accounting records. □ Test check cost prices used with purchase invoices received in the month(s) prior to counting. □ Follow up valuation of all damaged or obsolete inventories noted during observance of physical counting with a view to establishing a realistic net realizable value.

	• For Work in progress □ Ascertain how the various stages of production/ value additions 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. • For Finished goods and goods for resale □ Enquire as to what costs are included, how these have been established and ensure that the overheads included have been determined based on normal costs and appear reasonable in relation to the information disclosed in the financial statements. □ Ensure that inventories are valued at net realizable value if they are likely to fetch a value lower than their cost. For any such items, also verify if the relevant semi/ partly processed inventories (work in progress) and raw materials have also been written down.
	Follow up for items that are obsolete, damaged, slow moving and ascertain the possible realizable value of such items. Carefully examine the valuation of obsolete and damaged inventory. For the purpose, request the client to provide inventory ageing split and

	follow up for any inventories which at time of observance of physical counting were noted as being damaged or obsolete. • Compare recorded costs with replacement costs. • Examine vendor price lists to determine if recorded cost is less than current prices. • Calculate inventory turnover ratio. Obsolete inventory may be revealed if ratio is significantly lower. • In manufacturing environments, test overhead allocation rates and ensure that only direct labor, direct material and overhead have been included. • Verify the correct application of lower-of-cost-or-net realizable value principles.
Required DISCLOSURES for inventories have been appropriately made	Ensure whether the following disclosures as required under Schedule III (Part I) to the Companies Act, 2013 have been made: • 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 inventories. • Mode of valuation shall be stated.

3.7 Land, Building, Plant & Equipment, Furniture & Fixtures, Vehicles, Office Equipment, Computers etc. referred to AS “Property, Plant And Equipment” (“PPE”)

The Valuation of PPE becomes a very important aspect of consideration by the auditor in the course of his audit. The auditor should analyze the expenditure incurred on PPE, whether they are of Revenue or Capital in nature.

Recognition Criteria for PPE

The cost of an item of PPE should 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 enterprise, and
- (b) The cost of the item can be measured reliably.

An enterprise evaluates under this recognition principle all its costs on property, plant and equipment at the time they are incurred. These costs include costs incurred:

- (a) initially to acquire or construct an item of property, plant and equipment; and
- (b) subsequently to add to, replace part of, or service it.

Measurement at Recognition

An item of property, plant and equipment that qualifies for recognition as an asset should be measured at its cost.

Elements of Cost

The cost of an item of property, plant and equipment comprises:

- (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.
- (c) the initial estimate of the costs of dismantling, removing the item and restoring the site on which it is located, referred to as decommissioning,

restoration and similar liabilities', the obligation for which an enterprise 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.

Examples of directly attributable costs are:

- (a) costs of employee benefits (as defined in AS 15, Employee Benefits) arising directly from the construction or acquisition of the item of property, plant and equipment;
- (b) costs of site preparation;
- (c) initial delivery and handling costs;
- (d) installation and assembly costs;
- (e) 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
- (f) professional fees.

Examples of costs that are not costs of an item of property, plant and equipment are:

- (a) costs of opening a new facility or business, such as, inauguration costs;
- (b) costs of introducing a new product or service (including costs of advertising and promotional activities);
- (c) costs of conducting business in a new location or with a new class of customer (including costs of staff training); and
- (d) administration and other general overhead costs.

The expenses have to be analysed and properly classified. The revenue expense like regular repairs on assets have to be charged off to the Statement of Profit and Loss.

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



Brief description	Audit procedures
To establish the EXISTENCE of PPE as at the period-end	• Review entity's plan for performing physical verification of PPE i.e. whether performed by own staff or by a third party and the policy regarding periodicity i.e. whether physical verification shall be done on annual basis or once in two years/three years. • Evidence of appropriate supervision of those performing physical verification of PPE should be examined. • Obtain PPE physical verification report backed by the working sheets from the entity and perform the following procedures: — 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 management and depreciation should have ceased to be charged after the date of deletion.
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 (COMPLETENESS)	• Verify the movement in the PPE schedule (asset class-wise like building, Plant & machinery etc.) compiled by the management i.e. Opening balances + Additions during the period – Deletions during the period = Closing balances. Tally the closing balance to the entity's books of account. • Check the arithmetical accuracy of the movement in PPE schedule. Tally the opening balances to the previous year audited financial statements. For additions during the period under audit, obtain a listing of all additions from the management and perform the following procedures: — For all material additions, verify if such expenditure meets the criteria of PPE as per AS 10 (Revised). 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. Verify that the cost of an item of property, plant and equipment is as per AS 10 (Revised). - o Items such as spare parts, stand-by equipment and servicing equipment are recognised in accordance with AS 10 (Revised) when they meet the definition of property, plant and equipment. Otherwise, such items are classified as inventory. Ensure that the entity is not recognizing costs of the day-to-day servicing in the carrying amount of an item of property, plant and equipment. - o Test the purchase invoice, installation certificate or report or other similar

	documentation maintained by the entity to verify the date of addition, for all additions samples of PPE during the period under audit. ○ Verify whether the PPE additions have been approved by authorized personnel. ○ Verify whether proper internal processes and procedures like inviting competitive quotations/ floating tenders etc. were followed prior to finalising the vendor for procuring items of PPE/ awarding of work contract for capital projects by checking the supporting documents of the samples selected. ● 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 disposal of the asset from its active use. Verify the process followed for sale of discarded PPE, for example - inviting competitive quotes, tenders and the basis of calculation of sales proceeds. Verify that the management has accurately recorded the deletion of PPE (original cost and accumulated depreciation up to the date of disposal) and the resultant gain/ loss on disposal of PPE item in the entity's books of account.
PPE have been VALUED appropriately and as per generally accepted accounting policies and practices	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-depreciable like freehold land;

	- Assess that the depreciation method used reflects the pattern in which the asset's future economic benefits are expected to be consumed by the entity. It could be Straight line method, diminishing value method, unit of production method, as applicable. - The auditor should also verify whether the management has done an impairment assessment to determine whether an item of property, plant and equipment is impaired as per the requirements of AS 28 - Impairment of Assets.
The entity has valid legal ownership rights over the PPE claimed to be held by the entity and recorded in the financial statements (RIGHTS AND OBLIGATION)	- 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 and building in particular, the auditor should check the conveyance deed/ sale deed to verify whether the entity is the legal and valid owner or not. - The auditor should insist and verify the original title deeds for all immoveable properties held as at the balance sheet date. - In case the entity has given such immoveable property as security for any borrowings and the original title deeds are not available with the entity, the auditor should request the entity's management for obtaining a confirmation from the respective lenders that they are holding the original title deeds of immoveable property as security. - In addition, the auditor should also verify the register of charges, available with the entity to assess that any charge has been created against the PPE.

Required DISCLOSURES for PPE have been appropriately made	Ensure whether the following disclosures as required under Schedule III (Part I) to the Companies Act, 2013 have been made under the heading “Property, Plant and Equipment”: (i) Classification shall be given as: (a) Land; (b) Buildings; (c) Plant and Equipment; (d) Furniture and Fixtures; (e) Vehicles; (f) Office equipment; (g) Others (specify nature). (ii) Assets under lease shall be separately specified under each class of asset. (iii) A reconciliation of the gross and net carrying amounts of each class of assets at the beginning and end of the reporting period showing additions, disposals, acquisitions through business combinations, amount of change due to revaluation (if change is 10% or more in the aggregate of the net carrying value of each class of Property, Plant and Equipment) and other adjustments and the related depreciation and impairment losses/reversals shall be disclosed separately. (iv) Where sums have been written-off on a reduction of capital or revaluation of assets or where sums have been added on revaluation of assets, every balance sheet subsequent to date of such write-off, or addition shall show the reduced or increased figures as applicable and shall by way of a note also show the amount of the reduction or increase as applicable together with the date thereof for the first five years subsequent to the date of such reduction or increase.
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Notes:

To be disclosed as Additional Regulatory Information

(i) Title deeds of Immovable Property not held in name of the Company

The company shall provide the details of all the immovable property (other than properties where the Company is the lessee and the lease agreements are duly executed in favour of the lessee) whose title deeds are not held in the name of the company in format given below and where such immovable property is jointly held with others, details are required to be given to the extent of the company's share.

Relevant line item in the Balance sheet	Description of item of property	Gross carrying value	Title deeds held in the name of	Whether title deed holder is a promoter, director or relative# of promoter*/director or employee of promoter/director	Property held since which date	Reason for not being held in the name of the company**
PPE -	Land Building	-	-	-	-	**also indicate if in dispute
Investment property	Land Building					
PPE retired from active use and held for disposal-	Land Building					
Others						

#Relative here means relative as defined in the Companies Act, 2013.

*Promoter here means promoter as defined in the Companies Act, 2013.

(ii) Where the Company has revalued its Property, Plant and Equipment, the company shall disclose as to whether the revaluation is based on the valuation by a registered valuer as defined under rule 2 of the Companies (Registered Valuers and Valuation) Rules, 2017.

(iii) Capital-Work-in Progress (CWIP)

(a) For Capital-work-in progress, following ageing schedule shall be given:

CWIP ageing schedule

(Amount in ₹)					
	Amount in CWIP for a period of				Total*
CWIP	Less than 1 year	1-2 years	2-3 years	More than 3 years	
Projects in Progress					
Projects temporarily suspended					

*Total shall tally with CWIP amount in the balance sheet.

- (b) For capital-work-in progress, whose completion is overdue or has exceeded its cost compared to its original plan, following CWIP completion schedule shall be given**:

(Amount in ₹)				
	To be completed in			
CWIP	Less than 1 year	1-2 years	2-3 years	More than 3 years
Project 1				
Project 2				

**Details of projects where activity has been suspended shall be given separately.

3.8 Intangible Assets (comprising Goodwill, Brand/Trademarks, Computer Software etc.)

An intangible asset is an identifiable non-monetary asset, without physical substance, held for use in the production or supply of goods or services, for rental to others, or for administrative purposes. Enterprises frequently spend resources on the acquisition, development, maintenance or enhancement of intangible assets such as scientific or technical knowledge,



design and implementation of new processes or systems, licenses, intellectual property, market knowledge and trademarks (including brand names and publishing titles).

Common examples of items encompassed by these broad headings are computer software, patents, copyrights, motion picture films, customer lists, mortgage servicing rights, fishing licenses, import quotas, franchises, customer or supplier relationships, customer loyalty, market share and marketing rights. Goodwill is another example of an item of intangible nature which either arises on acquisition or may be internally generated.

Not all the items described in above paragraph will meet the definition of an intangible asset, that is, identifiability, control over a resource and expectation of future economic benefits flowing to the enterprise. If an item covered by this Standard 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.

As per AS 26 – Intangible Assets, internally generated goodwill should not be recognized as an asset.

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 licence 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. 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.

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

Brief description	Audit procedures
To establish the EXISTENCE of intangible fixed assets as at the period- end	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 beyond the date of deletion.
All additions to Intangible assets during the period under audit have been recorded appropriately in the financial statements. (COMPLETENESS)	Verify the movement in the intangible assets schedule (asset class wise like software, designs/ drawings, goodwill etc.) compiled by the management i.e. Opening balances + Additions – Deletions = Closing balances. Tally the closing balances to the entity's books of account.

	• Check the arithmetical accuracy of the movement in intangible assets schedule. 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 whether such expenditure meets the criterion for recognition of an intangible asset as per AS 26. □ Ensure that no intangible asset arising from research (or from the research phase of an internal project) should be recognised. Expenditure on research (or on the research phase of an internal project) should be recognised as an expense when it is incurred. Check the certificate or report or other similar documentation maintained by the entity to verify the date of use of the intangible which could be linked to date of commencement of commercial production/ economic use to the entity, for all additions to intangible assets during the period under audit. □ Verify whether the additions (acquisitions) have been approved by appropriate entity's personnel. □ Verify whether proper internal processes and procedures like inviting competitive quotations/ proper tenders etc. were followed prior to finalizing the vendor for procuring item of intangible assets by testing those documents on a sample basis. • In relation to deletions of intangible assets, understand from the management the reason and rationale for deletion and the manner of disposal. Obtain the
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	management approval and disposal note authoring disposal of the asset from its active use. Verify the process followed for sale of discarded asset, example inviting competitive quotes, tenders and the basis of calculation of sales proceeds. Verify that the management has accurately recorded the deletion of intangible asset (original cost and accumulated amortization up to the date of disposal) and the resultant gain/ loss on disposal in the entity's books of account.
Intangible assets 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 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 whether the management has done an impairment assessment to determine whether an intangible asset is impaired. For this purpose, the auditor needs to verify whether the entity has applied AS 28 - Impairment of Assets for determining the manner of reviewing the carrying amount of its intangible asset, determining the recoverable amount of the asset to determine impairment loss, if any.

The entity has valid legal ownership rights over the Intangible Assets claimed to be held by the entity and recorded in the financial statements (RIGHTS AND OBLIGATION)	In addition to the procedures for verifying completeness of additions to intangible assets during the period under audit, the auditor while performing testing of additions should also verify that all expense invoices/ purchase contracts are in the name of the entity that entitles legal title of ownership to the entity.
Required DISCLOSURES for Intangible Assets have been appropriately made	Ensure that the following disclosures as required under Schedule III (Part I) to the Companies Act, 2013 have been made <i>under the heading "Intangible Assets":</i> (i) <i>Classification shall be given as:</i> (a) <i>Goodwill;</i> (b) <i>Brands /trademarks;</i> (c) <i>Computer software;</i> (d) <i>Mastheads and publishing titles;</i> (e) <i>Mining rights;</i> (f) <i>Copyrights, and patents and other intellectual property rights, services and operating rights;</i> (g) <i>Recipes, formulae, models, designs and prototypes;</i> (h) <i>Licences and franchise;</i> (i) <i>Others (specify nature).</i> (ii) <i>A reconciliation of the gross and net carrying amounts of each class of assets at the beginning and end of the reporting period showing additions, disposals, acquisitions through business combinations, amount of change due to revaluation (if change is 10% or more in the aggregate of the net carrying value of each class of intangible assets) and other adjustments and the related depreciation and impairment losses or reversals shall be disclosed separately.</i>

	(iii) Where sums have been written-off on a reduction of capital or revaluation of assets or where sums have been added on revaluation of assets, every balance sheet subsequent to date of such write-off, or addition shall show the reduced or increased figures as applicable and shall by way of a note also show the amount of the reduction or increase as applicable together with the date thereof for the first five years subsequent to the date of such reduction or increase.
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Notes:

To be disclosed as Additional Regulatory Information.

Intangible assets under development:

- (a) For Intangible assets under development, following ageing schedule shall be given:

Intangible assets under development ageing schedule

(Amount in ₹)					
	Amount in CWIP for a period of				Total*
Intangible asset under development	Less than 1 year	1-2 years	2-3 years	More than 3 years	
Projects in Progress					
Projects temporarily suspended					

* Total shall tally with the amount of Intangible assets under development in the balance sheet.

- (b) For Intangible assets under development, whose completion is overdue or has exceeded its cost compared to its original plan, following Intangible assets under development completion schedule shall be given**:

(Amount in ₹)				
	To be completed in			
Intangible asset under development	Less than 1 year	1-2 years	2-3 years	More than 3 years
Project 1				
Project 2				

***Details of projects where activity has been suspended shall be given separately.*

3.9 Trade Payables and Other Current Liabilities

Liabilities in addition to borrowings (discussed above), include trade payables and other current liabilities, deferred payment credits and provisions. A liability is considered to be current if it is due to be paid within twelve months and held primarily for the purpose of being traded in the entity's normal operating cycle. E.g. Short term debt, dividends etc. Verification of liabilities is as important as that of assets, considering if any liability is omitted or understated or overstated, the financial statements would not show a true and fair view of the state of affairs of the entity.



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

Brief description	Audit procedures
To establish the EXISTENCE of trade payables and other current liabilities as at the period-end	- Check whether there are controls in place to ensure that any purchase/ expense invoice does not get recorded more than once and payable balances are automatically recorded in the general ledger at the time of recording of expense. - Obtain the accounts payable ageing report and trace its balances to the general ledger. If there are any differences, investigate reconciling items. Journal entries specially for large amounts should be carefully examined.

	Direct confirmation procedure An important audit activity is to contact vendors directly/independently and ask them to confirm the amounts of accounts payable as of the end of the reporting period under audit. This should necessarily be done for all significant account payable balances as at the period-end and for parties from whom material purchases have been made during the period under audit even if period-end balance of such parties is not significant.
	• The auditor employs direct confirmation procedure with the consent of the entity under audit. There may be situations where the management of the entity requests the auditor not to seek confirmation from certain trade payables. In such cases, the auditor should consider whether there are valid grounds for such a request. In appropriate cases, the auditor may also need to reconsider the nature, timing and extent of his audit procedures including the degree of planned reliance on management's representations. • The trade creditors may be requested to confirm the balances either (a) as at the date of the balance sheet, or (b) as at any other selected date which is reasonably close to the date of the balance sheet. The date should be decided by the auditor in consultation with the Company. • The form of requesting confirmation from the trade creditor may be either (a) the form with balance as at year end wherein the trade creditor is requested to respond whether or not he is in agreement with the balance shown, or (b) the form with no balance wherein the trade creditor is requested to respond the balance as per his records. The use of the form with no balance is preferable.

- 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. The auditor should maintain strict control to ensure the correctness and proper dispatch of request letters. In the alternative, the auditor may request the client to furnish duly authorised confirmation letters and the auditor may fill in the names, addresses and the amounts relating to trade creditors selected by him and mail the letters directly. It should be ensured that confirmations as well as any undelivered letters are returned to the auditor and not to the client.
- 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:
 - Testing of subsequent payments in respect of the trade payables to whom confirmations were rolled out but no replies received;

	□ Agreeing the details of the respective balance to the underlying vendor invoices; □ Preparing a detailed analysis of the balance, ensuring it consists of identifiable transactions and confirming that these purchases/ expense transactions actually occurred. (examination in depth)
	• If there are any related party payables, review whether they were properly authorized and the value of such transactions were reasonable and at arm's length. • Review a trend line of purchases/ expenses and accounts payable, or a comparison of the two over time, to see if there are any unusual trends. Make inquiries about reasons for changes in trends from the management.
Trade payables and liability balances that were supposed to be recorded have been recognized in the financial statements. (COMPLETENESS)	• The auditor needs to perform the following cut off procedures: □ For the last 5 invoices received/ recorded at the end of the reporting date (cut off date) and which have been included in the trade payables; the goods should have been received/ risk and rewards of ownership in goods should have been transferred in favour of the entity; □ All goods received prior to the period/ year- end should have been booked in the form of purchases and included in trade creditors. • Test purchases/ expenses on a sample basis selecting the same from the accounts payable ledgers and checking their supporting documents to ensure that the purchases were recorded at the correct amounts and correct dates.

	Match purchase invoice dates to the gate entry (inward) dates to check whether the purchases are being recorded in the correct accounting period. This can include an examination of purchase/ expense invoices received subsequent to the period being audited, to see if they should have been included in the period under audit.
	- 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. Enquire from the entity's management if there has been any dispute with the customer and if there is any additional liability to be recorded. For all such advances, the auditor should verify the underlying documentation based on which the entity had received the advance. - In relation to statutory dues liability like withholding tax (TDS) payable, GST payable, luxury tax payable, professional tax payable, PF and ESI payable etc., prepare a reasonability with respect to sales/ purchases/ employee benefit expenses. Example- GST liability for last month may be calculated by applying the applicable rate to the sales made and in case of any variance with the GST liability recorded by the entity, reasons for variance should be requested from client and in case found satisfactory, the same should be maintained as part of audit documentation. Similarly, Provident Fund liability for last month may be calculated by applying the applicable rate to the employee benefit expense and in case of any

	variance with the liability recorded by the entity, reasons for variance should be requested from client and in case found satisfactory, the same should be maintained as part of audit documentation. Further, the auditor should obtain and verify the challans for deposits made subsequent to the period-end for all statutory liabilities as at the balance sheet date and also analyse the reasons, if any, in consultation with the management for any variance between the amounts deposited subsequently vis-à-vis the liability recorded in books of account. • He shall prepare a complete list of all statutory dues and consider his reporting requirements under CARO,2020.
Trade payables and other liability balances have been VALUED appropriately.	• 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, and the list of vendors with whom the Company has disputes and any claims from customers, under litigation and compare with previous year. • Check that write backs in the liability balances assessed as no longer payable have been approved by an appropriate and authorised member of senior management, for example – CEO/MD.
	• Check that the restatement of foreign currency trade payables has been done properly in accordance with AS 11. Understand management's process to identify the principal amount and the interest due

	thereon (if any) remaining unpaid to any Micro, Small and Medium Sized Enterprises suppliers at the end of accounting year. Test check the management process to assess if the auditor could rely on the management process.
Required DISCLOSURES for trade payables and other liabilities have been appropriately made	Ensure whether the following disclosures as required under Schedule III (Part I) to the Companies Act, 2013 have been made: • Whether the Company has disclosed the following details relating to micro 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.

- **Trade payables due for payment**

The following ageing schedule shall be given for Trade payables due for payment:-

Trade Payables ageing schedule

(Amount in ₹)					
Particulars	Outstanding for following periods from due date of payment#				
	Less than 1 year	1-2 years	2-3 years	More than 3 years	Total
(i) MSME					
(ii) Others					
(iii) Disputed Dues-MSME					
(iv) Disputed Dues Others					

similar information shall be given where no due date of payment is specified in that case disclosure shall be from the date of the transaction.

Unbilled dues shall be disclosed separately.

Other Current Liabilities

- Whether the amount disclosed under other current liabilities are classified as below:
 - Current maturities of finance lease obligations
 - Interest accrued but not due on borrowings
 - *Interest accrued and due on borrowings*
 - Income received in advance
 - Unpaid Dividends
 - *Application money received for allotment of securities and due for refund and interest accrued thereon. Share application money includes advances towards allotment of share capital. The terms and conditions including the*

	<i>number of shares proposed to be issued, the amount of premium, if any, and the period before which shares shall be allotted shall be disclosed. It shall also be disclosed whether the company has sufficient authorised capital to cover the share capital amount resulting from allotment of shares out of such share application money. Further, the period for which the share application money has been pending beyond the period for allotment as mentioned in the document inviting application for shares along with the reason for such share application money being pending shall be disclosed. Share application money not exceeding the issued capital and to the extent not refundable shall be shown under the head Equity and share application money to the extent refundable, i.e., the amount in excess of subscription or in case the requirements of minimum subscription are not met, shall be separately shown under "Other current liabilities";</i> □ Unpaid matured deposits/debentures and interest accrued thereon □ <i>Unpaid matured debentures and interest accrued thereon</i> □ Others (specify nature).
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3.10 Loans and Advances and Other Current Assets

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

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



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

Brief description	Audit procedures
To establish the EXISTENCE of loans and advances and other current assets as at the period-end	For establishing existence of loans and advances, direct confirmation procedures, similar to those performed for Accounts receivable balances are should be performed with the only difference that while performing circularisation of direct confirmations, in addition to the principal amount, interest receivable, if any, as per the agreed terms between the parties, may also be included as part of the balance to be confirmed.
Loans and advances and other current asset balances that were supposed to be recorded have been recognized in the financial statements. (COMPLETENESS)	- Obtain a list of all advances and other current assets and compare them with balances in the ledger. - Verify loan agreements and acknowledgements of parties in respect of outstanding loans. A loan or an advance, if material, is granted only if authorised by the Memorandum and
	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. • If there are any related party loans and advances, review whether they were properly authorized and the value of such transactions were reasonable and at arm's length. • In relation to balances with statutory authorities like GST input credit, prepare a reasonability with respect to purchases/ expenses by applying the applicable rate to the purchases/ expenses and in case of any variance with the asset recorded by the entity, reasons for variance should be requested from the entity. • Further, the auditor should obtain statutory returns filed with the authorities like GST returns and verify whether the amount recorded as per books of account tallies with the claim made with the authorities.
Loans and advances and other current asset balances have been VALUED appropriately.	• 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. Also, obtain the list of loans and advances under litigation and compare with previous year. • Scrutinize the analysis and identify those loans and advances that appear doubtful; discuss with management about the reasons as to why these loans/ advances are not included in the provision for doubtful balances. • Assess bad loans/ advances write-offs. Prepare schedule of movements on Bad loans/ advances – Provision Accounts and loans/ advances written off. • Check that write-offs or other reductions in the recoverable balances have been approved by the authorised and appropriate senior authority • Check that the restatement of foreign currency loans and advances/ other current assets has been done properly in accordance with AS 11
Required DISCLOSURE for loans and advances and other current assets have been appropriately made	Ensure whether the following disclosures as required under Schedule III (Part I) to the Companies Act, 2013 have been made: <u>Long Term loans & Advances</u> (i) <i>Long-term loans and advances shall be classified as:</i> • <i>Capital Advances;</i> • <i>Loans and advances to related parties (giving details thereof);</i> • <i>Other loans and advances (specify nature).</i> (ii) <i>The above shall also be separately sub-classified as:</i>

	(a) Secured, considered good; (b) Unsecured, considered good; (c) Doubtful. (iii) Allowance for bad and doubtful loans and advances shall be disclosed under the relevant heads separately. (iv) Loans and advances due by • Directors or other officers of the company or any of them either severally or jointly with any other persons or • amounts due by firms or private companies respectively in which any director is a partner or a director or a member should be separately stated. <u>Short-term loans and advances</u> (i) Short-term loans and advances shall be classified as: (a) Loans and advances to related parties (giving details thereof); (b) Others (specify nature). (ii) The above shall also be sub-classified as: (a) Secured, considered good; (b) Unsecured, considered good; (c) Doubtful. (iii) Allowance for bad and doubtful loans and advances shall be disclosed under the relevant heads separately. (iv) Loans and advances due by • directors or other officers of the company or any of them either severally or jointly with any other person or • amounts due by firms or private companies respectively in which any director is a partner or a director or a member shall be separately stated.
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Notes:**To be disclosed as Additional Regulatory Information**

- (i) Following disclosures shall be made where Loans or Advances in the nature of loans are granted to promoters, Directors, KMPs and the related parties (as defined under the Companies Act, 2013,) either severally or jointly with any other person, that are:
- (a) repayable on demand or
 - (b) without specifying any terms or period of repayment

Type of Borrower	Amount of loan or advance in the nature of loan outstanding	Percentage to the total Loans and Advances in the nature of loans
Promoters		
Directors		
KMPs		
Related Parties		

3.11 Provisions and Contingent Liabilities

A provision is a liability which can be measured only by using a substantial degree of estimation.

A provision is recognised when:

- (i) an entity has a present obligation (legal or constructive) as a result of a past event;
- (ii) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and
- (iii) a reliable estimate can be made of the amount of the obligation.

If the above conditions are not met, no provision is recognised.

Example

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

A contingent liability is:

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

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

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

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

Brief description	Audit procedures
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. (COMPLETENESS) Provision balances have been valued appropriately. (VALUATION AND ALLOCATION)	• Obtain a list of all provisions and compare them with balances in the ledger. • Inspect the underlying agreements like agreement with customers to assess warranty commitments, any legal and other claims on the entity i.e. litigations. • Obtain the underlying working and the basis for each of the provisions made, from the management and verify whether the same is complete and accurate. • Wherever required, obtain expert's report, calculation and underlying working for the provision amount, example for warranty involving complex calculations, some entities get that valued through an actuary. In such a case, the auditor may request the management to share the actuarial valuation report and in case of any matter under legal dispute, the auditor should request for assessment made by a legal expert in relation to likelihood of a liability devolving on the entity i.e.

	whether probable or possible or remote as defined above. The auditor should then verify the underlying assumptions used by the expert with the data shared by the management.
	• 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 an outside party. ▪ Whether the expert is independent in respect of the entity. ▪ Auditor’s previous experience of the work of the expert. ▪ Knowledge of the expert, his qualification, membership of a professional body or industry association, etc. □ Obtain an understanding of the work of that expert: ▪ Whether the auditor has expertise to evaluate the work of the expert. ▪ Evaluating the assumptions and methods used by the management. ▪ Evaluating the nature of internal or external data used by the expert.

	□ 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. □ The auditor shall obtain written representation from the management that it has made all the provisions which were required to be made as per the recognized accounting principles.
Required DISCLOSURE for provisions have been appropriately made	Ensure whether the following disclosures as required under Schedule III (Part I) to the Companies Act, 2013 have been made: <u>Long-term provisions</u> <i>The amounts shall be classified as:</i> (a) Provision for employee benefits; (b) Others (specify nature). <u>Short-term provisions</u> <i>The amounts shall be classified as:</i> (a) Provision for employee benefits. (b) Others (specify nature). <u>Contingent liabilities and commitments (to the extent not provided for)</u> (i) <i>Contingent liabilities shall be classified as:</i> (a) Claims against the company not acknowledged as debt; (b) Guarantees; (c) Other money for which the company is contingently liable.

	(ii) <i>Commitments shall be classified as:</i> (a) <i>Estimated amount of contracts remaining to be executed on capital account and not provided for;</i> (b) <i>Uncalled liability on shares and other investments partly paid;</i> (c) <i>Other commitments (specify nature).</i> <i>In terms of AS 29, "Provisions, Contingent Liabilities and Contingent Assets", ensure whether following disclosures have been made:</i> • For each class of provision, an enterprise shall disclose: □ 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. • An enterprise shall disclose the following for each class of provision: □ 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
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	□ the amount of any expected reimbursement, stating the amount of any asset that has been recognized for that expected reimbursement. • Unless the possibility of any outflow in settlement is remote, <i>an enterprise should disclose for each class of contingent liability at the balance sheet date a brief description of the nature of the contingent liability and, where practicable:</i> □ an estimate of its financial effect □ an indication of the uncertainties relating to <i>any outflow</i>; and □ the possibility of any reimbursement. Where any of the information required by above paragraph is not disclosed because it is not practicable to do so, that fact should be stated.
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Other information as per requirement of Part I, Schedule III, to be disclosed as Additional Regulatory Information

1. Details of Benami Property held

Where any proceedings have been initiated or pending against the company for holding any benami property under the Benami Transactions (Prohibition) Act, 1988 (45 of 1988) and the rules made thereunder, the company shall disclose the following:-

- (a) Details of such property, including year of acquisition,
- (b) Amount thereof,
- (c) Details of Beneficiaries,
- (d) If property is in the books, then reference to the item in the Balance Sheet,
- (e) If property is not in the books, then the fact shall be stated with reasons,

- (f) Where there are proceedings against the company under this law as an abettor of the transaction or as the transferor then the details shall be provided,
- (g) Nature of proceedings, status of same and company's view on same.

2. Relationship with Struck off Companies

Where the company has any transactions with companies struck off under section 248 of the Companies Act, 2013 or section 560 of the Companies Act, 1956, the Company shall disclose the following details:-

Name of struck off Company	Nature of transactions with struck off Company	Balance outstanding	Relationship with the Struck off company, if any, to be disclosed
	Investments in securities		
	Receivables		
	Payables		
	Shares held by struck off company		
	Other outstanding balances (to be specified)		

3. Following Ratios to be disclosed:-

- (a) Current Ratio,
- (b) Debt-Equity Ratio,
- (c) Debt Service Coverage Ratio,
- (d) Return on Equity Ratio,
- (e) Inventory turnover ratio,
- (f) Trade Receivables turnover ratio,
- (g) Trade payables turnover ratio,
- (h) Net capital turnover ratio,
- (i) Net profit ratio,

- (j) Return on Capital employed,
- (k) Return on investment.

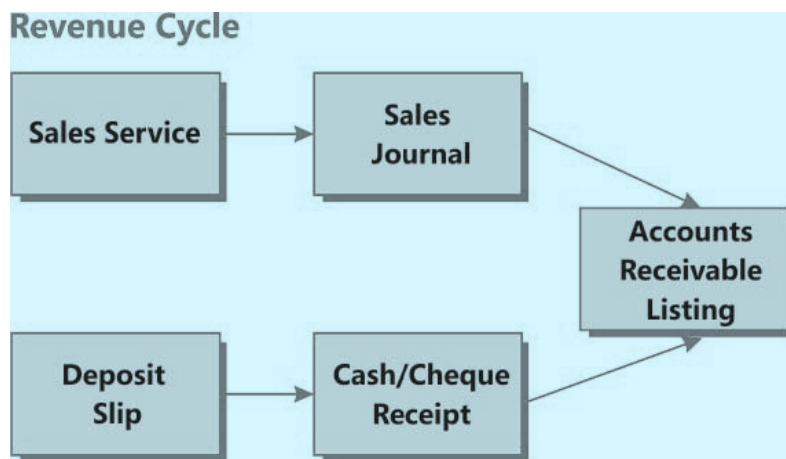
The company shall explain the items included in numerator and denominator for computing the above ratios. Further explanation shall be provided for any change in the ratio by more than 25% as compared to the preceding year.

4. STATEMENT OF PROFIT AND LOSS-CAPTIONS

4.1 Sale of Products and Services

The sales and collections cycle in a business refers to the set of processes that begin when a customer purchases goods or services and ends when the entity receives complete payment against the sales. Sales is one of the most important item in the financial statements which will have a considerable effect on the profit generated, closing stock etc. As per SA 315, the risk of material misstatement in case of revenue items is generally high.

As part of the year-end audit of an entity's financial statements, auditors test sales transactions and the internal controls over those transactions to ensure that the entity is not materially misstating its revenues or accounts receivable.



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

Example

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

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

Example

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

2. An auditor tests the controls the entity has set up for the sales cycle to determine how strong and reliable they are. If they are strong and operating effectively, the auditor can reduce the extent of substantive testing. Any deficiencies in the internal control shall be communicated as per SA 265.

Example

Common internal controls over the sales cycle include pre -numbered sales invoices, proper authority for approval of orders, execution of sales order, 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 to ensure that the control being tested is a numbered sales invoice. This will enable the auditor to determine the nature, timing and extent of his substantive procedures to be applied.

Example

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

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

Example

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

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

Brief description	Audit procedures
Recorded sales represent goods shipped/ services performed during the period (OCCURRENCE)	• 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. □ Test check few invoices with their relevant entries in sales journal. □ Obtain confirmation from few customers to ensure genuineness of sales transaction □ Whether any fictitious customers and sales have been recorded. □ Whether any shipments were done without the consent and agreement of the customer, especially at the year end to inflate the sales figure

	□ 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 • Calculate the ratio of sales return to sales and compare it with previous year and enquire for the reasons for increase/ decrease. • Check the sales return with sales invoice, challan, credit note, stock register, etc.
All sales made during the period were recorded and there is no understatement or overstatement. (COMPLETENESS)	• Perform cut-off procedures to ensure that revenues are recognised in the current accounting period and sales were not tampered towards the period end. • Cut-off errors will usually arise when companies recognise revenue based on the date on which the sales invoices are generated rather than the date on which the risks and rewards are transferred to the buyer. In order to perform a robust sales cut-off test, auditors need to understand and consider the specific cut-off error risk of each engagement. • Auditors should also verify the credit notes issued after the accounting period. Sometimes sales team or sales personnel can make fictitious sales before the year-end to meet performance target and cancel out those sales with a post year end credit note. • Trace from the shipping documents to the sales journal. • Check whether quantity is appearing in sales register or not and check reconciliation of total sales/goods dispatched as per stock

	records and financial records and statutory records like GST. Review GST tax and GST returns and ensure that the same are reconciled with revenue reported in the profit and loss account. Verify reasonability say of GST by applying the applicable rate to the gross sales value and compare the amount of GST as per statutory returns and analyze the reasons for variance, if any.
All sales are accurately measured as per applicable accounting standards and correctly journalized, summarized, and posted (ACCURACY OR MEASUREMENT)	- Trace a few transactions from inception to completion. (Examination in depth) E.g: Take few sales transaction, and check from the receipt of sales order to the payment of receivable balance, every underlying document to ensure if it is properly recorded at every stage and measured accurately taking into consideration all the incentives, discounts, if any. The recognition shall be according to the revenue recognition policy of the entity. - if the client is engaged in export sales, then compliance with AS 11 shall be ensured. - Auditor must understand client's operations and related GAAP issues e.g. point of sale revenue recognition vs. percentage of completion, wherever applicable. - Compare the rate of sales affected with related parties and review them for collectability, as well as whether they were properly authorized and the value of such transactions were reasonable and at arm's length.
Required DISCLOSURE for sales have been appropriately made	Ensure whether the following disclosures as required under Schedule III (Part II) to the Companies Act, 2013 have been made: (A) In respect of a company other than a finance company revenue from operations shall disclose separately in the notes revenue from—

	(a) Sale of products; (b) Sale of services; (ba) Grants or donations received (relevant in case of section 8 companies only),] (c) Other operating revenues; Less: (d) Excise duty. (B) In respect of a finance company, revenue from operations shall include revenue from— (a) Interest; and (b) Other financial services. Revenue under each of the above heads shall be disclosed separately by way of notes to accounts to the extent applicable. • Whether brokerage and discount on sales other than usual trade discount has been disclosed. • Whether the transactions with related parties are appropriately disclosed in notes to accounts.
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4.2 Other Income comprising interest income, dividend income, Gain/ Loss on sale of investments etc.

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

- **Interest income** on fixed deposits is recognized on a time proportion basis taking into account the amount outstanding and the applicable interest rate.
- **Dividends** are recognised in the statement of profit and loss only when:
 - (i) the entity's right to receive payment of the dividend is established;
 - (ii) it is probable that the economic benefits associated with the dividend will flow to the entity; and

(iii) the amount of the dividend can be measured reliably.

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

Brief description	Audit procedures
Recorded other income was earned during the Period (OCCURRENCE) Other income earned during the period was appropriately recorded and there in no understatement or overstatement. (COMPLETENESS) Other income has been measured appropriately as per the applicable accounting standards (ACCURACY OR MEASUREMENT)	• 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 recomputing i.e. multiplying the deposit amount with the applicable rate and number of days during the period under audit. □ For deposits still outstanding as at the period- end, trace the same to the direct confirmations obtained from the respective bank/ financial institution. □ Obtain a confirmation of interest income from the bank and verify that the interest income as per bank reconciles to the calculation shared by the entity. □ Also, obtain a copy of Form 26AS (TDS withholding by the bank/ financial institution) and reconcile the interest reflected

	therein to the calculation shared by client.
	- For Dividends, verify that the same are recognised in the statement of profit and loss only when the entity's right to receive payment of the dividend is established. - Verify that Gain/(loss) on sale of investment in mutual funds is recorded as other income only on - transfer of title from the entity AND - is determined as the difference between the redemption price and carrying value of the investments. For the purpose, obtain the mutual fund statement and trace the gain / loss as recorded in the books of account to the gain/ loss as reflected in the statement.
Required DISCLOSURE for other income have been appropriately made	Ensure whether the following disclosures as required under Schedule III (Part II) to the Companies Act, 2013 have been made: Other income Other income shall be classified as: (a) Interest Income (in case of a company other than a finance company); (b) Dividend Income; (c) Net gain/loss on sale of investments; (d) Other non-operating income (net of expenses directly attributable to such income).

Note:**To be disclosed as Additional Information****Undisclosed income**

The Company shall give details of any transaction not recorded in the books of accounts that has been surrendered or disclosed as income during the year in the tax assessments under the Income Tax Act, 1961 (such as, search or survey or any other relevant provisions of the Income Tax Act, 1961), unless there is immunity for disclosure under any scheme and also shall state whether the previously unrecorded income and related assets have been properly recorded in the books of account during the year.

4.3 Purchases

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

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

1. An auditor needs to identify the control points over purchases e.g. whether segregation of duties exist, whether competitive quotes are invited, whether a purchase committee exists who authorises purchase price, issues and authorizes purchase orders, when and how the goods are received and acknowledged, who checks the quality, quantity and specifications of the goods received and prepares Goods Receipt Note (GRN), who approves the vendor invoice, whether a 2 way/ 3 way match process exists (i.e. tally between purchase order, GRN and vendor invoice), how the purchases have been recognised in the system.

2. An auditor tests the controls the entity has set up for the purchase cycle to determine whether they are effective or not. If the controls are effective, the auditor can reduce the extent of substantive testing. Common internal controls over the purchase cycle include inviting competitive quotations for shortlisting the vendors, numbered purchase orders, purchase order authorization over a certain limit, generation of GRN on receipt of goods, quality inspection of goods, 2 way/ 3-way match, authorization of purchase invoices, appropriate authority to recognise the purchases in the system.
3. The auditor selects a random sample of transactions and examines the related purchase orders, GRN, purchase invoices, inward gate entry register and vendor reconciliation/ statements.
4. Performing substantive 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. E.g: If the purchase price is 100 and if 15000 units were received under multiple orders during the year, the auditor expects the purchases to be 15,00,000. If there is a variance in the amount recorded in the books, he shall check for additional details like discounts received, change of purchase price for few orders due to excess demand etc.

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

Brief description	Audit procedures
Recorded purchases represent goods actually received/ services availed during the period (OCCURRENCE)	Ensure purchases are not understated/ overstated by performing following audit procedures: - Whether any fictitious vendors have been booked or purchases have been recorded by reviewing the vendor selection process followed by the entity and also performing procedures to ensure existence of the vendors. - Whether the goods were received at the factory gate and whether there exists an entry in the security gate inward register

	• 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 entity has recorded the purchase in its books of account. • Purchase invoice should have been booked only once risk and reward incidental to ownership has been transferred to the entity. Specific consideration for cases where the terms of delivery as agreed with vendor are F.O.B., C.I.F. etc. • Purchase invoice should be in the name of entity. However, in case of different 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 tax returns filed with the authorities and tally the input tax as reflected in the books to the amount disclosed in the returns. • In case of purchases made from related parties or allied and associated concerns, the auditor needs to verify if requisite approval from Board of Directors
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	(appropriate authority) has been obtained and should verify the selected samples and perform analytical procedures in relation to price of goods to confirm that the price charged is at arm's length.
	- 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.
All purchases made during the period were recorded and there in no understatement or overstatement. (COMPLETENESS) All purchases have been measured appropriately (ACCURACY OR MEASUREMENT)	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, say, last 5 transactions at the period end to check that all corresponding invoices have been duly entered in the Purchases book and none have been omitted. - Ensure correct accounting treatment of goods – in – transit as per the agreed terms with the vendor regarding transfer of risk and reward of ownership in goods. - Obtain written representation from the management that all the purchases that took place during the year have been properly recorded in the books. - 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 the management, if any significant variations are found. □ Stock Composition Analysis: Auditor to collect the reports from management for composition of stock i.e. raw materials as a percentage of total stock and compare the same with previous year and ask for reasons from management in case of significant variations.
	□ Ratios: Auditor should compare the creditors turnover ratios and stock turnover ratios of the current year with previous years. □ Auditor should review quantitative reconciliation of closing stocks with opening stock, purchases and consumption.
Required DISCLOSURES for purchases have been appropriately made	Ensure whether the following disclosures as required under Schedule III (Part II) to the Companies Act, 2013 have been made: • Whether purchases of stock-in-trade have been specifically disclosed. • Whether changes in inventories of finished goods, stock-in-trade and work-in-progress have been specifically disclosed. • Whether the transactions with related parties are appropriately disclosed in notes to accounts.

4.4 Employee Benefits Expenses

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

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

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

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

Brief description	Audit procedures
Recorded employee benefit expenses were actually incurred during the period	• Obtain an understanding of entity's process of capturing employee attendance. There is always a risk that an

(OCCURRENCE) Employee benefit expenses pertaining to the period have been recorded appropriately (COMPLETENESS) Employee benefit expenses have been measured appropriately. There is no understatement or overstatement. (ACCURACY OR MEASUREMENT)	entity could record expense for fictitious employees. To address this risk, the auditor may choose to meet the employees in person, on a sample basis. Further, the auditor may choose to select a sample of employees and ask the payroll department to share their bank details/ identity proofs of the employees. • Obtain a list of employees as at the period-end along with a monthly movement split between new hires, leavers and continuing employees. • For a sample (selected randomly) of new hires, obtain the appointment letter and verify whether the salary for first month and subsequent months was processed as per the agreed terms. • For a sample (selected randomly) of resigned employees, obtain their full and final computation and verify whether all their dues including post-retirement benefits like gratuity, leave encashment have been paid and whether the respective employee's acknowledgement on final computation has been obtained. • Obtain the monthly salary registers for all 12 months. Compile a monthly payroll reasonability by calculating the average salary per employee per month and compare with the previous year and preceding month and analyse the reasons for variance which could be attributable to annual increments, an 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, etc.

	• In case provident fund (PF), employee state insurance (ESI) are applicable to the entity, compile a reasonability by applying the rate to the basic wages and comparing to the amount recorded in books and analyse reasons for variance, if any. Also, obtain monthly deposit challans to verify if the month on month liability was subsequently deposited with the authorities and within the defined timelines. • Perform analytical procedures to obtain audit evidence as to overall reasonableness of employee benefit expenses which may include production per employee analysis. Auditor should analyse units produced per employee and compare the same with previous years and present industry trends and ask for the reasons from the management, if any significant variations are found.
Required DISCLOSURES for employee benefit expenses have been appropriately made	Ensure whether the following disclosures as required under Schedule III (Part II) to the Companies Act, 2013 have been made: (a) Employee Benefits Expense [showing separately (i) salaries and wages, (ii) contribution to provident and other funds, (iii) expense on Employee Stock Option Scheme (ESOP) and Employee Stock Purchase Plan (ESPP), (iv) staff welfare expenses].

4.5 Depreciation and Amortisation

One of the key principles of accrual basis of accounting requires that an asset's cost is proportionally expensed based on the period over which the asset is expected to be used. Both depreciation and amortization are methods that are used to prorate

the cost of a specific type of asset over its useful life. Depreciation represents systematic allocation of the depreciable value of an item of PPE over its useful life while amortisation represents systematic allocation of the depreciable amount of an intangible asset over its useful life.

Depreciation and amortisation generally constitute an entity's significant part of overall expenses and have direct impact on the profit/ loss of the entity, hence auditors need to verify and ensure that such expenditure is appropriate, accurately calculated and has been accounted as per applicable provisions of the Companies Act, 2013 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 the Companies Act, 2013/ applicable accounting standards.
- The accounting policy has been applied consistently year on year. Any change in the accounting policy has been adequately disclosed.
- 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.
- Whether each part of an item of PPE with a cost that is significant in relation to the total cost of the item have been depreciated separately.

Example: It may be appropriate to depreciate separately the airframe and engines of an aircraft, whether owned or subject to a finance lease.

- Whether the most appropriate depreciation method for each separately depreciable component has been used.

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

Brief description	Audit procedures
Depreciation and amortization expenses pertaining to the period have been recorded appropriately and there is 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, at least 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 and depreciation calculations. ▪ 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 and not from the date of actual usage. In other words, depreciation of an asset begins when it is available for use, i.e., when it is in the location and condition necessary for it to be capable of operating in the manner intended by the management. ▪ 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 the Companies Act, 2013 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. For example- Re-compute the depreciation expense for the year. ▪ Ensure that the depreciation and amortization has been charged as per the useful lives of PPE and intangible assets. ▪ Ensure that residual values have been properly verified as that impacts the computation of depreciation. ▪ Ensure that the depreciation and amortization has been computed prospectively whenever there is any change in useful lives of PPE and intangible assets.

Required disclosures for depreciation and amortisation have been appropriately made	Ensure whether the following disclosures as required have been made: ▪ Accounting policy for depreciation and amortization. ▪ Useful lives of assets as per Schedule II to the Companies Act, 2013. ▪ Residual value of assets. ▪ Depreciation method.
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4.6 Other Expenses like Power and Fuel, Rent, Repair to Building, Plant and Machinery, Insurance, Travelling, Legal and Professional, Miscellaneous Expenses

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

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

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

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

Brief description	Audit procedures
Recorded other expenses were actually incurred during the period Other expenses pertaining to the period have been recorded appropriately and there is 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 required to be recorded on a straight-line basis during the period under audit. - Also, verify if the agreement is in the name of the entity and whether the expense pertains to premises used for running business operations of the entity. 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.
	Insurance expense - - Obtain a summary of insurance policies taken along with their validity period. - Verify whether the expense has been correctly classified between prepaid and expense for the period based on number of days.

	Legal and professional expenses - • Obtain a month-wise and consultant-wise summary. • In case of monthly retainerhip agreements, verify whether the expenditure for all 12 months has been recorded correctly. • For non- recurring expenses, select a sample and vouch for the attributes discussed above. • The auditor should be cautious while vouching for legal expenses as the same may highlight a dispute for which the entity may not have made any provision and the matter may also not have been discussed/ highlighted to the auditor for his specific consideration. Travel, repair and maintenance, printing and stationery, miscellaneous expenses – • The auditor should select a sample and vouch for the attributes discussed above. Wherever possible, the auditor should try to 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 of production analysis. • Auditor should analyse expense per unit produced and compare the same with previous years and present industry trends and ask for the reasons from the management, if any significant variations are found.
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Required DISCLOSURE 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.
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Notes:

To be disclosed as Additional Information

1. Corporate Social Responsibility (CSR)

Where the company covered under section 135 of the Companies Act, 2013 the following shall be disclosed with regard to CSR activities:-

- amount required to be spent by the company during the year,
- amount of expenditure incurred,
- shortfall at the end of the year,
- total of previous years shortfall,
- reason for shortfall,
- nature of CSR activities,
- details of related party transactions, e.g., contribution to a trust controlled by the company in relation to CSR expenditure as per relevant Accounting Standard,
- where a provision is made with respect to a liability incurred by entering into a contractual obligation, the movements in the provision during the year should be shown separately.

2. Details of Crypto Currency or Virtual Currency

Where the Company has traded or invested in Crypto currency or Virtual Currency during the financial year, the following shall be disclosed:-

- (a) profit or loss on transactions involving Crypto currency or Virtual Currency
- (b) amount of currency held as at the reporting date,
- (c) deposits or advances from any person for the purpose of trading or investing in Crypto Currency/ virtual currency.

Test Your Understanding 3

Various ratios of current year and preceding year are disclosed in financial statements of a company in accordance with requirements of Schedule III of the Companies Act, 2013. Discuss requirements of law in this regard (Do not list out names of ratios)

Test Your Understanding 4

An auditor of a company is focusing upon revenues of a company. In this regard, besides performing usual detailed checking of sales, he wants to perform substantive analytical procedures in respect of sales. Discuss how he can perform such procedures.

Test Your Understanding 5

While verifying depreciation charged to statement of profit and loss account of a company, it is noticed by auditor that one new machinery was purchased and installed in month of April. The necessary trials were carried out and machinery was ready for use in April itself. However, owing to lack of orders in the market, the said machinery was put into actual operation from 1st October. The company has, accordingly, provided depreciation in its books on this machinery w.e.f. 1st October. Is above recording of deprecation by company proper in its books?

CASE STUDY

Sunsteel Ltd. is a company engaged in the manufacture of variety of stainless steel household items ranging from hot pot, pressure cooker, cutlery set, bottles, to serving trays. The company has its corporate office in Delhi and its plant in Raigarh, a city in the state of Chhattisgarh. The company is planning to expand its manufacturing activities by setting up two new plants in the Raipur district of the state. For this purpose, the company also raised funds by making a follow-on public offer during the financial year 2025-26. R K Maheshwari & Associates are the statutory auditors of the company since the year 2023-24. The engagement team consisted of 5 members, with CA Raman as the engagement partner, CA Madhu as the senior associate and three articled trainees namely, Aman, Chetanya and Depesh.

The company raised fresh capital of ₹ 5 Cr during the FY 2025-26. The shares with the nominal value of ₹ 10 per share were issued at a premium of ₹ 5 per share.

The company has the Reserves and Surplus totaling to ₹ 2 Cr, comprising of securities premium and general reserve.

CA Raman directed CA Madhu to verify the issue of the share capital in detail giving special consideration to the utilization of the securities premium amount.

The audit engagement team discussed with the management about the performance of the company during the year under consideration. To this, the management told the engagement team that the company is performing very well and the company has doubled its revenue during the year as compared to the last year. The management of the company also told the auditors that during the year the company has made majority of its sales on credit basis to its customers. CA Raman directed Mr. Aman to send balance confirmation requests to debtors having balance in excess of ₹ 1 lakh.

During the course of audit, CA Raman, Chetanya and Depesh also visited the power plants in Raigarh to get a detailed understanding of the manufacturing process. The team performed analytical procedures to obtain audit evidence with respect to the overall reasonableness of purchase quantity and price of inventory. More specifically, Chetanya collected the reports from the management for composition of stock i.e. raw materials as a percentage of total stock and compared the same

with the data of the previous year. CA Raman and Chetanya thereafter, discussed the reasons for the variations with the management.

Also, while considering the presentation and disclosure requirements as per Schedule III to the Companies Act, 2013 CA Madhu discussed with CA Raman the disclosure with respect to the following account balances:

- Current maturities to long term borrowings
- Long term maturities of finance lease obligations
- Interest accrued but not due on borrowings
- Interest accrued and due on borrowings

Based on the above facts, answer the following questions:

1. Which of the following is not correct with respect to shares issued at premium and securities premium account in terms of Section 52 of the Companies Act, 2013?
 - (a) 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.
 - (b) The securities premium account can be applied by the company in paying up unissued equity shares of the company to be issued to members of the company as fully paid bonus shares.
 - (c) The securities premium account cannot be applied by the company in writing off the expenses of or the commission paid or discount allowed on any issue of equity shares of the company.
 - (d) The securities premium account can be applied by the company for the purchase of its own shares or securities under section 68.
2. Which of the following is not an example of capital reserve?
 - (a) Revaluation reserve arising from revaluation of fixed assets
 - (b) Securities Premium
 - (c) Capital redemption reserve
 - (d) General reserve

3. **Statement 1:** *Confirmations as well as undelivered letters should be given/ returned to the auditor and not to the client.*

Statement 2: *When no reply is received, the auditor should perform alternate procedures regarding the balances.*

- (a) *Only statement 1 is correct*
 - (b) *Only statement 2 is correct*
 - (c) *Both statements 1 & 2 are correct*
 - (d) *Both statements 1 & 2 are incorrect*
4. *Mr. Chetanya performed which of the following analytical procedures to obtain the audit evidence with respect to the overall reasonableness of purchase quantity and price of raw material?*
- (a) *Consumption Analysis*
 - (b) *Stock Composition Analysis*
 - (c) *Reasonableness test*
 - (d) *Ratio analysis*
5. *Which of the following is not correct with respect to the disclosure requirements of Schedule III to the Companies Act, 2013?*
- (a) *Current maturities of long term borrowings is to be disclosed under the head long term borrowings*
 - (b) *Long term maturities of finance lease obligations is to be disclosed under the head long term borrowings*
 - (c) *Interest accrued but not due on borrowings is to be disclosed under the head Other Current Liabilities*
 - (d) *Interest accrued and due on borrowings is to be disclosed under the head Other Current Liabilities*

Answers to Questions involving case study

1.	(c)	2.	(d)	3.	(c)	4.	(b)	5.	(a)
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Important Note:

Students are advised to refer Advanced Accounting Study Material (Paper-1) wherever reference to Accounting Standards is given and also to Corporate and Other Laws Study Material (Paper-2) wherever reference to Sections of the Companies Act, 2013 is given.

SUMMARY

- ◆ Assertion refers to the representations by management, explicit or otherwise, that are embodied in the financial statements, as used by the auditor to consider the different types of potential misstatements that may occur.
- ◆ Assertions pertaining to Balance sheet captions comprise of existence, completeness, cut-off, rights and obligations, valuation and presentation and disclosure.
- ◆ Assertions pertaining to Income statement captions comprise of occurrence, completeness, cut-off, measurement and presentation and disclosure.
- ◆ Audit procedures are performed by auditor to verify assertions pertaining to Balance sheet captions and income statement captions.
- ◆ Requirements of Schedule III of the Companies Act, 2013 have to be kept in mind while verifying assertions in case of a company.
- ◆ Performance of such audit procedures to verify these assertions leads to obtaining of audit evidence which is evaluated by auditor.

For a concise revision of the key concepts covered in this chapter, students may refer to the Saransh Booklet for Paper 5: Auditing and Ethics, which serves as a useful last-mile revision resource for examination preparation. Saransh Booklet can be accessed at <https://resource.cdn.icai.org/85998bos-aps751-int-p5.pdf>

TEST YOUR KNOWLEDGE

MCQs based Questions

1. *An auditor is verifying purchases to ensure their genuineness. Consequently, he is also trying to verify that no fake "trade payables" are present in financial statements. Which assertions concerning purchase transactions and trade payables respectively are being verified by auditor?*
 - (a) *Occurrence; Existence*
 - (b) *Occurrence; Completeness*
 - (c) *Existence; Occurrence*
 - (d) *Completeness; Occurrence*
2. *Which of the following statement is most appropriate as regards to disclosure of goods in transit in financial statements of a company?*
 - (a) *No separate disclosure of goods in transit is required.*
 - (b) *Disclosure of total goods in transit under head of inventories is required.*
 - (c) *Disclosure of goods in transit under each sub-head of inventories is required.*
 - (d) *Disclosure of goods in transit for raw material and finished goods is required.*
3. *Sweat Equity shares are issued by a company at a discount or for consideration other than cash to its:-*
 - (a) *Directors only*
 - (b) *Clients only*
 - (c) *Directors or employees*
 - (d) *Auditors only*
4. *Which of the following is not an element of cost of an item of machinery included under head "Property, Plant and Equipment"?*
 - (a) *Installation costs*
 - (b) *Freight cost of bringing the item to its location*

- (c) *Inaugural costs*
 - (d) *Employee benefit cost for making such an item suitable for production*
5. Which of the classification is not required by a company in respect of its "Cash and cash equivalents?"
- (a) *Balance with Banks*
 - (b) *Balance with scheduled banks*
 - (c) *Cash on hand*
 - (d) *Cheques on hand*

Correct/Incorrect

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

1. *Employee benefits expenses represent the sum an entity pays to its employees for their labour/ efforts only.*
2. *Dividends are recognised in the statement of profit and loss only when the entity's right to receive payment of the dividend is established.*
3. *"Sweat Equity Shares" means equity shares issued by the company to employees or directors at a premium or for consideration other than cash for providing know-how or making available right in the nature of intellectual property rights or value additions, by whatever name called.*
4. *Capital reserves represent profits that are available for distribution to shareholders held for the time being or any one or more purpose.*
5. *A capital reserve, generally, can be utilised for writing down fictitious assets or losses or (subject to provisions in the Articles) for issuing bonus shares if it is realised.*
6. *If Company X's balance sheet shows building with carrying amount of ₹ 100 lakh, the auditor shall assume only one point that the management has only asserted that the building recognized in the balance sheet exists as at the period-end.*
7. *The securities premium account may only be applied by the Company towards the issue of unissued shares of the company to the members of the company as fully paid bonus shares.*

8. *Material and wages are considered to be revenue expenditure when incurred for construction of building.*
9. *PPE are depreciated when the asset is actually put to active use.*
10. *Increase in authorised capital of the company requires special resolution to be passed at the general meeting.*
11. *Capital redemption reserve can be used for distribution of dividends.*
12. *Dividends are recommended by the Board, and declared by the Shareholders.*
13. *In verifying Trade Receivables balance, Direct Confirmation Procedure is one of the important audit activity.*

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.*
5. *ABC Ltd. has issued shares for cash at a premium. 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. Advise the means in which the amount in the account can be applied.*
6. *The auditor A of ABC & Co.- firm of auditors is conducting the audit of XYZ Ltd and while performing testing of additions wanted to verify that all PPE (Property Plant and Equipment) purchase invoices are in the name of the entity*

he is auditing. For all additions to land, building in particular, the auditor desires to have concrete evidence about ownership. The auditor is worried about whether the entity has valid legal ownership rights over the PPE claimed to be held by the entity and recorded in the financial statements. Advise the auditor.

7. *Write the audit Procedure for verification of existence of Trade Receivables.*
8. *MNO & Associates are the statutory auditor of Venus Ltd. for the FY 2025-26. During the course of audit, one of the audit team members, Mr. Viaan noticed that the company has made loans totaling to ₹ 50 lakhs to the promoters of the company, namely, Mr. Raj and Mr. Rajeew without specifying the period of repayment. Mr. Viaan discussed with Mr. Manik, the engagement partner, about the disclosure requirements with respect to such loans required by Schedule III to the Companies Act, 2013. What should Mr. Manik advise Mr. Viaan?*
9. *What are the disclosures requirements as per Part I of Schedule III to the Companies Act, 2013 with respect to the cash & cash equivalents held by a company?*
10. *Mercury Ltd. is a company engaged in the manufacture of floor mats. The company sells its goods on credit. The debtors balance as on 31.03.2026 amounted to ₹ 20 cr. What is the disclosure requirement as per Schedule III to the Companies Act 2013, with respect to the ageing schedule of debtors of the company?*
11. *You are the statutory auditor of Jupiter Ltd. for the FY 2025-26. During the course of audit, you noticed that the company has PPE under construction i.e. Capital Work in Progress. What disclosures should the company give with respect to the ageing schedule of such capital work in progress as required by Schedule III to the Companies Act, 2013?*
12. *The auditor of Saturn Ltd. wants to verify whether the company has valid legal ownership rights over the inventories recorded in the balance sheet as on 31.03.2026. What audit procedures should the statutory auditor of the company perform?*
13. *ABC & Co., a Chartered Accountant firm, has been appointed as the statutory auditors of Pen Private Limited for the F.Y 2025-26. During the audit, one of the team members, Mr. R noticed that Pen Private Limited has purchased*

software amounting to ₹2.00 crore and the said software is not an integral part of the related hardware. Mr. R further observed that Pen Private Limited has conducted some research of an internal project work amounting to ₹1.00 crore. Pen Private Limited, following Indian GAAP, has presented the aforesaid details in the Balance Sheet as on 31st March, 2026 as follows:

Property, Plant, and Equipment	₹
- Software	2.00 crore
- Research	1.00 crore

Mr. R approached the engagement partner with above details and enquired about the correctness of the presentation made by Pen Private Limited in terms of Schedule III to the Companies Act, 2013. Mr. R further wanted to ensure that all additions to Intangible assets during the year 2025-26 have been recorded appropriately in the financial statements of Pen Private Limited. Guide Mr. R.

14. The accounts team of Infant Garments Private Ltd., while ascertaining the cost of Property, Plant and Equipment (PPE), included various expenses such as:

- Cost of testing a machine: ₹1,80,000
- Cost of inauguration of the new machine: ₹1,00,000

As a Senior auditor, guide the team regarding the recognition criteria of PPE and the elements of costs to be included at the time of recognition.

15. Identify and explain the assertions that the auditor will check by performing the following audit procedures-
- Inventory recognised in the balance sheet actually existed as at the period end.
 - All the items of inventory pertaining to the relevant year shall be included regardless of the location.
 - All goods dispatched prior to the period/ year-end have been invoiced and included in debtors on a test check basis.
 - Examine client correspondence, sales and receivables records, purchase documents.
 - Verifying that the entity has charged depreciation on all items of PPE unless any item of PPE is non-depreciable like freehold land.

16. CA Sohail, while conducting statutory audit of a company, has noticed that there are items such as computer software, patents appearing in its books of accounts. These are identifiable non-monetary assets, without physical substance, held for use in the production or supply of goods or services, for rental to others, or for administrative purposes. He wants to ensure that such items are properly valued in financial statements of the company. Suggest few audit procedures to be performed by him in this regard.
17. SRT Pvt. Ltd., based in Mumbai, is engaged in export of brassware goods. The company has huge export receivables as on 31st March 2026. It is also analysed from Export Sales account of the company that large number of small shipments were almost despatched daily during the month of March 2026. The auditor is ensuring that all goods despatched prior to the year-end have been invoiced. Which assertion concerning trade receivables is being verified by auditor? List out few audit procedures you would adopt as an auditor to verify this assertion.
18. M/s Veer and Associates is appointed as auditor of KMP limited. During the audit, auditor wants to verify that trade payables and liability balances that were supposed to be recorded have been recognized in the financial statements. Which assertion auditor wants to ensure and what audit procedures should be followed by him in this regard?
19. BOTS is a manufacturing entity having material Property, Plant and Equipment (PPE) items in its financial statements. The auditor of the entity wants to verify that PPE items have been valued appropriately as per generally accepted accounting policies and practices. Comment on significance of such verification. Suggest a few audit procedures in this regard.
20. You are appointed as the auditor of JK Apparels Ltd., a public limited company. The company entered into an arrangement during the financial year 2025-26 with one of its promoters Mr. K whose son is a director in JK Apparels Ltd. Under this arrangement, the company acquired an immovable property owned by the promoter. As consideration for the purchase, the company allotted 2% of its equity share capital to the promoter instead of making payment in cash. The title deed of the property has been duly transferred and held in the name of the company.

Discuss the disclosure requirements of Shareholding of Promoters under Schedule III (Part I) of the Companies Act, 2013.
21. While auditing the financial statements of Moon Ltd. for the year ended 31 March 2026, the auditor was verifying the disclosures relating to trade

payables and other liabilities. During the course of the audit, it was noticed that the company has certain outstanding balance payable to Micro and Small Enterprises.

The auditor decided to ensure that the disclosures required under Schedule III of the Companies Act 2013, in respect of such enterprises have been appropriately made in the notes to accounts.

State the disclosures that the auditor should verify in respect of Micro and Small Enterprises while auditing trade payables and other liabilities.

22. *Identify and explain the assertions that the auditor will check by performing the following audit procedures:*
- (i) *Any inventory held by the entity on behalf of another entity has not been recognised as part of inventory of the entity.*
 - (ii) *Employee benefit expense has been incurred during the period in respect of the personnel employed by the entity.*
 - (iii) *Inventory has been recognised at the lower of cost and net realisable value in accordance with AS 2 - Inventories.*
 - (iv) *Sales shall include the despatch of goods made at the year-end as they belong to the relevant period.*
 - (v) *Any inventory held by a third party on behalf of the entity has been included as part of the inventory balance.*
23. *Kyte Private Limited acquired an immovable property of substantial value during the financial year 2025-26, which is recorded in the financial statements as an addition in the Schedule of PPE. The auditor also observed that this immovable property has been mortgaged to a bank for availing credit facilities. How should the auditor verify the rights and obligations assertion for this property to ensure the entity's legal ownership and identify any charges against it?*
24. *CA J is appointed as statutory auditor of Sigma and Beta Limited for the year 2025-26. During the audit he observed trade receivables amounting to ₹ 50 crores are reflected in the financial statements of the company. He wants to obtain sufficient appropriate evidence to conclude that trade receivables have been valued Appropriately. Suggest few audit procedures in this regard.*
25. *Zed Limited is engaged in the manufacturing and export of shoes. The statutory auditor of the company wants to reasonably ensure that only the inventories recorded in the financial statements are exclusively owned by the company and*

do not include any inventories that belong to third parties but includes inventories owned by the company but lying with third party. Advise the auditor on the audit procedures to be performed to achieve this assurance.

26. *While verifying cash and cash equivalents of a company, CA D engagement partner, is very particular that Bank reconciliation statement (BRS) prepared by the management in respect of bank account maintained by the company is proper to rule out misstatements in cash and cash equivalents reflected in the financial statements of the company. The company does not use net banking and prefers to issue cheques to its creditors and receives substantial payments locally through account payee cheques. Which aspects need to be taken care of and verified by CA D in respect of BRS?*
27. *Identify and explain the assertions that the auditor will check by performing the following audit procedures:*
- (i) Employee benefit expenses recognised during the period relates to the current accounting period only.*
 - (ii) Employee benefit expenses in respect of all personnel have been fully accounted for.*
 - (iii) Any inventory held by the entity on behalf of another entity has not been recognised as part of inventory of the entity.*
 - (iv) Recorded sales represent goods which were ordered by valid customers and were despatched and invoiced in the period.*
28. *During the audit of Rapid Industries Private Limited, CA Akshat notices that inventories of raw materials & consumables and work-in- progress amounting ₹ 2.50 crores and ₹ 0.25 crores appear in the financial statements of the company as on March 31st, 2026. He wants to verify that the above-mentioned inventories have been valued appropriately and as per generally accepted accounting policies and practices. How should he proceed to verify the above?*
29. *LMN Ltd., a mid-sized manufacturing company, generates revenue primarily through the sale of consumer electronics in domestic and international market. The company reported sales of ₹ 2 crores in the Financial Year 2025-26. The company generates revenue through sale of standard electronics devices, customized product orders with specific delivery terms and extended warranties and after-sales services.*

The auditor has to verify that all sales are accurately measured as per applicable accounting standards and correctly journalized, summarized and posted in the financial statements,

Explain the audit procedures to ensure the same.

30. *While auditing the accounts of PQR Ltd., a member of the audit team wants to carry out test of controls for checking the effectiveness of internal control over sales as a part of debtor's audit procedure. State any four points that need to be considered in respect of trade receivables.*

ANSWERS/SOLUTIONS

Answers to MCQs

1.	(a)	2.	(c)	3.	(c)	4.	(c)	5.	(b)
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Answers to Correct/Incorrect

- 1. Incorrect:** Employee benefits expenses, commonly called payroll expenses, represent the aggregate sum an entity pays to its employees for their labour/ efforts, as well as associated expenses such as perquisites/ benefits, post-employment benefits like gratuity, superannuation, leave encashment, provident fund contribution etc. as well as towards their hiring, their welfare and training.
- 2. Incorrect:** Dividends are recognised in the statement of profit and loss only when:
 - the entity's right to receive payment of the dividend is established;
 - 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.
- 3. Incorrect:** "Sweat Equity Shares" means equity shares issued by the company to employees or directors at a discount or for consideration other than cash for providing know-how or making available right in the nature of intellectual property rights or value additions, by whatever name called.
- 4. Incorrect:** Revenue reserves represent profits that are available for distribution to shareholders.

5. **Correct:** A capital reserve, generally, can be utilised for writing down fictitious assets or losses or (subject to provisions in the Articles) for issuing bonus shares if it is realised. But the amount of share premium or capital redemption reserve account can be utilised only for the purpose specified in Sections 52 and 55 respectively of the Companies Act, 2013.
6. **Incorrect:** If Company X's balance sheet shows building with carrying amount of ₹ 100 lakh, the auditor shall assume that the management has claimed/ asserted that:
- The building recognized in the balance sheet exists as at the period-end (existence assertion);
 - Company X owns and controls such building (Rights and obligations assertion);
 - The building has been valued accurately in accordance with the measurement principles (Valuation and allocation assertion);
 - All buildings owned and controlled by Company X are included within the carrying amount of ₹ 100 lakh (Completeness assertion).
7. **Incorrect:** The securities premium account may be applied by the Company:
- (a) towards the issue of unissued shares of the company to the members of the company as fully paid bonus shares;
 - (b) in writing off the preliminary expenses of the Company;
 - (c) in writing off the expenses of, or the commission paid or discount allowed on, any issue of shares or debentures of the company;
 - (d) in providing for the premium payable on the redemption of any redeemable preference shares or of any debentures of the company; or
 - (e) for the purchase of its own shares or other securities under section 68.
8. **Incorrect:** Material and Wages incurred on construction of building qualify to be capital expenditure as per AS 10 "Property, Plant and Equipment". Therefore, these have to be added to the cost of the asset i.e building and shall not be expensed off to Statement of Profit and Loss.
9. **Incorrect:** Depreciation is a fall in value of asset due to obsolescence, usage and effluxion of time, Therefore, depreciation is charged when the asset is ready for use. Active use of asset is not a mandatory criteria for charge of depreciation.

10. **Incorrect:** Increase in Authorised capital requires alteration of capital clause of memorandum of Association. Therefore, ordinary resolution is passed for increase in authorised capital of the company as per the Companies Act, 2013.
11. **Incorrect:** Capital Redemption reserve is not a free reserve. It is a restrictive reserve and can be used only for purposes given in the Act. Since it is not a free reserve, it cannot be utilised for payment of dividends. CRR can be used only for the purpose of issuing fully paid up bonus shares.
12. **Correct:** The dividends are recommended by the Board of Directors by passing a resolution at the board meeting. The Shareholders declare the dividends at the AGM by passing an ordinary resolution. Declaration of dividend is an item of ordinary business. However, the shareholders can decrease the amount of dividends recommended by the board but cannot increase it.
13. **Correct:** While auditing trade receivable balance, direct confirmations as per SA 505, is considered to be the most important audit activity. Direct confirmation can be sought from the debtors directly confirming their balance due. The replies to the confirmation can be then matched with the records maintained by the client. Any discrepancies so revealed, can be investigated and checked in detail for possibility of any risk of material misstatement. Auditor selects few debtors' balances and ask the client to prepare the confirmations properly addressed to the debtors. Auditor maintains strict control over this process.

Answer to Theoretical Questions

1. (a) **Goods Sent Out on Sale or Return Basis:**
- (i) Check whether a separate memoranda record of goods sent out on sale or return basis is maintained. The party accounts are debited only after the goods have been sold and the sales account is credited.
 - (ii) Verify that price of such goods is unloaded from the sales account and the trade receivables record. Check the memoranda record to confirm that on the receipt of acceptance from each party, his account has been debited and the sales account correspondingly credited.

- (iii) Ensure that the goods in respect of which the period of approval has expired at the end of the year, have either been received back or customers' accounts have been debited.
 - (iv) Confirm that the inventory of goods sent out on approval, the period of approval in respect of which had not expired till the end of the year lying with the party, has been included in the closing inventory.
- (b) Borrowing from Banks:** Borrowing from banks may be either in the form of overdraft limits or term loans. In each case, the borrowings should be verified as follows-
- (i) Reconcile the balances in the overdrafts or loan accounts with that shown in the pass book(s) and confirm the last mentioned balance by obtaining a certificate from the bank showing the balance in the accounts as at the end of the year.
 - (ii) Obtain independent balance confirmation from the bank showing balances, particulars of securities deposited with the bank as security for the loans or of the charge created on an asset and confirm that the same has been correctly disclosed and duly registered with Registrar of Companies and recorded in the Register of charges.
 - (iii) Verify the authority under which the loan or draft has been raised. In the case of a company, only the Board of Directors is authorised to raise a loan or borrow from a bank.
 - (iv) Confirm, in the case of a company, that the restraint contained in Section 180 of the Companies Act, 2013 as regards the maximum amount of loan that the company can raise has not been contravened.

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

2. (a) Goods Sent on Consignment:

- (i) Verify the accounts sales submitted by the consignee showing goods sold and inventory of goods in hand.

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

(b) Foreign Travel Expenses:

- (i) Examine Travelling Allowance bills submitted by the employees stating the details of tour, details of expenses, etc.
- (ii) Verify that the tour programme was properly authorised by the competent authority.
- (iii) Check the T.A. bills along with accompanying supporting documents such as air tickets, travel agents bill and hotel bills with reference to the internal rules for entitlement of the employees and also make sure that the bills are properly passed.
- (iv) See that the tour report accompanies the T.A. bill. The tour report will show the purpose of the tour. Satisfy that the purpose of the tour as shown by the tour report conforms to the authorisation for the tour.

- (v) Check Reserve Bank of India's permission, if necessary, for withdrawing the foreign exchange. For a company the amount of foreign exchange spent is to be disclosed separately in the accounts as per requirement of Schedule III to the Companies Act, 2013 and Accounting Standard 11 "The Effects of Changes in Foreign Exchange Rates".

(c) Receipt of Capital Subsidy:

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

(d) Provision for Income Tax:

- (i) Obtain the computation of income and income tax prepared by the entity and verify whether it is as per the Income-tax Act, 1961 and Rules made thereunder.
- (ii) Review adjustments, expenses, disallowed special rebates, etc. with particular reference to the last available completed assessment.
- (iii) Examine relevant records and documents pertaining to advance tax, self-assessment tax and other demands.
- (iv) Compute tax payable as per the latest applicable rates in the Finance Act.

- (v) Ensure that overall provisions on the date of the balance sheet is adequate having regard to current year provision, advance tax paid, assessment orders, etc.
- (vi) Ensure that the requirements of AS 22 on Accounting for Taxes on Income have been appropriately followed for the period under audit.

3. Vouching of Payment of Taxes:

- (i) Payment on account of income-tax and other taxes consequent upon a regular assessment should be verified by reference to the copy of the assessment order, assessment form, notice of demand and the receipted challan.
- (ii) Payments or advance payments of income-tax should also be verified with the notice of demand and the receipted challan acknowledging the amount paid.
- (iii) The interest allowed on advance payments of income-tax should be included as income and penal interest charged for non-payment should be debited to the interest account.
- (iv) Nowadays, electronic payment of taxes is also in trend. Electronic payment of taxes means payment of taxes by way of internet banking facility or credit or debit cards.
- (v) The entity can make electronic payment of taxes also from the account of any other person. However, the challan for making such payment must clearly indicate the Permanent Account Number (PAN) of the assessee on whose behalf the payment is made. This should be checked by the auditor.
- (vi) It is not necessary for the entity to make payment of taxes from his own account in an authorized bank. While vouching such e-payment, the auditor should cross verify the payments of taxes through the receipted challan along with PAN No /TAN No. etc.

4. (a) Advertisement Expenses:

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

(b) Sale of Scrap:

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

5. 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.

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

6. 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 the balance sheet date. In case the entity has given such immoveable property as security for any borrowings and the original title

deeds are not available with the entity, the auditor should request the entity's management for obtaining a confirmation from the respective lenders that they are holding the original title deeds of immoveable property as security. In addition, the auditor should also verify the register of charges, available with the entity to assess that any charge has been created against the PPE.

7. For Verification of Existence of Trade Receivables, the auditor should check the following :

- i. Check whether there are controls in place to ensure that invoices cannot be recorded more than once and receivable balances are automatically recorded in the general ledger from the original invoice.

Ask for a period-end accounts receivable ageing report and trace the balance as per the report to the general ledger.

- ii. Check whether realization is recorded invoice-wise or not. If not, check that money received from debtors is adjusted chronologically invoice-wise and on FIFO basis i.e. previous bill is adjusted first.
- iii. If any large balance is due for a long time, auditor should ask for reasons and justification for the same.
- iv. 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.
- v. The auditor should maintain strict control to ensure the correctness and proper despatch of request letters. It should be ensured that confirmations as well as any undelivered letters are returned to the auditor and not to the client.
- vi. 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.
- vii. Where no reply is received, the auditor should perform alternate procedures regarding the balances.
- viii. Agreeing the balance to cash received subsequently;

- ix. Preparing a detailed analysis of the balance, ensuring it consists of identifiable transactions and confirming that these revenue transactions actually occurred. (examination in depth for those balances)
 - x. 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.
 - xi. Check that receivables for other than sales or services are not included in the list.
 - xii. Review a trend line of sales and accounts receivable, or a comparison of the two over time, to check if there are any unusual trends i.e. perform Analytical procedures. Make inquiries about reasons for changes in trends with the management and document the same in audit work papers.
8. Mr. Manik should advise Mr. Viaan to consider whether the following disclosures as required by Schedule III to the Companies Act, 2013, has been made in respect of the loans granted to promoters, namely, Mr. Raj and Mr. Rajeev, either severally or jointly with any other person, that are:
- (a) repayable on demand or
 - (b) without specifying any terms or period of repayment

Type of Borrower	Amount of loan or advance in the nature of loan outstanding	Percentage to the total Loans and Advances in the nature of loans
Promoters		
Directors		
KMPs		
Related Parties		

9. The following are the disclosure requirements as per Schedule III to the Companies Act, 2013, with respect to the cash & cash equivalents held by the company:

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.
- 10.** The following are the disclosure requirement as per Schedule III to the Companies Act 2013, with respect to the ageing schedule of debtors of the company:

Trade Receivables ageing schedule

					(Amount in ₹)	
Particulars	Outstanding for following periods from due date of payment#					
	Less than 6 months	6 months - 1 year	1-2 years	2-3 years	More than 3 years	Total
(i) Undisputed Trade receivables – considered good						
(ii) Undisputed Trade Receivables – considered doubtful						

(iii)	Disputed Receivables considered good	Trade						
(iv)	Disputed Receivables considered doubtful	Trade						

similar information shall be given where no due date of payment is specified, in that case disclosure shall be from the date of the transaction.

Unbilled dues shall be disclosed separately.

11. Capital-Work-in Progress

- (a) For Capital-work-in progress, following ageing schedule shall be given:

CWIP ageing schedule

(Amount in ₹)					
	Amount in CWIP for a period of				Total*
CWIP	Less than 1 year	1-2 years	2-3 years	More than 3 years	
Projects in Progress					
Projects temporarily suspended					

*Total shall tally with CWIP amount in the balance sheet.

- (b) For capital-work-in progress, whose completion is overdue or has exceeded its cost compared to its original plan, following CWIP completion schedule shall be given**:

(Amount in ₹)				
	To be completed in			
CWIP	Less than 1 year	1-2 years	2-3 years	More than 3 years
Project 1				
Project 2				

**Details of projects where activity has been suspended shall be given separately.

12. The statutory auditor of Saturn Ltd. should perform the following audit procedures to verify if the company has valid legal ownership rights over the inventories recorded in the balance sheet as on 31.03.2026. The auditor should:

- vouch recorded purchases to underlying documentation (purchase requisition, purchase order, receiving report, vendor invoice and cancelled cheque or payment file).
- evaluate the consigned goods.
- examine client correspondence, sales and receivables records, purchase documents.
- determine existence of collateral agreements.
- review consignment agreements.
- review material purchase commitment agreements.
- examine invoices for evidence of ownership i.e. the invoices shall be in the name of the client.
- obtain confirmation for significant items of inventory.

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.

13. Where the software is not an integral part of the related hardware, computer software is treated as an intangible asset. Thus, purchase of software, which is not an integral part of related hardware, amounting to ₹ 2 crore by Pen Private Limited should be presented in the Balance Sheet under the head intangible asset not under the head Fixed Asset.

Further, Expenditure on research (or on the research phase of an internal project) should be recognised as an expense when it is incurred. Therefore, presentation of research amounting to ₹ 1 crore of an integral project work by Pen Private Limited under the head Property, Plant and Equipment as Research is not correct as it should be recognised as an expense.

Audit Procedure for ensuring all additions to Intangible assets during the year have been recorded appropriately in the financial statements of Pen Private Limited:

- For all material additions, verify whether such expenditure meets the criterion for recognition of an intangible asset as per AS 26.
- Ensure that no intangible asset arising from research (or from the research phase of an internal project) should be recognised. Expenditure on research (or on the research phase of an internal project) should be recognised as an expense when it is incurred.
- Check the certificate or report or other similar documentation maintained by the entity to verify the date of use of the intangible which could be linked to date of commencement of commercial production/ economic use to the entity, for all additions to intangible assets during the period under audit.
- Verify whether the additions (acquisitions) have been approved by appropriate entity's personnel.
- Verify whether proper internal processes and procedures like inviting competitive quotations/ proper tenders etc. were followed prior to finalizing the vendor for procuring item of intangible assets by testing those documents on a sample basis

14. Recognition Criteria for PPE: The cost of an item of PPE should be recognised as an asset if, and only if:

- (1) It is probable that future economic benefits associated with the item will flow to the enterprise, and
- (2) The cost of the item can be measured reliably.

Elements of Cost to be included at the time of recognition: The cost of an item of property, plant and equipment comprises:

- (1) its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates.
- (2) 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.

- (3) the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located (decommissioning, restoration and similar liabilities), the obligation for which is incurred on acquisition of the asset or as a consequence of its use.

Treatment of expenses given in the question

- **Cost of testing the machine (₹ 1,80,000):** Testing costs incurred to check whether the asset is functioning properly before it is put to use are directly attributable costs and are therefore capitalised as part of the cost of PPE.
 - **Cost of inauguration of the new machine (₹ 1,00,000):** Inauguration expenses are not directly attributable to bringing the asset to the condition necessary for its intended use and do not generate future economic benefits. Hence, such costs are not capitalised and should be charged to the Statement of Profit and Loss.
15. (i) The auditor will check the Existence Assertion to ensure Assets, liabilities and equity balances exist as at the period end.
- (ii) The auditor will check the Cut-off assertion to ensure that all assets and liabilities are reported in the appropriate period.
- (iii) The auditor will check Completeness Assertion to ensure all Trade receivable balances that were supposed to be recorded have been recognized in the financial statements.
- (iv) The auditor will check Rights & Obligations assertion to ensure that the entity has valid legal ownership rights over the inventories claimed to be held by the entity and recorded in the financial statements.
- (v) The auditor will check Valuation and allocation assertion to ensure PPE have been valued appropriately and as per generally accepted accounting policies and practices
16. Computer software and patents are examples of intangible assets. The value of intangible assets may diminish due to efflux of time, use and/ or obsolescence. The diminution of the value represents cost to the entity for earning revenue during a given period. Unless this cost in the form of amortization is charged to the accounts, the profit or loss would not be correctly ascertained, and the values of intangible asset would be shown at higher amounts.

The auditor should: -

- Verify that the entity has charged amortization on all intangible assets;
- Verify that the amortization method used reflects the pattern in which the asset's future economic benefits are expected to be consumed by the entity.
- The auditor should also verify whether the management has done an impairment assessment to determine whether an intangible asset is impaired. For this purpose, the auditor needs to verify whether the entity has applied AS 28 Impairment of Assets for determining the manner of reviewing the carrying amount of its intangible asset, determining the recoverable amount of the asset determine impairment loss, if any.

- 17.** In the given situation, the auditor is verifying Completeness assertion by ensuring that all goods dispatched prior to the year-end have been invoiced.

Audit procedures to be adopted by the auditor to verify the Completeness assertion are as under:

- Check that in respect of invoices raised in last few days nearing the cut-off date, goods have been actually dispatched and not lying with the company.
- 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 or not.

- Review the receiving log to see if the Company has recorded an inordinately large amount of customer returns after the audit period, which would suggest that the Company may have shipped more goods near the end of the audit period than what the customers had authorized to inflate the profits of the company.
- Review the process of giving discounts/ incentives and check whether the same were given as per the Company's policy/ general industry trends.

18. Refer Completeness in Para 3.9

19. 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. Therefore, such verification is significant.

Audit procedures that the auditor should follow to verify that the PPE items have been valued appropriately as per generally accepted accounting policies and practices are: -

- Verify that the entity has charged depreciation on all items of PPE unless any item of PPE is non- depreciable like freehold land.
- Assess that the depreciation method used reflects the pattern in which the asset's future economic benefits are expected to be consumed by the entity. It could be Straight line method, diminishing value method, unit of production method, as applicable.
- The auditor should also verify whether the management has done an impairment assessment to determine whether an item of property, plant and equipment is impaired as per the requirements of AS 28 Impairment of Assets.

20. A company shall disclose Shareholding of Promoters* as below:

Shares held by promoters at the end of the year				% Change during the year***
S. No.	Promoter Name	No. of shares	% of total shares**	
Total				

* Promoter here means promoter as defined in the Companies Act, 2013.

** Details shall be given separately for each class of shares

***percentage change shall be computed with respect to the number at the beginning of the year or if issued during the year for the first time then with respect to the date of issue.

21. **The auditor should ensure whether the following disclosures as required under Schedule III (Part I) to Companies Act, 2013 have been made:**

Whether the Company has disclosed the following details relating to micro and small enterprises in the notes to accounts:

- (i) the principal amount and the interest due thereon (to be shown separately) remaining unpaid to any supplier at the end of each accounting year.
- (ii) 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.
- (iii) 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.
- (iv) the amount of interest accrued and remaining unpaid at the end of each accounting year.
- (v) 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.

- (vi) The following ageing schedule shall be given for Trade payables due for payment:

Trade Payables ageing schedule

<i>(Amount in ₹)</i>					
Particulars	Outstanding for following periods from due date of payment#				
	Less than 1 year	1-2 years	2-3 years	More than 3 years	Total
(i) MSME					
(ii) <i>Others</i>					
(iii) <i>Disputed Dues- MSME</i>					
(iv) <i>Disputed Dues Others</i>					

Similar information shall be given where no due date of payment is specified in that case disclosure shall be from the date of the transaction. Unbilled dues shall be disclosed separately.

22. (i) The auditor will check **Rights & Obligations assertion** to ensure that the entity has the right to assets i.e. (whether the entity has ownership and legal title to assets) and the liabilities recognised in the financial statements represent all the entity's obligations to repayment as at a given date.
- (ii) The auditor will check **Occurrence assertion** to ensure that the transactions recognized in the financial statements have occurred and relate to the entity.
- (iii) The auditor will check **Valuation and allocation assertion** to ensure assets, liabilities and equity balances have been valued appropriately i.e. the amounts at which they are recorded are appropriate. There has been no overstatement or understatement.
- (iv) The auditor will check **Cut-off assertion** to ensure that all income and expenses are reported in the-correct accounting period. Cut-off is a separate assertion because the substantive procedures to verify it are

typically different from those applied to the other components of completeness.

- (v) The auditor will verify **Completeness assertion** to ensure that all assets, liabilities and equity balances that were supposed to be recorded have been recognized in the financial statements.

23. To verify the rights and obligations assertion regarding Property, Plant, and Equipment (PPE), the auditor must ensure the entity has valid legal ownership and identify any charges against it. The audit procedures should include the following:

- 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 and building in particular, the auditor should check the conveyance deed/ sale deed to verify whether the entity is the legal and valid owner or not.
- The auditor should insist and verify title deeds for immoveable property acquired.
- In case, the entity has given such immoveable property as security for any borrowings and the original title deeds are not likely to be 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.
- The auditor should also verify the register of charges, available with the entity to assess that any charge has been created against the PPE.

24. Few audit procedures to obtain sufficient appropriate audit evidence to conclude that trade receivables have been valued appropriately are as under:-

- 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 receivable (both Dr/Cr balance).
 - Also, obtain the list of debtors under litigation and compare with previous year.
 - Scrutinize the analysis and identify those debtors which appear doubtful; discuss with management about reasons as to why these debtors are not included in the provision for bad debts. Perform further testing where any disputes exist.
 - He should check if provisions are made at appropriate rates considering recoverability of amounts due.
 - Prepare schedule of movements of bad debts – Provision accounts and debts written off and compare the proportion of bad debt expense to sales for the current year in comparison to prior years to see if the current expense appears reasonable.
 - Check that write-offs of the receivable balances have been authority appropriate approved by an appropriate authority i.e. the Board of Directors in case of a company.
- 25.** Audit procedures to be followed by the statutory auditor of Zed Limited to ensure that 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 are as under: -
- 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 other measurements.
 - Perform purchase and sales cut-off tests. Trace shipping documents (bills of lading and receiving reports, warehouse records, and inventory records) to accounting records immediately before and after year-end.

- With respect to tagged inventory, perform tests for omitted transactions and tests for invalid transactions.
 - Verify the clerical and arithmetical accuracy of inventory listings.
 - Reconcile physical inventory amounts with perpetual records.
 - Reconcile physical counts with ledger control totals.
 - Reconcile inventories which belong to client but are held with third parties like transporters, warehouses, port authorities etc.
 - Goods received on a consignment basis have been properly segregated from other items of inventory.
- 26.** CA D should ensure that BRS is signed by the authorized personnel 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 bank book to the bank confirmation/statement.
- Checking of all material reconciling items included under cheques issued but presented for payment to the underlying bank book forming part of books of account. In addition, the auditor should request for bank statements of subsequent period and should verify if the cheques issued have subsequently been cleared by the bank. For all cases where cheques have become stale i.e. 3 months or more have lapsed since the issue date, the same should not appear in the BRS and should instead be taken back to liabilities.
- Checking of all material reconciling items included under cheques deposited but not credited by bank by requesting for bank deposit slips, duly acknowledged by bank and verifying if the balances were credited by bank subsequently by tallying to the bank statement of subsequent period. For any instances related to cheques not cleared beyond reasonable time, the auditor should seek brief descriptions from the management and in case such explanations are found to be unsatisfactory, the auditor should verify the revenue recognition related to such parties was in order and as per the Company's revenue recognition policy.

- Checking of all material reconciling items included under amounts or charges debited/ credited by bank but not accounted for by requesting for bank statements for the period under audit and tallying the same. If the amounts are found to be material, the auditor should ensure that the management records the adjustments for the same in its books of account.
- 27.** (i) The auditor will check the cut-off assertion to ensure that whether all income and expenses are reported in the-correct accounting period. Cut-off is a separate assertion because the substantive procedures to verify it are typically different from those applied to the other components of completeness.
- (ii) The auditor will check the completeness assertion for the same to ensure that all transactions that were supposed to be recorded have been recognised in the financial statements. Transactions have not been omitted.
- (iii) The auditor will check rights & obligations assertion to ensure that the entity has the right to assets i.e. (whether the entity has ownership and legal title to assets) and the liabilities recognised in the financial statements represent all the entity's obligations to repayment as at a given date.
- (iv) The auditor will check the occurrence assertion for the same to ensure that transactions recognised in the financial statements have occurred and relate to the entity.
- 28.** To verify that inventories of raw material & consumables and work-in-progress have been valued appropriately and as per generally accepted accounting policies and practices, the following procedures should be performed by CA Akshat:

For Raw materials and consumables:

- Ascertain what elements of cost are included e.g. carriage inward, non-refundable duties etc.
- If standard costs are used, enquire into basis of standards; how these are compared with actual costs and how variances are analysed 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.

For Work in Progress:

- Ascertain how the various stages of production/ value additions 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.
- 29.** The auditor will apply the following audit procedures to verify that all sales are accurately measured as per applicable accounting standards and correctly journalised, summarised, and posted in the financial statements are:
- Trace a few transactions from inception to completion. (Examination in depth)
 - Eg: Take few sales transaction, and check from the receipt of sales order to the payment of receivable balance, every underlying document to ensure if it is properly recorded at every stage and measured accurately taking into consideration all the incentives, discounts, if any. The recognition shall be according to the revenue recognition policy of the entity.
 - If the client is engaged in export sales, then compliance with AS 11 shall be ensured.
 - Auditor must understand client's operations and related GAAP issues e.g. point of sale revenue recognition vs. percentage of completion, wherever applicable.
 - Compare the rate of sales affected with related parties and review them for collectability, as well as whether they were properly authorised and the value of such transactions were reasonable and at arm's length.

- 30.** To carry out test of controls for checking the effectiveness of internal control over sales as a part of the debtors' audit procedure, following points need to be considered in respect of trade receivables by audit team of PQR Ltd:
- Only bona fide sales lead to trade receivables.
 - All such sales are made to approved customers.
 - All such sales are properly recorded in the books of accounts.
 - Once recorded, the debtors can be settled only by receipt of cash or on the authority of a responsible official.
 - Segregation of duties at every point in sales transaction. (accounting for debtors, collecting the payments, sending reminders etc.)
 - Debtors are collected on time.
 - In case debtors are not collected in time, sending reminders and taking legal actions if required.
 - Balances are regularly reviewed.
 - A proper system of follow up exists and if necessary, adequate provision for bad debt should be made by preparing adequate ageing schedule of the debtors.

Answers to Questions involving Test Your Understanding

- 1.** The auditor is trying to verify assertion relating to "Rights and Obligations". He is verifying that the company owns or controls the inventory recorded in the financial statements. Any inventory held by the company on behalf of another entity has not been recognized as part of inventory of the company.
- This can be achieved by verifying stock records pertaining to goods received from mills and sent back to mills after carrying out necessary operations. Besides, agreements with such mills may also be verified.
- 2.** It shall be shown under the head "Borrowings" and classified as Short-term secured borrowings specifying nature of security. The above said outstanding amount shall be further sub-classified under heading "Loans repayable on Demand" from Banks. As per requirements of Schedule III of the Companies Act, 2013, where loans have been guaranteed by directors

or others, aggregate amount of such loans under each head shall be disclosed.

3. A company has to disclose various ratios in its financial statements in accordance with requirements of Schedule III of the Companies Act, 2013. The company shall also explain the terms included in numerator and denominator for computing the above ratios. Further explanation shall be provided for any change in the ratio by more than 25% as compared to the preceding year.
4. Substantive analytical procedures in respect of sales will consist of sales trend analysis, comparison with previous accounting period, category-wise sales analysis, any analysis the auditor may find relevant and most important of all, building a sales expectation and comparing that with the client's sales records. The auditor will need to know the sales prices of the products or services over the year, monthly average sales price per product or service, discount policy.
5. Depreciation of an asset begins when it is available for use i.e. when it is in the location and condition necessary for it to be capable of operating in the manner intended by the management. Depreciation on asset is charged on asset from the date when it is ready for use and not from date of actual usage.

Hence, recording of depreciation by company w.e.f. 1st October is not proper.