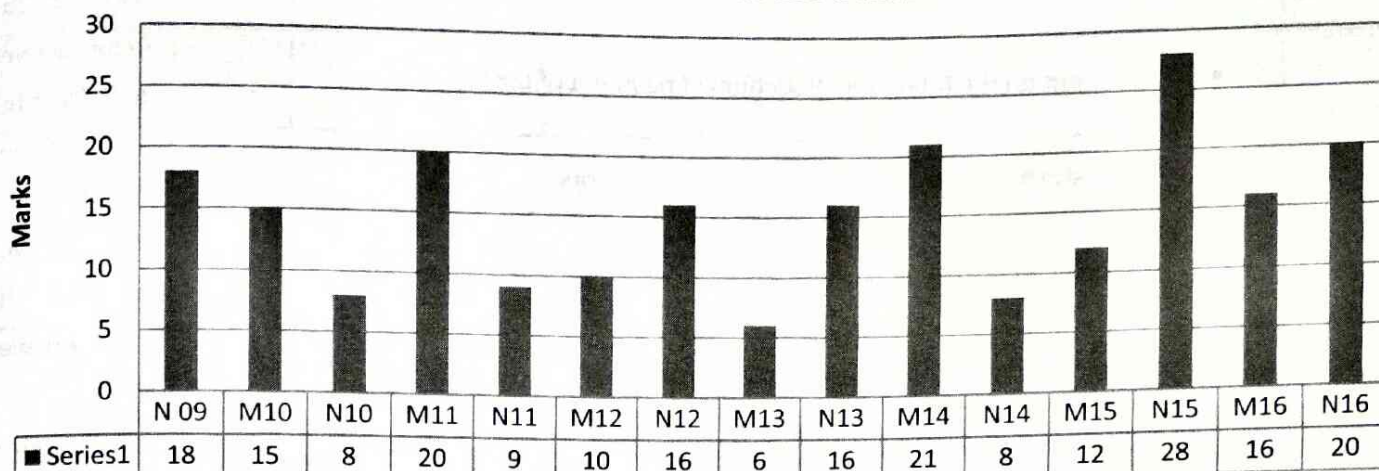


"Marks Distribution of Past 15 Exams"



Scanner of Past Examination Questions (Nov. 2009 – Nov. 2016)

Attempt	Q. No.	Questions	Marks	Suggested Answer
N-09	2(a)*	Comment on the following situation: XYZ Ltd. Co. gave a donation of Rs.50,000 each to a Charitable Society running a school and a trust set up for the service of Blind during financial year ending on 31st March, 2009. The average net profits of the company for the last three years were 15 lakhs.	8	Refer Answer of Q. No. 13
	7(b)	Goods sent out on Sale or Return Basis.	5	Refer Answer of Q. No. 25(e)
	8(b)	Cut Off Arrangements	5	Refer Answer of Q. No. 26
M-10	3*	A trader is worried that inspite of substantial increase in sales compared to earlier year, there is considerable fall in Gross Profit after satisfying himself that sales and expenses are correctly recorded and that the valuation of inventories is on consistent basis, he wants to ensure that purchases have been truthfully recorded. How will you proceed with this assignment?	10	Refer Answer of Q. No. 24A
	7(b)*	How would you vouch/verify the following: Receipt of Capital subsidy.	5	Refer Answer of Q. No. 17(a)
N-10	4(c)	Write short note on: Verification of credit sales.	4	Refer Answer of Q. No. 25(a)
	7(a)	What points shall an auditor keep in mind while auditing an account of Bought Ledger having a debit balance?	4	Refer Answer of Q. No. 30
M-11	2(b)	List out some examples of fraud that can be done by ledger keeper in Bought ledger and sales ledger.	8	Refer Answer of Q. No. 28

	4(a)	Give various factors which result in increase in Gross profit.	8	Refer Answer of Q. No. 21
	7(e)	Write short note on: Cut-off procedure.	4	Refer Answer of Q. No. 26
N-11	1(b)*	Comment on the following: Vouching of payment of taxes.	5	Refer Answer of Q. No. 6(a)
	7(c)	Write short notes on: Audit of sale of Investments	4	Refer Answer of Q. No. 15(c)
M-12	3(a)	How will you verify/ vouch the retirement gratuity to employees?	6	Refer Answer of Q. No. 7(h)
	7(b)	Write short note on: Preliminary Expenses.	4	Refer Answer of Q. No. 9(a)
N-12	6(b)	Explain, what are the factors to be considered while "Vouching of travelling expenses"?	8	Refer Answer of Q. No. 7(b)
	7(a)	Write short notes on: Audit of discounted bills receivable dishonored.	4	Refer Answer of Q. No. 19(c)
	7(d)	Write short note on: Cut-off arrangements.	4	Refer Answer of Q. No. 26
M-13	2(i)	Correct/Incorrect: PQR Ltd. Include underwriting commission and stamp duty as preliminary expenses.	2	Refer Answer of Q. No. 31(1)
	4(b)	How will you vouch/verify the followings: Purchase with invoice	4	Refer Answer of Q. No. 23(b)
N-13	4(a)	How will you vouch/verify the following: Remuneration paid to directors.	4	Refer Answer of Q. No. 4(b)
	4(b)	How will you vouch/verify the following: Assets acquired on hire purchase.	4	Refer Answer of Q. No. 5(c)
	4(c)	How will you vouch/verify the following: Profit or loss arising on sale of plots held by real estate dealer	4	Refer Answer of Q. No. 22A
	4(d)	How will you vouch/verify the following: Advertisement expenses.	4	Refer Answer of Q. No. 8(a)
M-14	1(b)*	As an auditor what are the essential points to be borne in mind while examining a voucher?	5	Refer Answer of Q. No. 1
	2(iii)	Correct/Incorrect: The Whole Time Director of a public company is automatically entitled for remuneration.	2	Refer Answer of Q. No. 31(2)
	2(ix)	ABC Ltd., a government company came into existence in year 2012, donated Rs. 50,000 to a political party.	2	Refer Answer of Q. No.31(3)
	3(a)	How will you vouch/verify the following: Preliminary expenses	4	Refer Answer of Q. No. 9(a)
	3(b)	How will you vouch the following: Recovery of bad debts written off	4	Refer Answer of Q. No. 19(b)
	3(c)	Write short note on: Cut-off arrangement/procedures.	4	Refer Answer of Q. No. 26

N-14	3(d)	How will you vouch the following: Retirement gratuity to employees.	4	Refer Answer of Q. No. 7(h)
	6(c)	Casting or totaling is an important tool of audit for an Auditor	4	Refer Answer of Q. No. 3
M-15	3(a)	How will you vouch the following: Rental receipts.	4	Refer Answer of Q. No. 16(b)
	3(b)	How will you vouch the following: Repair to Assets	4	Refer Answer of Q. No. 7(d)
	3(d)	How will you vouch the following: Insurance Claims	4	Refer Answer of Q. No. 18(a)
N-15	2(vii)	Correct/Incorrect: Teeming and lading is one of the techniques of inflating cash payments.	2	Refer Answer of Q. No.31(4)
	3(a)	How will you verify the following: Refund of General Insurance premium paid.	4	Refer Answer of Q. No. 18(b)
	3(b)	How will you verify the following: Payment of Taxes.	4	Refer Answer of Q. No.6(a)
	3(c)	How will you verify the following: Sale Proceeds of Junk Material.	4	Refer Answer of Q. No. 15(d)
	5(b)	As the statutory auditor of A Ltd., you have observed that the gross profit of the company has decreased in comparison to last years. Mention the possible factors which may responsible for decrease in gross profit.	6	Refer Answer of Q. No. 22
	7(a)	Write short note on: Remuneration paid to director of a public company.	4	Refer Answer of Q. No. 4(b)
	7(b)	Write short note on: Payment for acquisition of asset.	4	Refer Answer of Q. No. 5(a)
M-16	3(a)	How will you vouch/verify the following: Preliminary Expenses.	4	Refer Answer of Q. No. 9(a)
	3(b)	How will you vouch/verify the following: Custom and Excise Duties.	4	Refer Answer of Q. No. 6(b)
	3(d)	How will you vouch/verify the following: Recovery of bad debts written – off	4	Refer Answer of Q. No. 19(b)
	6(c)	State the factors to be considered to verify the validity of any transaction.	4	Refer Answer of Q. No. 1
N-16	3(a)	How will you vouch/verify the following: Foreign Travel Expenses.	4	Refer Answer of Q. No. 7(c)
	3(b)	How will you vouch/verify the following: Receipt of Capital Subsidy	4	Refer Answer of Q. No. 17(a)
	3(c)	How will you vouch/verify the following: Royalties received.	4	Refer Answer of Q. No. 16(c)
	3(d)	How will you vouch/verify the following: Goods sent out on Sale or Return basis.	4	Refer Answer of Q. No. 25(c)
	7(d)	Write short note on: Scrutiny of General Ledger	4	Refer Answer of Q. No. 29

* Compulsory Questions

QUESTIONS and ANSWERS

5.1 VOUCHING – MEANING & CONSIDERATIONS

Q.1 Write short note on: Vouching. [Nov. 05 (4 Marks)]

or

Discuss the following: As an auditor what are the essential points to be borne in mind while examining a voucher? [May 14 (5 Marks)]

Or

Define vouching. Also discuss the essential points to be borne in mind while examining a voucher.

Or

State the factors to be considered to verify the validity of any transaction. [May 16 (4 Marks)]

Answer: Vouching:

- Vouching may be defined as act of examining vouchers. Its basic objective is to establish the authenticity of the transactions recorded in the primary books of account.
- Vouching may be classified as substantive audit procedure which aims at verifying the genuineness and validity of a transaction contained in the accounting records.
- It consists of comparing the entries in the books with the particulars in the vouchers as regards date, amount, name of party etc.
- Vouching is used to ensure that various transactions for the period are fairly & truly recorded in the books.

Considerations during Vouching:

- (a) Verify that all transactions recorded in the books of accounts are supported by documentary evidence.
- (b) No transaction has been recorded which does not related to business.
- (c) To see that transaction has been recorded on and under the proper date.
- (d) Ensure that date of voucher falls within the accounting period.
- (e) Ensure that voucher is made out in the client's name.
- (f) Ensure that voucher is duly authorized.
- (g) Whether accuracy has been observed while totaling, carry forward and recording an amount in the account.

Q.2 Discuss the following: In vouching payments, the auditor does not merely check proof that money has been paid away.

Answer: Vouching of Payments:

Statement is correct, as the object of vouching is not merely to ascertain that money has been paid away, but also to obtain reasonable assurance with regard to various assertions like authorisation, completeness, cutoff, classification, validity etc.

Considerations during vouching: Refer Q. No. 1

5.2 - AUDITING OF CASH TRANSACTIONS

Q.3 Casting or Totalling is an important tool of audit for an auditor. Comment. [Nov. 14 (4 Marks)]

Answer: Casting or Totalling:

- Casting is an important tool for an auditor as it helps the auditor in detecting the fraud associated with wrong totalling.

- Sometimes the total of an expenses like wages are inflated by over totaling the column in which the expenses are entered. Such a fraud can be detected only if the totals of the wage bill are checked. Similarly, a cashier may misappropriate receipts from account receivables by under-totalling the receipts column of the cash book. Such shortages in cash may be covered up by over totaling. Such frauds can be detected only if the totals of the cash book and the general ledger are checked.
- The frauds that may be detected with the help of casting may be listed as below:
 1. under casting the receipt side of the cash book;
 2. Over casting the payment side of the cash;
 3. fictitious entries being made in the cash column to show that amounts have been deposited in the account when, in fact, no deposit has been made;
 4. posting an amount of cash sale to the credit of a party and subsequently withdrawing the amount; and
 5. wrong totals or balances being carried forward in the cash book or in the ledger.

5.3 - AUDIT OF PAYMENTS

Q.4 How would you vouch the following:

(a) **Personal Expenses of Directors met by a company.**

Answer: Personal Expenses of Directors:

1. Check the articles of association, service contract, minutes of general meeting, etc., to check the authorisation for such payment.
2. Enquire to ensure that personal expenses are not debited in any other revenue items as contemplated u/s 143 (1) of the Companies Act, 2013.
3. Ascertain compliance with disclosure according to requirements of Schedule III to the Companies Act, 2013.
4. Check documentary evidences to examine the payments reimbursed.

(b) **Remuneration Paid to Directors**

[Nov. 13, Nov. 15 (4 Marks)]

Answer: Remuneration Paid to Directors:

1. Refer to General Meeting or Board meeting resolution for the appointment and terms of appointment of the director.
2. Examine the Entitlement of remuneration payable to director as the directors are not automatically entitled to remuneration, it is paid either according to the terms of articles of association or in accordance with a resolution of the general meeting.
3. Examine Articles of Association and general meeting resolution to determine the mode of payment-monthly, quarterly, or at a specified percentage of the net profits.
4. Check agreement with the director.
5. Verify director's attendance in the board meetings.
6. Ensure compliance with the provisions of Sections 197, 198 and Schedule V of the Companies Act, 2013, where appropriate.
7. Check computation of the net profits under section 198 and the details of commission payable as percentage of profits to directors.

(c) **Advance Given to Director of a company.****Answer: Advance given to Directors of a company:**

1. Study the Articles of association to ascertain the powers of the company to grant advances to director.
2. Ensure compliance of Section 185 of the Companies Act, 2013.
3. Trace the amount paid to director with the bank statement.
4. Study the contract /loan agreement, terms, rate of interest and inquire whether they are prejudicial to the interest of the company.
5. Obtain a confirmation from the director w.r.t. outstanding advances.
6. Check interest had been duly charged for the outstanding unless it is an interest free advance.
7. The loan or advances made to the directors should be shown distinctly in the balance sheet in compliance of Schedule III of Companies Act, 2013.
8. Ensure disclosures of related party transaction in notes to accounts as per the requirements of AS 18.

Q.5 How would you vouch the following:(a) **Payment for acquisition of Assets.****[Nov. 15 (4 Marks)]****Answer: Payment for Acquisition of Assets:**

1. Ensure that the purchase of asset must be approved by appropriate authority. Companies Act, 2013 provides that only the Board of Directors can invest the funds of the company. Thus the Board alone can sanction the purchase of a fixed asset.
2. Trace the amount paid for purchases with the bank statement.
3. Inspect the title deeds, in case of purchase of an immovable property and ensure that that property has been registered in the client name.
4. In case of movable property like car or a ship which requires registration of ownership, auditor must verified that registration has been made in favour of the client.
5. If the benefit of an item of expense has been acquired by the purchaser along with the asset, its value should be debited to a separate account, e.g., when a motor car has been purchased on which certain taxes and insurance charges were paid by the seller for a period that had not expired.
6. In the case of self constructed asset, auditor must verify that the cost of labour, materials and other direct expenses incurred has been charged as cost of the asset on a proper allocation of the total expenditure debited under these heads.
7. Ensure that expenses on repairs and maintenance have not been capitalised and the cost of additions to assets should not be charged off as revenue expenses.
8. Ensure compliance of AS-10 and Schedule III to the Companies Act, 2013.

(b) **Purchase of Motor Car.****Answer: Vouching of Purchase of Motor Car:**

1. Ascertain whether the purchase of vehicle has been properly authenticated.
2. Check invoice of the vehicle dealer to confirm purchase price.
3. Examine registration with Transport Authorities to verify the ownership.

4. Ensure that all expenses relating to purchase of vehicle have been properly capitalized and the same have been disclosed properly in the balance sheet.

(c) Assets acquired on Hire Purchase

[Nov. 13 (4 Marks)]

Answer: Vouching of Assets acquired on Hire Purchase:

1. Ensure that purchase of assets on hire purchases basis has been duly approved by the authorized person.
2. Examining the agreement regarding hire purchase to ascertain the terms and conditions, the instalment and amount of interest included in the instalment.
3. Ensure that interest included in the instalment is not capitalised but is transferred to revenue account.
4. Ensure that these assets are treated as assets acquired under finance lease as per AS 19.
5. Assets acquired under Hire Purchase System should be recorded at the full cash value with corresponding liability of the same amount. In case cash value is not readily available, it should be calculated presuming an appropriate rate of interest.
6. Hire purchased assets are shown in the balance sheet with an appropriate narration to indicate that the enterprise does not have full ownership thereof.

(d) Assets acquired on lease.

Answer: Vouching of Assets acquired on Lease:

1. Inspect the lease agreement to ascertain the amount of premium and other terms and conditions of the lease.
2. In case of operating lease, ensure that lease payment should be recognized as an expense in the Statement of Profit and Loss on a straight line basis over the lease term.
3. In case of finance lease, ensure that all the substantial risks and rewards incidental to ownership are transferred, considering the indication as prescribed in AS-19. The lessee should recognise the lease as an asset and as a liability. Such recognition should be at an amount equal to the fair value of the leased asset at the inception of the lease.
4. Ensure that assets acquired under finance lease are segregated from the assets owned.
5. If a part of the leasehold property has been sublet, examine the tenant's agreements.
6. Ensure compliance of AS-19 and disclosure requirements of Schedule III to the Companies Act, 2013.

(e) Repayment of amount of foreign loan for purchase of an asset.

Answer: Vouching of repayment of foreign loan:

1. Examine the loan agreement to ascertain the terms and conditions w.r.t. rate of interest, frequency of repayment, terms of security etc.
2. Check the remittances made during the year towards installments of repayments made.
3. Obtain confirmation for the outstanding balance.
4. Ensure that the year end liability of foreign loan should be translated to the rate of exchange prevalent as on the closing date and the resultant gain or loss is to be credited or debited to Statement of Profit and Loss in accordance with the AS 11.
5. Check banker exchange rate chart for correctness of the conversion.
6. Check RBI or other agencies' permission for remittances outside India.

(f) **Purchase of Quoted Investments****Answer: Vouching of Purchase of Quoted Investments:**

1. Determine the date of purchase, amount of purchase, nature of investments purchased (long term or short term) and nature of transaction, i.e., cum-dividend/interest/right/bonus.
2. Compare the amount of purchase with quotation available.
3. Verify the amount paid towards purchase of investments.
4. Trace the amount in the bank statements.
5. Obtain a schedule of investment from Management for physical verification at the year end.
6. Verify the investment certificate to confirm title.
7. Confirm compliance with statutory provisions such as those of Companies Act, 2013.
8. Verify whether investments are duly disclosed in financial statements in accordance with AS-13 and Schedule III to the Companies Act 2013.

Q.6 How would you vouch the following:**(a) Payment of Taxes****[Nov. 11, Nov. 15 (5 Marks)]****Answer: Vouching of Payment of taxes:**

1. Obtain the computation of income prepared by the client and verify whether it is as per the Income-tax Act, 1961 and Rules made there under.
2. Review adjustments, expenses disallowed, special rebates etc. with particular reference to the last available completed assessment.
3. Examine relevant records and documents pertaining to payment of advance tax, self assessment tax, TDS and other demands.
4. 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 and notice of demand.
5. Payments or advance payments of income-tax should also be verified with the notice of demand and the receipted challan acknowledging the amount paid.
6. 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.
7. Ensure that the requirements of AS 22 on 'Accounting for Taxes on Income' have been appropriately followed for the period under audit.

(b) Customs and Excise Duties**[May 16 (4 Marks)]****Answer: Vouching of Custom Duties:**

1. **Examine Cash Book:** Examine the payment of custom duties in the cash book with reference to bill of entry.
2. **Examine Bill of Entry:** Check the bills of clearing agents duly supported by receipted Bills of Entry, where the custom duty has been paid by the Custom Agents.
3. **Examination of disputed cases:** In the event of dispute where a provisional payment has been made, the amount determined as payable finally should be ascertained.
4. **Duty Drawback:** In certain cases, drawback of customs duty is allowed if goods (imported or containing imported materials) are exported. The auditor should verify the claim of duty drawback with reference to acknowledgement issued by Directorate of duty drawback.

(f) **Purchase of Quoted Investments****Answer: Vouching of Purchase of Quoted Investments:**

1. Determine the date of purchase, amount of purchase, nature of investments purchased (long term or short term) and nature of transaction, i.e., cum-dividend/interest/right/bonus.
2. Compare the amount of purchase with quotation available.
3. Verify the amount paid towards purchase of investments.
4. Trace the amount in the bank statements.
5. Obtain a schedule of investment from Management for physical verification at the year end.
6. Verify the investment certificate to confirm title.
7. Confirm compliance with statutory provisions such as those of Companies Act, 2013.
8. Verify whether investments are duly disclosed in financial statements in accordance with AS-13 and Schedule III to the Companies Act 2013.

Q.6 How would you vouch the following:**(a) Payment of Taxes****[Nov. 11, Nov. 15 (5 Marks)]****Answer: Vouching of Payment of taxes:**

1. Obtain the computation of income prepared by the client and verify whether it is as per the Income-tax Act, 1961 and Rules made there under.
2. Review adjustments, expenses disallowed, special rebates etc. with particular reference to the last available completed assessment.
3. Examine relevant records and documents pertaining to payment of advance tax, self assessment tax, TDS and other demands.
4. 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 and notice of demand.
5. Payments or advance payments of income-tax should also be verified with the notice of demand and the receipted challan acknowledging the amount paid.
6. 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.
7. Ensure that the requirements of AS 22 on 'Accounting for Taxes on Income' have been appropriately followed for the period under audit.

(b) Customs and Excise Duties**[May 16 (4 Marks)]****Answer: Vouching of Custom Duties:**

1. **Examine Cash Book:** Examine the payment of custom duties in the cash book with reference to bill of entry.
2. **Examine Bill of Entry:** Check the bills of clearing agents duly supported by receipted Bills of Entry, where the custom duty has been paid by the Custom Agents.
3. **Examination of disputed cases:** In the event of dispute where a provisional payment has been made, the amount determined as payable finally should be ascertained.
4. **Duty Drawback:** In certain cases, drawback of customs duty is allowed if goods (imported or containing imported materials) are exported. The auditor should verify the claim of duty drawback with reference to acknowledgement issued by Directorate of duty drawback.

Payment of Excise Duties:

1. The amount of duty paid must be checked with quantity of goods in respect of which the issue permits for the goods have been received.
2. Check the copy of the GAR-7 challan, if available in the file in respect of such payments. It will serve as an additional evidence of the duty having been paid.
3. Ascertain the rates of excise duty and apply it to the total sales and see that the amount actually paid does not exceed the amount thus calculated.
4. Ensure that CENVAT credit has been appropriately adjusted wherever allowed.

Q.7 How would you vouch the following:**(a) Payment of revenue Expenses.****Answer: Vouching of Payment of Revenue Expenses:**

1. Ensure that all payments have been duly authorised by a competent authority and must related to business.
2. Ensure that all payments have been received by the correct payee and acknowledged by a receipt note or in the voucher itself.
3. Ensure that expenses relate to the period under audit and no personal expenses are charged as business expenditure.
4. Examine whether all payments have been correctly recorded in the books under appropriate sub-head.
5. Ensure that payments made in cash or through cheques are appropriately recorded in cash or Bank book.
6. Ensure that if any payment relates to period that extends to next year, a proportionate amount is carried forward as Pre-paid expenses.

(b) Travelling Expenses**[Nov. 12 (8 Marks)]****Answer: Vouching of Travelling Expenses:**

1. Travelling expenses should be examined on the basis of client's policy for such expenditure. In the absence of such policy, the expenditure should be vouched on the basis of actual expenditure incurred. For this purpose, a voucher should be demanded for all items of expenses incurred.
2. The voucher for travelling expenses should be examined with regard to name and designation of the person claiming the amount, particulars of the journey, amount of railway or air fare, amount of boarding or lodging expenses and other expenses claimed.
3. If expenditure was incurred by directors, the auditor should satisfy himself that these were incurred in the interest of the business and that the directors were entitled for reimbursement.
4. If the journey was undertaken by air, the counterfoil of the air ticket should be attached to the voucher.
5. Particulars of boarding and lodging expenses should be verified independently.
6. Ensure that vouchers for travelling expenses should be authorised by some responsible official.
7. If any advance taken against such travelling, adjustments thereof should be examined by verifying entries in the books.

(c) Foreign Travel Expenses

[Nov. 16 (4 Marks)]

Answer: Vouching of foreign Travel Expenses:

Note: Points as covered in Vouching of Travel Expenses may be covered. (Refer answer of 7(b))

Additional points in relation to foreign travel expenses may be:

- Foreign currency drawn from authorised dealers for expenses abroad should be verified.
- Check RBI permission, if required for withdrawing the foreign exchange.
- Ensure compliance of AS-11 and Schedule III.

(d) Repairs to Assets

[May 15 (4 Marks)]

Answer; Vouching of Repair of assets:

1. Ascertain and evaluate the internal control system for authorisation of repairs to assets.
2. Compare the payment for repairs with the estimate provided by the contractor.
3. Trace the payment made for repairs with the entry recorded in cash book.
4. Ensure that repairs of only revenue nature have been debited to repairs accounts.
5. Repairs that had the effect of increasing the value of an asset or the life should be treated as capital expenditure.
6. In case, it is not possible to form an opinion as regards the nature of repairs, a certificate from the engineer under whose supervision the repairs were carried out should be obtained.
7. Ensure that repairs to certain assets like Building and machinery have been separately disclosed as per the requirements of Schedule III to Companies act, 2013.

(e) Premium Paid for Insurance of Motor Car.**Answer: Vouching of Insurance Premium:**

1. Examine the insurance cover note or policy document issued by the insurance company to verify the car no., period of insurance coverage, amount of premium paid etc.
2. Verify that "no claim bonus" is given, where entitled, by the Insurance Company.
3. Ensure that proper adjustment is made for pre-paid insurance premium.
4. Trace the payment from bank statement.

(f) Wages paid to seasonal labourer**Answer: Vouching of Wages paid to seasonal labourer:**

1. Ascertain and evaluate the internal control system for recruitment and usage of seasonal labourers.
2. Ensure that these labourers are hired under authority and pay rates are authorized at appropriate levels.
3. Ensure that the attendance is properly checked by the Time Keeping department.
4. Check that the certificate regarding work done by the labourers has been given by the proper person, in case the labourers have been appointed on a per piece basis.
5. Check the computation of wages payable to the labourers, after taking into account the deductions.
6. Confirm that all the payment to the labourers have been acknowledged.
7. See the time and job records, to ensure that the labourers have been paid for time worked. See the treatment of abnormal idle time.
8. Reconcile the number of seasonal labourers on payroll as per the Personnel Department's records vis-à-vis the number of labourers to whom the wages have been paid.

(g) **Production incentive paid to workers.** [May 09 (5 Marks)]**Answer: Vouching of Production Incentive:**

1. Trace the total production incentive paid to workers from Statement of Profit and Loss to prime records/division wise/dept wise records.
2. Obtain the details of incentive scheme from the management and check whether it is approved by a competent authority.
3. Check the production figures from independent source and correlate them with the incentive payment working computed by the accounts department.
4. Make an overall analytical procedure to ensure that the expense booked is commensurate in quantum with statistical data on production and strength of workers.

(h) **Payment of Retirement Gratuity to employees.** [May 12 (6 Marks), Nov. 14 (4 Marks)]**Answer: Vouching of payment of Gratuity:**

1. Examine the basis on which the gratuity payable to employees is worked out. The liability for gratuity may either be worked out on actuarial valuation or agreement or on the presumption that all employees retire on the balance sheet date.
2. Ensure that the basis on which gratuity has been computed is valid.
3. Verify computation of liability of gratuity on the aggregate basis.
4. Check the amount of gratuity paid to employees who retired during the year with reference to number of years of service rendered by them.
5. See that the annual premium (if policy taken from insurance company) has been charged to Profit and Loss account.
6. Ensure that the accounting treatment is in accordance with AS-15, "Employee Benefits".
7. Ensure that disclosures as required under Schedule III of Companies Act 2013 have been appropriately made.

Q.8 How would you vouch the following:(a) **Advertisement Expenses** [Nov. 13 (4 Marks)]**Answer: Vouching of Advertisement Expenses:**

1. Ascertain the value of advertisement expenses so as to ensure that it has been properly allocated i.e. capital, revenue or deferred revenue. .
2. Examine that expense must relate to the client's business.
3. Review and examination of the complete list of media of advertisement indicating the dates, location, timing, etc., along with the amounts paid in respect of each category.
4. Examination of the receipts for amounts paid.
5. Reviewing the contracts with the different agencies and ensuring that the billing conforms to the term and conditions specified therein.
6. Ensuring that outstanding expenses have been properly accounted for.

(b) **Expenditure for advertisement in Newspaper****Answer: Expenditure for advertisement in Newspaper:**

1. Examine the copy of the newspaper in which the advertisement was booked.
2. Check whether the date on which advertisement appears in the newspaper falls in the current accounting year.
3. Verify the contents of advertisement to ascertain that the advertisement was of the entity and was for the business and not of personal nature.
4. Ensure the rate charged is in accordance with the size and placement of advertisement.

5. Ensure deduction of TDS and service tax wherever applicable.
6. Ensure that it is printed in all issues of the newspaper for which newspaper has charged.

(c) Sales Commission Expenditure**[Nov. 05 (4 Marks)]****Answer: Vouching of Sales commission Expenditure:**

1. Determine the rate of commission by checking the agreement, if any, in respect of sales transaction actually occurred during the year carried out by authorized parties on its behalf.
2. The commission should be in accordance with the terms and conditions of the agreement.
3. Ensure that the services in respect of which commission is paid has been rendered to the client.
4. Ensure that the sales commission in fact have been paid and charged to Statement of Profit and Loss.
5. Compare the amount incurred in previous years with reference to total turnover.
6. Check the deduction of TDS and its payment to the credit of Central Government.

(d) Expenditure incurred for promotion of a product.**Answer: Vouching of Expenditure incurred on promotion of a product:**

The expenditure incurred for promotion of a new or existing product may entail future benefits. It may be like advertisement in the papers, television, sales exhibition, participation in trade fair, issue of promotional pamphlets, free gifts etc. Auditor shall perform the following to vouch this expenditure:

1. Examine the authority and accuracy of the transactions. He should read the contract with advertisement agencies, promotional policies decided by the management from the board minutes etc.
2. Check the amounts paid to the agencies from bank book and ascertain whether tax had been deducted in accordance with the tax law provisions if any applicable in this regard.
3. Check whether the unpaid amounts and accrued liability towards promotional advertisement contracts had been duly provided for in the accounts.

Ensure that the huge expenditure should not be treated as deferred revenue expenditure. According to AS 26, these are not intangible assets that may be carried over the periods of accounting. These must be expensed with in the year in which these arise.

Q.9 How would you vouch the following:**(a) Preliminary Expenses****[May 12, May 14, May 16 (4 Marks)]****Answer: Vouching of preliminary Expenses:**

1. Check Minute book of Board's meetings containing the resolution approving the expenses claimed by promoters as having been spent in formation of the company.
2. Expenses should be checked with reference to bills and agreements.
3. Check receipt for the registration fee paid for registration of the company.
4. Verify Stamp duty paid which is required to be paid for memorandum and articles of association.
5. Ascertain the amount which has been written off over a period. The quantum which has not yet been written off should be shown in the balance sheet under the head miscellaneous expenditure.
6. Check that no expenses other than those which constitute preliminary expenses are booked under this head, e.g. underwriting commission and brokerage paid.

(b) **Research and development Expenditure****Answer: Vouching of research and Development Expenditure:**

1. Ascertain the nature of research and development work at the outset and enquire whether separate Research and Development Department exists.
2. See allocation of expenses under revenue and capital. Ensure that expenses which are routine development expenses are charged to Profit and Loss Account.
3. Check whether the concerned research activity is authorised by the Board and has relevance to the objectives of the company.
4. Examine that generally research expenses for developing products or for inventing a new product are treated as capital expenditure to be written off over a reasonable period, if successful. In case it is established that the research effort is not going to succeed, the entire expenses incurred should be written off to the profit and loss account.
5. Ensure that if any machinery and equipment have been bought specially for the purpose of research activity, the cost thereof, less the residual value should be appropriately debited to the Research and Development Account over the years of research.

Q.10 Describe how the payments from petty cash should be verified.**Answer: Examination of Petty Cash:**

1. Verify whether the amount of petty cash imprest is fixed and the amount is reasonable considering the total cash payments made out of petty cash.
2. Trace the amounts given to the petty cashier from the Cash Book in the Petty Book.
3. Vouch payments with docket vouchers which must be supported, by appropriate evidence like bills, invoices, cash memo, etc.
4. Trace payments made for the purchase of postage stamps recorded in the Postage Book. Confirm that the postage expenses for the year are reasonable as compared with that in the postage expenses from month to month.
5. Where a columnar Petty Cash Book is maintained, check that the extension have been carried forward into appropriate amount columns.
6. Check the totals of columns and examine the cross totals.
7. Trace posting of the various columns in which payments are classified to the respective ledger accounts.
8. Verify the cash balance in hand.

5.4 - TRANSACTIONS GOVERNED BY COMPANIES ACT, 2013**Q.11 How will you vouch/verify the transactions with related parties?****Answer: Examination of Transactions with Related parties:**

While vouching the transaction with related parties, auditor is required to ensure compliance of Sec. 188, which provides the following:

1. No company shall enter into any contract or arrangement with a related party except with the consent of the BOD given by a resolution at a meeting of the Board with respect to transactions like sale, purchase or supply of any goods or materials; selling or otherwise disposing of, or buying, property of any kind; leasing of property of any kind; availing or rendering of any services etc.

2. The agenda of the Board meeting at which the resolution is proposed to be moved shall disclose the name of the related party and nature of relationship; the nature, duration of the contract and particulars of the contract or arrangement etc.
3. Where any director is interested in any contract of company with a related party, such director shall not be present at the meeting during discussions on the subject matter of the resolution relating to such contract.
4. Where a member of the company is a related party, he shall not vote on such special resolution to approve any contract which may be entered into by the Company.
5. Prior approval of the company by a special resolution is required for entering into transaction(s) with any related party, where transaction(s) to be entered into
 - (a) are contracts with below mentioned criteria:
 - sale, purchase or supply of any goods or materials directly or through appointment of agents exceeding 10% of the turnover of the company or Rs. 100 crore, whichever is lower;
 - selling or otherwise disposing of or buying property of any kind, directly or through appointment of agents, exceeding 10% of net worth of the company or Rs. 100 crore, whichever is lower;
 - leasing of property of any kind exceeding 10% of the net worth of the company or 10% of turnover of the company or Rs. 100 crore, whichever is lower;
 - availing or rendering of any services directly or through appointment of agents exceeding 10% of the turnover of the company or Rs. 50 crore, whichever is lower;
 - (b) is for appointment to any office or place of profit in the company, its subsidiary company or associate company at a monthly remuneration exceeding Rs. 2.5 lakh;
 - (c) is for remuneration for underwriting the subscription of any securities or derivatives thereof of the company exceeding 1% of the net worth.

Q.12 As a Statutory Auditor, how would you deal with the following: Apex Ltd., a well reputed manufacturing public limited company has made a contribution of Rs. 2.5 lacs during the financial year ended 31.03.16 to a political party for running a school, situated in the village, where most of the workers of the company reside. It is admitted that the benefit of the school is mostly for the children of the workers of the company. The company has not made any profits in the last four years.

Answer: Restrictions over Political Contribution:

Provisions and Explanations:

- As per Section 182 of the Companies Act, 2013 a government company or any other company which has been in existence for less than three financial years cannot contribute any amount directly or indirectly to any political party.
- In other cases, contribution in any financial year should not exceed 7½ % of average net profits during the three immediately preceding financial years.
- In the instant case, Apex Ltd. has contributed Rs. 2.5 lacs during the year to a political party for running a school.

Conclusion: Company has violated the provisions of Sec. 182 of Companies Act 2013 as it has contributed Rs. 2.5 Lacs to a political party inspite of the fact that company has not earned any profit in last four years. Hence auditor need to qualify his report stating the said violation.

- Q.13 As an Auditor, comment on the following: Board of Directors of PQ Ltd. has given donations of Rs. 50,000 each to a charitable school and a trust for blinds, during the year ended 31-03-2016. The average net profit of the company during last three financial years amounts to Rs. 12 lacs.

Answer: Donation to Charitable and Other Funds:

[Nov. 09 (8 Marks)]

Provisions and Explanations:

- As per Sec. 181 of Companies Act, 2013, the Board of Directors of a company can contribute to the bonafide charitable and other funds any amount in any financial year.
- However, prior permission of the company in general meeting is required in case if the aggregate of such contribution exceeds 5% of its average net profits for the 3 immediately preceding financial years.
- In the given case, the donations made by Board amounts to Rs. 1,00,000 which is more than Rs. 60,000, i.e. 5% of average net profit for the three immediately preceding financial years.

Conclusion: BOD has violated Section 181 of the Companies Act, 2013 and this matter should be reported in the auditor's report.

- Q.14 Janta Ltd. has made a contribution of Rs. 7.8 lacs during the financial year ended 31.03.16 to Samaj Seva Party, a political party, for running a teaching institute situated in the rural area, where most of the workers of the company reside. It is admitted that the benefit of the institute is mostly for the children of the workers of the company. The average net profit of the company during the three immediately preceding financial years was Rs. 100 lakhs. Comment.

Answer: Restrictions over Political Contribution:

Provisions and Explanations:

- As per Section 182 of the Companies Act, 2013 a government company or any other company which has been in existence for less than three financial years cannot contribute any amount directly or indirectly to any political party.
- In other cases, contribution in any financial year should not exceed 7½ % of average net profits during the three immediately preceding financial years.
- In the instant case, Janta Ltd. has contributed Rs. 7.8 lacs during the year to a political party for running a teaching institute.

Conclusion: Company has violated the provisions of Sec. 182 of Companies Act 2013 as it has contributed Rs. 7.8 Lacs to a political party inspite of the fact that company can only contribute 7.5 Lacs, i.e. 7.5% of Rs. 100 Cr. Hence auditor need to qualify his report stating the violation.

5.5 - AUDIT OF CASH RECEIPTS

- Q.15 How will you verify/vouch the following:

[May 07 (5 Marks)]

(a) Cash Sales

Answer: Vouching of Cash Sales:

1. Examine the system of internal check to ascertain any loopholes therein.
2. Ascertain the practice followed in the matter of issuing cash memos and trace the memos into cash sale summary.
3. Ensure that the date of cash memos tally with the entry in the cash book/summary.
4. Verify that prices of goods sold have been correctly recorded and check the calculation.
5. Verify the entry in the goods outward book with the sales summary.
6. See that the cancelled cash memos are not removed from the receipt book.

(b) Receipts from Account Receivables**Answer: Vouching of Receipts from Account receivable:**

1. Verify that there exists a system of internal check which acts as a safeguard against amounts collected being misappropriated.
2. Receipt of cash against the goods sold should be checked with the counterfoils of receipts issued.
3. Be cautious for the frauds like teeming and lading.
4. In case a fraud is suspected, the auditor should compare the amount deposited in the bank with the counterfoils of pay in slips.
5. If evidence of fraud exists, the customers shall be requested to send statement of accounts for the period during which fraud is suspected.

[Nov. 11 (4 Marks)]**(c) Sale of Investments****Answer: Vouching of Sale of Investments:**

1. Ensure that decision of sale of investment has been taken by the person authorized to do so, for example, Board of Directors in case of a company.
2. Ascertain the mode of sale of investments. It may be either directly or through broker or a bank. In case of sale through broker, vouch the sale with reference to broker's sold note.
3. Ensure that the difference between the carrying amount and the disposal proceeds, net of expenses, is recognised in the profit and loss statement.
4. If a part of the investment is sold out, ensure that the carrying amount to be allocated to that part is to be determined on the basis of the average carrying amount of the total investment.
5. Ensure compliance of disclosure requirements of AS-13 "Accounting for Investments" and in particular the following:
 - profits and losses on disposal of current investments and changes in carrying amount of such investments;
 - profits and losses on disposal of long-term investments and changes in the carrying amount of such investments;

[Nov. 15 (4 Marks)]**(d) Sale Proceeds of Junk materials.****Answer: Vouching of Sale proceeds of Junk Materials:**

1. Review the internal control system w.r.t. to generation, storage and disposal of junk materials and see whether it has been operating effectively.
2. Ascertain whether the organisation is maintaining appropriate records for the sale and disposal of junk materials.
3. Examine the production records for the determination of the quantity of junk materials that may generate in a given period.
4. Compare the sale proceeds of junk materials of current year with the corresponding figures of the preceding three to five years.
5. Check the price at which various types of junk materials have been sold and compare the same with the rates prevailing in the preceding years.
6. Ensure that all junk materials sold have been billed and check the calculations on the invoices.
7. Ensure that there exists a proper system for identification of junk material and there is no mixing of junk material with good quality material.
8. Make an overall assessment of the value of the realisation from the sale of junk materials as to its reasonableness. Ensure that proper accounting has been done for it.

Q.16

How will you verify/vouch the following:

(a) **Income from Investments.**

Answer: Vouching of Income from Investments:

1. Obtain a schedule of investments from the client and ascertain the nature of investments made and the types of income to be earned on such investments, i.e. interest, dividend or rent.
2. In respect of dividend income, counterfoils of Dividend Warrants to be vouched.
3. The amounts collected, i.e. dividend or interest should be traced into the Investment Register; to ascertain whether any interest or dividend, relating to any investment, has remained unrealised. If so, the reasons thereof should be ascertained.
4. Ensure that the income should be disclosed in the Statement of Profit and Loss at its gross amount (Gross of tax deducted at source).
5. In case of fixed deposits with the bank, interest earned should be verified by reference to the bank statement and the agreed rate of interest.
6. Ensure compliance of provisions of AS-9 and disclosure requirements of Schedule III to Companies Act, 2013.

(b) **Rental Receipts** **[May 07 (5 Marks), May 15 (4 Marks)]**

Answer: Vouching of Rental Receipts:

- (a) The auditor should examine the lease deeds and agreements to ascertain the amount of rent payable, the due date and provisions regarding the repairs etc.
- (b) Rent received may also be compared with the "rental register" if they are maintained.
- (c) If receipts are issued to tenants for the rent paid, the counter foils of the receipts would be a good evidence.
- (d) If rent are collected by agents, their accounts must be examined.
- (e) Particular attention should be paid towards outstanding rent. Provision should be made for doubtful outstanding rents.
- (f) If rent is received net of TDS, see that rent income is shown at gross and TDS is shown in Balance Sheet as advance tax.

(c) **Royalties Received** **[Nov. 16 (4 Marks)]**

Answer: Vouching of Royalties received:

1. Read the relevant contract and examine the provisions relating to the conditions of royalty such as rate, mode of calculation and due date.
2. Check the periodical statement received from the publisher.
3. Check the computation in the royalty statement and ensure that any deduction or adjustment made from the royalty due is as per conditions stated in the agreement.
4. Ensure that the royalties due but not yet received have been properly accounted for.

Q.17

How will you verify/vouch the following:

(a) **Receipt of Capital Subsidy** **[May 10 (5 Marks), Nov. 16 (4 Marks)]**

Answer: Vouching of Receipt of Capital Subsidy:

1. Examine the application made for the claim of subsidy to ascertain the purpose and the scheme under which the subsidy has been made available.
2. Examine documents for the grant of subsidy and note the conditions attached with the same relating to its use, etc.

3. Ascertain whether the terms and conditions has been fulfilled especially when the subsidy is for a specific asset or is for setting up a factory at a specific location.
4. Check relevant entries for receipt of subsidy.
5. Ensure compliance 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.

(b) Grant received for reimbursement of revenue expenses.**Answer: Vouching of Grant Received for reimbursement of revenue expenses:**

1. Check the amount of receipt, donor details etc. from donor letter.
2. Examine the terms and conditions of grant for its utilization and ensure whether they had been complied with.
3. Examine whether the grant has been appropriately recorded and disclosed in accordance with AS 12 and Schedule III to Companies Act, 2013.
4. If the grant comes from abroad, ensure compliance of the provisions of law, affecting foreign contributions.

(c) Receipt of Special backward area subsidy from Government.**Answer: Vouching of Receipt of Special backward area subsidy from government:**

1. Examine the application made for the claim for backward area subsidy submitted to the authorities.
2. Ascertain whether the grant is of a capital nature or of a revenue nature.
3. The accounting of grant should be in accordance with AS 12 "Accounting for Government Grants". The revenue grant can be taken to income statement, with appropriate disclosure.
4. The capital grant may be adjusted against cost of asset or may be kept in a capital reserve to be transferred to Statement of Profit and Loss each year in proportion to depreciation of that asset charged in Statement of Profit and Loss.
5. The receipt of the grant should be traced with bank statement.
6. Ensure compliance of conditions attached to grant. In case of any non compliance, ascertain whether any liability or refund of grant for breach of conditions could arise.

Q.18 How will you verify/vouch the following:**(a) Insurance Claim****[May 15 (4 Marks)]****Answer: Vouching of Insurance Claim:**

While vouching the receipts of insurance claims, the auditor should:

1. Examine a copy of the insurance claim lodged with the insurance company.
2. Determine the adjustment of the amount received in excess or short of the value of the actual loss as per the insurance policy.
3. Verify the copy of certificate/report containing full particulars of the amount of loss.
4. Verify the accounting treatment of the amount received to ensure that revenue is credited with the appropriate amount and that in respect of claim against asset, the Statement of Profit and Loss is debited with the short fall of the claim admitted against book value, if the claim was lodged in the previous year but no entries were passed, entries in the Statement of Profit and Loss should be appropriately described.

(b) **Refund of General Insurance Premium Paid.** [Nov. 15 (4 Marks)]

Answer: Vouching of Refund of General Insurance Premium Paid:

Refund of insurance premium may arise because of excess payment of premium or due to cancellation of a policy. The auditor should take following steps while vouching the refunds:

1. Ascertain the reasons for refund of insurance premium.
2. Find out the amount of premium paid by examining insurance policy or cover note.
3. Check advice of refund received from the insurance company.
4. Check correspondence between the insurance company and the client.
5. Check entries in the bank book or the bank statement. If necessary, the counterfoil of the pay-in-slips can also be verified.

Q.19 How will you verify/vouch the following:

(a) **Bankruptcy Dividend.**

Answer: Vouching of Bankruptcy Dividend:

1. Refer to the correspondence with the Official Receiver or Assignee to find particulars of part amounts already collected and the balance outstanding at the beginning of the year.
2. The advice, if any, received from the Official Receiver along with the payment should be referred to.
3. Trace the amount received to Bank Statement.
4. Ensure the appropriate recording of amount received in the books of accounts.

(b) **Recovery of Bad Debt written off** [Nov. 07 (5 Marks), May 14, May 16 (4 Marks)]

Answer: Recovery of Bad Debt Written Off:

1. Check all correspondence and proper authorization of bad debts written off earlier and ensure that the decision of writing off of bad debts was recorded properly.
2. Ascertain total bad debts and see whether all recovery of bad debts is recorded properly in the books of account and deposited into bank.
3. Check all notifications from Court or bankruptcy trustee and all correspondence from debtors and collecting agencies.
4. Check Credit Manager's files for amount recovered and confirm acknowledgement receipts issued to trustee/debtors.

(c) **Discounted Bill receivable dishonoured.** [May 06, Nov. 12 (4 Marks)]

Answer: Vouching o Discounted BR dishonoured:

1. Obtain the schedule of discounted bills receivable dishonoured.
2. Check the entry in bank statement regarding the amount of bills dishonoured and see that the bank has debited the account of client.
3. Verify the bills receivable returned by the bank along with bank's advice.
4. See that the dishonoured bills have been noted and protested by following the proper procedure and the account of the drawee or the trade receivable is also debited.
5. Check that bank commission, if any, charged by the bank has been recovered from the party.

Q.20 Comment on the following; "It is not essential to verify the sale proceeds of scrap which did not have a significant value if the company had a good accounting and costing systems".

Answer: Verification of Sale Proceeds of Scrap:

- The existence of a good accounting and costing system would provide evidence about the adequacy and reliability of accounting records, but it does not provide assurance as to other aspects like sale price of scrap, quantity of scrap produced, billing of scrap sold etc.
- Auditor is required to review the production and cost records for the determination of the extent of scrap materials that may arise in a given period. In the ordinary course of duties, the auditor should ensure that scrap generated in the company, if any, are properly accounted for.
- Besides the rates at which the scrap have been sold, correct billing of the same and their identification that good quality material has not been mixed up, are the other aspects to be examined by the auditor.

Conclusion: Statement is not correct, auditor cannot overlook other aspects like existence of internal control, percentage of scrap produced, sale price of scrap etc.

5.6 – AUDIT OF TRADING TRANSACTIONS

Q.21 While conducting the audit of the accounts of a manufacturing company, you discover that the rate of Gross Profit on Sales has sharply risen in comparison to the previous year. State the steps you would take to satisfy yourself.

or

In the course of audit of a trade, you noticed that although there is no change in either selling or purchase price of the goods, there is considerable increase in Gross Profit Ratio in comparison to previous year. What matters would you examine to assess the reason for such increase?

or

Give various factors which result in increase in gross profit.

[May 11 (8 Marks)]

Answer: Factors causing increase in Gross Profit:

1. **Increase in Sales Prices:** Auditor should enquire whether there have been general or specific price increase and the reasons for the same. He should obtain copies of the company price lists prevailing at different point of time for the purpose of comparison.
2. **Reduction in Cost of Manufacturing:** The auditor should compare current costs with those in the previous year and detailed information supporting the possibility should be sought from the company.
3. **Alteration in Sales-mix:** Auditor should analyse the sales in detail to ascertain whether the more profitable lines constituted a large proportion of the total sales.
4. **Impact of Automation:** The automation of certain manufacturing processes may have resulted in considerable saving in labour cost and this possibility could be easily verify by comparisons of wages records.
5. **Adherence to Cut-off Procedures:** The company cut-off procedures as regards closing stock and work-in-progress should be investigated, as any change in the procedure as compared with the previous year would cause a difference in the gross profit ratio.
6. **Manipulating Sales:** The possibility of items which have been sent to customers on 'sale or return' basis being included in sales, should be investigated, as this would give effect for increase in the rate of gross profit.

7. **Adjustment in opening and closing inventory:** Gross profit may be increased by making adjustment in the following manner:
- Understatement of opening inventory
 - Overstatement of Closing Inventory
 - Alteration of basis of valuation of inventory.
8. **Wrong Allocation of Expenses:** Gross profit may be increase by wrong allocation of expenses, for example, wages paid for operating activities may be capitalized to capital assets, carriage inwards may be charged to profit and loss account instead of trading account.

Q.22 While conducting the audit of accounts of a manufacturing company, you discover that the rate of Gross Profit on Sales has sharply decreased in comparison to the previous year. State the steps you would take to satisfy yourself.

or

As the statutory auditor of A Ltd., you have observed that the gross profit of the company has decreased in comparison to last years. Mention the possible factors which may be responsible for decrease in gross profit. **[Nov. 15 (6 Marks)]**

Answer: Factors causing decrease in gross profit:

- Decrease in Sales Prices:** Auditor should enquire whether there have been general or specific price decrease and the reasons for the same. He should obtain copies of the company price lists prevailing at different point of time for the purpose of comparison.
- Increase in Cost of Manufacturing:** The auditor should compare current costs with those in the previous year and detailed information supporting the possibility should be sought from the company.
- Alteration in Sales-mix:** Auditor should analyse the sales in detail to ascertain whether the less profitable lines constituted a large proportion of the total sales.
- Adherence to Cut-off Procedures:** The company cut-off procedures as regards closing stock and work-in-progress should be investigated, as any change in the procedure as compared with the previous year would cause a difference in the gross profit ratio.
- Adjustment in opening and closing inventory:** Gross profit may be decreased by making adjustment in the following manner:
 - Overstatement of opening inventory
 - Understatement of Closing Inventory
 - Alteration of basis of valuation of inventory.
- Wrong Allocation of Expenses:** Gross profit may be decreased by wrong allocation of expenses, for example, wages paid for installation of machinery may be charged to wages account, Carriage outwards may be charged to trading account instead of profit & loss account.
- Other reasons:**
 - Goods sold or given as sample or destroyed, not accounted for.
 - Insurance claims received in respect of goods destroyed, not credited to trading account.
 - Excess provision for wages or direct expenses has been made.
 - Reversal of fictitious sale entries recorded earlier.

Q.22A

How will you vouch and verify the following: Profit or loss arising on sale of plots held by real estate dealer. [Nov. 13 (4 Marks)]

Answer: Profit or loss arising on sale of plots held by real estate dealer:

1. Examine the account of each property with special reference to the nature of charges so as to find out that only the appropriate cost and charges have been debited to the account and the total cost of the property has been matched against the price realised for it.
2. Scrutinise the basis of distribution of the common charges between different plots of land developed during the period and basis for allocation of cost to individual properties comprised in a particular piece of land.
3. Compare the prices of land as per price list with actual selling prices.
4. The sale price of different plots of land should be verified with cross reference to certified copies of sale deeds executed.

Q.23 How will you vouch/verify the following:

[May 06 (4 Marks)]

(a) Purchase Returns

Answer: Vouching of Purchase Returns:

- (a) Examine debit note issued to the supplier which in turn may be confirmed by corresponding credit note issued by the supplier acknowledging the same. The relevant correspondence may also be examined.
- (b) Verify by reference to relevant corresponding record in good outward book or the stores records.
- (c) Quantity and Value of Purchase Returns should be compared with the supplier's original invoices.
- (d) Examine in depth to eliminate the possibility of fictitious purchase returns for covering bogus purchases recorded earlier when such returns outwards are in substantial figure either at the beginning or end of the accounting year.
- (e) Cross-check with reference to original invoices any rebates in price or allowances if any given by suppliers on strength of their Credit Notes.

(b) Purchase with Invoice

[May 13 (4 Marks)]

Answer: Vouching of Purchase with Invoices:

While vouching entries for purchases with the invoices, the auditor should consider the followings:

1. Ensure that the date of invoice falls within the accounting period for which audit is to be performed;
2. Ensure that the invoice is made out in the name of the client;
3. Ensure that the credit to the supplier has been given with the full amount of the invoice;
4. Ascertain the nature of goods purchased and ensure that the goods purchased are those that are regularly dealt in by the concern and that the price payable has been correctly arrived at;
5. Trace the recording of purchases to an appropriate nominal account or accounts;
6. Ensure that the invoice has been verified by the accountant as well as by the store-keeper to indicate that the delivery of goods have been taken by him.; and
7. Ensure that payment has been made only after authorisation by the manager or some other official, competent to sanction payment, has authorised its payment.

Q.22A

How will you vouch and verify the following: Profit or loss arising on sale of plots held by real estate dealer. [Nov. 13 (4 Marks)]

Answer: Profit or loss arising on sale of plots held by real estate dealer:

1. Examine the account of each property with special reference to the nature of charges so as to find out that only the appropriate cost and charges have been debited to the account and the total cost of the property has been matched against the price realised for it.
2. Scrutinise the basis of distribution of the common charges between different plots of land developed during the period and basis for allocation of cost to individual properties comprised in a particular piece of land.
3. Compare the prices of land as per price list with actual selling prices.
4. The sale price of different plots of land should be verified with cross reference to certified copies of sale deeds executed.

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[May 06 (4 Marks)]

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- (e) Cross-check with reference to original invoices any rebates in price or allowances if any given by suppliers on strength of their Credit Notes.

(b) Purchase with Invoice

[May 13 (4 Marks)]

Answer: Vouching of Purchase with Invoices:

While vouching entries for purchases with the invoices, the auditor should consider the followings:

1. Ensure that the date of invoice falls within the accounting period for which audit is to be performed;
2. Ensure that the invoice is made out in the name of the client;
3. Ensure that the credit to the supplier has been given with the full amount of the invoice;
4. Ascertain the nature of goods purchased and ensure that the goods purchased are those that are regularly dealt in by the concern and that the price payable has been correctly arrived at;
5. Trace the recording of purchases to an appropriate nominal account or accounts;
6. Ensure that the invoice has been verified by the accountant as well as by the store-keeper to indicate that the delivery of goods have been taken by him.; and
7. Ensure that payment has been made only after authorisation by the manager or some other official, competent to sanction payment, has authorised its payment.

Q.24 Discuss the special precautions in verification of purchase invoice.

Answer: Special Precautions in verification of purchase Invoice:

1. **Adjustment of Invoice Amount:** In case, the total amount of the invoice has been adjusted in separate accounts, the entire amount so adjusted should be added together to confirm that there has not been error under adjustment.
2. **Duplicate copy of Invoice:** Ensure that if the payment is adjusted on the basis of duplicate invoice, the original invoice also needs to be marked as paid at the same time.
3. **Compliance of special conditions:** If supplies are received on certain special conditions, verified that these conditions are the same as were agreed to at the time the order was placed, e.g., payment of freight and insurance charges of goods while in transit, etc.
4. **Timings of Payment:** If the amount of an invoice was payable after the lapse of some time, subsequent to the receipt of goods, it should be ascertained that it has not been paid earlier and the benefit of cash discount, if any, has been obtained.
5. **Goods purchased for personal use:** Where goods have been purchased for the use of an officer but the invoice is made out in the name of the entity, it should be seen that the cost has been charged to the officer concerned and not to the Purchases Account of entity.
6. **Purchases from related parties:** If purchases are made from the associated concerns, ensure that such purchases are made only under an appropriate sanction.
7. **Inspection before taking delivery:** Ensure that the goods were inspected on arrival and the delivery note and the goods inward note should be examined.
8. **Goods delivered directly to customer:** The auditor should make appropriate inquiries in order to establish that the transaction was appropriately authorised by a responsible official. A copy of the delivery note signed by the account receivable on delivery of the goods should be examined, and it should be ascertained whether the account receivable is a regular purchaser of the company's goods and not an employee of the company wishing to take advantage of a weakness in the system.

Q.24A A trader is worried that inspite of substantial increase in sales compared to earlier year, there is considerable fall in Gross Profit after satisfying himself that sales and expenses are correctly recorded and that the valuation of inventories is on consistent basis, he wants to ensure that purchases have been truthfully recorded.

How will you proceed with this assignment?

[May 10 (10 Marks)]

Answer: Verification of Purchases:

(A) **Study and evaluation of internal control system:** w.r.t. following:

- Segregation of duties in respect of various activities like (a) Requisitioning the goods (b) Ordering the goods requisitioned (c) Receiving the goods ordered (d) Preparing the payment voucher.
- Ensure that printed and pre-numbered forms should be used for purchase requisitions, purchase orders, receiving reports and vouchers.
- Authorisation procedures should be designed for all various control points – requesting the goods, ordering the goods requisitioned, receiving the goods ordered and preparing the payment voucher.
- Ensure that there is adequate separation of duties and proper authorisation procedures with regard to processing and recording of purchase transactions.

(B) **Vouching of purchases transactions:** The auditor should vouch credit purchases in the following manner:

- Ensure that the date of invoice falls within the accounting period for which audit is to be performed;
- Ensure that the invoice is made out in the name of the client;
- Ensure that the credit to the supplier has been given with the full amount of the invoice;
- Ascertain the nature of goods purchased and ensure that the goods purchased are those that are regularly dealt in by the concern and that the price payable has been correctly arrived at;
- Trace the recording of purchases to an appropriate nominal account or accounts;
- Ensure that the invoice has been verified by the accountant as well as by the store-keeper to indicate that the delivery of goods have been taken by him.; and
- Ensure that payment has been made only after authorisation by the manager or some other official, competent to sanction payment, has authorised its payment.

(C) **Perform Analytical procedures:** Compare item-wise and location-wise both quantity and value of purchases for the current period with the corresponding figures for the previous period and ensure that major variations are explained and justified. Various analytical ratios should also be calculated and compare.

5.7 – AUDIT OF SALES

Q.25 How will you vouch/verify the following:

(a) **Credit Sales.**

Answer: Vouching of Credit Sales:

The credit sales should be verified with reference to copies of invoices issued to customers and, in the process, following needs to be examined:

1. Ensure that sales belongs to the accounting period under audit;
2. Ensure that that the goods are those that are normally dealt in by the concern.
3. Verify the sale price and check that the sale price has been correctly arrived at.
4. Trace the amount of the invoice has been recorded in an appropriate account; and
5. Ensure that the sale has been authorised by a responsible official and in token thereof he has initialed the invoice; also that any alteration in the invoice has been attested by the same person.

(b) **Sales Return.**

[Nov. 05 (4 Marks)]

Answer: Vouching of Sales Return:

1. Examine the accounting basis for such transactions by having reference to corresponding Debit Note.
2. Verify Sales return with reference to relevant corresponding record in good inward book or the stores records.
3. Quantity and value of sales returns should be compared with the original invoices.
4. Examine in depth to eliminate the possibility of fictitious sales returns so as to cover bogus sales recorded earlier particularly when such returns outwards are in substantial figure either at the start or end of the accounting year.
5. Cross-check with reference to original invoices any rebates in price or allowances if any given by buyers on strength of their Debit Notes.

(c) Sale of Empties**Answer: Vouching of Sale of Empties:**

When the empties or containers in which goods necessarily have to be supplied are costly, the manufacturer normally agrees to purchase them back at a reduced price as compared to the one charged for them. Therefore check whether

1. Separate account of issue and receipt of empties has been prepared.
2. In separate maintained a/c check how many empties lies in warehouse and how many are with customers.
3. Check how many empties customers may return after the close of the year.
4. Check whether proper provision has been made against the contingency of the containers being returned by customers and that for the wear and tear.
5. Check the amount of sale with entry in cash book.
6. See the sold empties are reduced from the stock.

(d) Consignment Sales**Answer: Vouching of Consignment Sales:**

1. Verify the terms of agreement between the consignor and the consignee to ascertain the terms and conditions regarding commission and other expenses.
2. Ensure that the goods consigned are not treated as ordinary sales.
3. Ensure that the gross sale proceeds as mentioned in the account Sales has been credited to the Consignment Account and debited to the consignee's account.
4. Ascertain that credit has been taken only for the profit on the goods sold through the consignee before the year end. No profit should be taken for the profit on goods remaining in the hands of the consignee.
5. Ensure that the stock lying with the consignee at the end should be taken in the balance sheet at cost on a consistent basis and credited to the Consignment A/c to arrive at the result of the consignment transactions.
6. Obtain confirmation of the balance in the account of the consignee from the consignee.
7. In case, goods are consigned at invoice price, auditor should ensure that the necessary adjustments to remove the loading have been made.
8. Examine the adjustments made at the year end in respect of the goods not yet sold, commission and the expense incurred by consignee.

(e) Goods sent out on sale or return basis.**[Nov. 09 (5 Marks), Nov. 16 (4 Marks)]****Answer; Vouching of Goods sent on sale or return basis:**

1. Check maintenance of separate memoranda records of goods sent out on sale or return. Only after approval from customer, personal account of customer is debited and the sales account is credited.
2. Ensure that the price of such goods is unloaded from the sales account and the debtor's record before the approval from customer.
3. In respect of the goods for which approval period has expired, ensure that either goods have been received back or customer's account have been debited.
4. In respect of the goods for which approval period has not expired till the close of the year and lying with the party, ensure that cost of such goods has been included in the closing stock.

5.8 – CUT OFF ARRANGEMENT

[May 11 (5 Marks), May 14 (4 Marks)]

Q.26 Write short note on: Cut Off procedures.

Answer: Cut Off Arrangement:

- **Meaning:** It refers to segregation of transaction of one period from the other so that the result of working of each period can be correctly ascertained. The arrangement that is made to ensure such separation is technically known as 'cut- off procedure'. It is part of the internal control system of the organization.
- **Applicability:** This procedure is generally applied to transactions affected by the continuity of business like sales, purchase and stock. Cut-off procedures are also relevant' in other areas, such as determining the cut offs for cash and bank balances.
- **Advantages:** This procedure ensures that goods purchased during a year have been included in inventory and the liability has been provided in the case of credit purchase. Similarly goods sold have been excluded from the inventories and credit has been taken for the sales.

5.9 – AUDIT OF LEDGERS

Q.27 Explain the steps involved in carrying out the audit of ledgers.

Answer: Steps Involved in carrying out audit of ledgers:

1. Examine the extent and effectiveness of internal check;
2. Tracing the opening balances from the last year's records;
3. Checking the postings from various books of prime entry and, if they are kept on the self-balancing system, also tallying the totals of balances in subsidiary ledgers with those in the total of control account;
4. Checking the closing balances of individual accounts on the balance schedule;
5. Checking the totals of ledger accounts, trial balance, schedules and groupings;
6. Verifying the ledger balances as below:
 - Personal accounts - either with the statements of account or confirmation of balances obtained from the parties;
 - Impersonal accounts like fixed assets - with the schedules containing details of assets and liabilities.
 - Nominal accounts - by reference to the documentary evidence;
7. Scrutinizing the accounts generally and, in particular, examining the composition of final balances; and
8. Ascertaining the extent of clearance of the balances brought forward from the last year particularly those relating to receivables and payables, sale or disposal of fixed assets and of inventories.

Q.28 List out some examples of fraud that can be done by ledger keeper in Bought Ledger and Sales Ledger.

[May 11 (8 Marks)]

Answer: Examples of Fraud:**(A) Bought Ledger:**

1. Adjusting fictitious or duplicate invoices as purchases in the accounts of suppliers and subsequently misappropriating the amounts when payments are made to the suppliers in respect of these invoices.
2. Suppressing the Credit Notes issued by suppliers and withdrawing the corresponding amounts not claimed by them.

3. Withdrawing amounts unclaimed by suppliers, for one reason or another by showing that the same have been paid to them.
4. Accepting purchase invoices at prices considerably higher than their market prices and collecting the excess amount, paid in cash, from the suppliers.

(B) Sales Ledger:

1. Teeming and Lading.
2. Misappropriating the amount collected from a customer and subsequently adjusting his account by crediting the amount on account of allowance or a rebate for excess price charged.
3. Crediting the amount received from a customer to the account of another customer and subsequently withdrawing the amount wrongly credited.
4. Writing off the amount receivable to bad debt account and misappropriating the amount received in payment of the debt.

Q.29

Write short note on: Scrutiny of General Ledger.**[May 06, Nov. 16 (4 Marks)]****Answer: Scrutiny of General Ledger:**

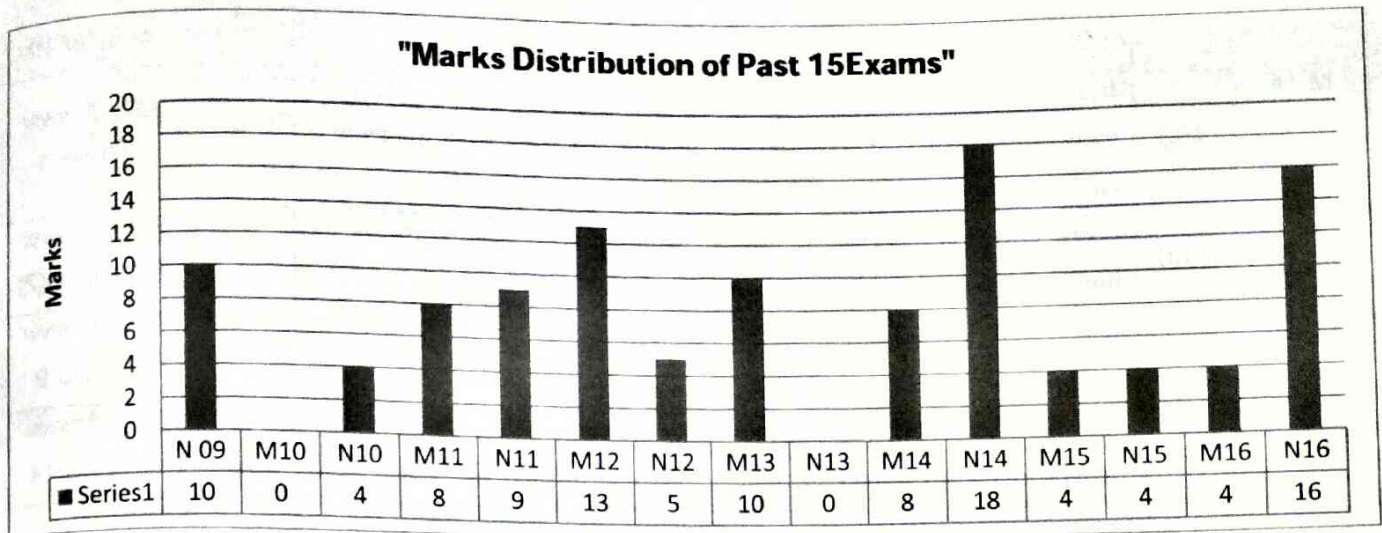
1. The General Ledger contains all the balances which are ultimately included in the Profit and Loss Account and the Balance Sheet. Hence it should be examined in last.
2. Entries in the General Ledger are posted in a summary form from the subsidiary books like Cash Book, Journal, Sales Book, Purchase Book etc. The auditor should see that correct amounts are posted in the correct account on the correct side. No entry should be left unposted or posted twice.
3. Ensure that all items of income adjusted for accrued and received in advance. All items of expenses must be adjusted for outstanding and prepaid.
4. Ensure that the totals are made correctly and there is no casting error. It should also be ascertained that correct amount are carried forward on correct side.
5. The balances in the General Ledger should be traced to the trial balance and from the trial balance to the final accounts. Total of debit side and credit side of the trial balance must tally.

Q.30

What points shall an auditor keep in mind while auditing an account of Bought Ledger having a debit balance?**Answer: Points to be kept in mind while auditing bought ledger with debit balance:**

1. Debit Balance in the bought ledger may represent the amount receivable on account of goods returned, rebate allowed by the supplier or advance paid against an order. The auditor should consider the following points while auditing:
 2. Confirm that the advance against the order had been paid in pursuance of a recognised trade practice, also that subsequently goods have been received against the advance.
 3. Ensure that debit balance may not be due to some error, for example, cost of goods purchased may be wrongly debited to the account of the supplier, instead of the Purchase Account.
 4. Ascertain that the debit balance is good and recoverable and if it is not considered recoverable, a provision against the same has been made.
 5. If the debit balance represents a loan to a director or officer of the company, the same should be separately disclosed in the Balance Sheet in accordance with the provisions contained in Schedule III to the Act.
 6. The maximum account due from the directors or other officers of the company at any time during the year should also be disclosed alongwith the names of companies.

Q.31 Objective Type Questions (Correct/Incorrect)	
1	<p>PQR Ltd. Include underwriting commission and stamp duty as preliminary expenses. [May 13 (2 Marks)]</p> <p>Answer: Statement is partly correct.</p> <ul style="list-style-type: none"> • Preliminary expenses include the expenses incidental to the creation and floating of a company, i.e. stamp duties, registration fees, legal costs, accountant's fees, cost of printing, etc. • Underwriting commission and brokerage paid for shares and debentures should not be included under the head preliminary expenses.
2	<p>The whole Time Director of a Public Company is automatically entitled for Remuneration. [May 14 (2 Marks)]</p> <p>Answer: Statement is not correct.</p> <p>Sec. 197 of Companies Act, 2013 provides that the remuneration payable to the directors of a company, including any managing or whole-time director or manager, shall be determined, in accordance with and subject to the provisions of this section, either by the articles of the company, or by a resolution or, if the articles so require, by a special resolution, passed by the company in general meeting.</p>
3	<p>ABC Ltd., a government company came into existence in year 2014, donated Rs. 50,000 to a political party. [May 14 (2 Marks)]</p> <p>Answer: Statement is Incorrect.</p> <p>As per Section 182 of the Companies Act, 2013, government company is not allowed to contribute any amount directly or indirectly to any political party.</p>
4	<p>Teeming and lading is one of the techniques of inflating cash payments. [Nov. 15 (2 Marks)]</p> <p>Answer: Statement is incorrect.</p> <ul style="list-style-type: none"> • Teeming and Lading is one of the techniques of suppressing cash receipts and not of inflating cash payments. • Money received from one customer is misappropriated and the account is adjusted with the subsequent receipt from another customer and so on.



Scanner of Past Examination Questions (Nov. 2009 – Nov. 2016)				
Attempt	Q. No.	Questions	Marks	Suggested Answer
N-09	7(b)	How will you vouch/verify the followings: Leasehold Property	5	Refer Answer of Q. No. 9
	7(c)	How will you vouch/verify the followings: Bank Overdraft	5	Refer Answer of Q. No. 39
M-10			0	
N-10	6(d)	Responsibility for properly determining the quantity and value of inventory rests with the management." Comment on this statement.	4	
M-11	4(b)	Define depreciation and discuss various purposes of providing depreciation.	8	Refer Answer of Q. No. 4
N-11	1(d)*	What procedure an auditor should adopt to test the authenticity of cash at bank.	5	Refer Answer of Q. No. 32
	7(d)	Write short note on: Verification of assets acquired on lease.	4	Refer Answer of Q. No. 9
M-12	1(c)*	Distinguish between Reserves and Provisions.	5	Refer Answer of Q. No. 5
	4(b)	You are the auditor and examining the book debts of a company. Give some indications which leads to doubt about recovery as uncollectable debts from debtors and advances.	8	Refer Answer of Q. No. 28
N-12	1(c)*	Write short note on: Purposes of providing depreciation.	5	Refer Answer of Q. No. 4
M-13	2(v)	Correct/Incorrect: Company can provide lower rate of depreciation than prescribed by Schedule XIV of the Companies Act; 1956.	2	Refer Answer of Q. No.48(1)
	4(b)	How will you vouch/verify the followings: (ii) Patterns, dies, loose tools etc. (iii) Work-in-Progress	8	Refer Answer of Q. No. 11 & 18

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N-13			0	
M-14	3(b)	How you will verify the following: Building	4	Refer Answer of Q. No. 10
	7(a)	Indicate expenses which are essentially of a revenue nature, if incurred for creating an asset, are also regarded as expenditure of a capital nature.	4	Refer Answer of Q. No. 1
N-14	2(iii)	Correct/Incorrect: The Statutory Auditor is required to verify inventory physically.	2	Refer Answer of Q. No.48(2)
	3(a)	How you will verify the following: Assets acquired on lease.	4	Refer Answer of Q. No. 9
	3(b)	How you will verify the following: Investment in the shares and debentures of subsidiary.	4	Refer Answer of Q. No. 14
	3(c)	How you will verify the following: Provision for income tax.	4	Refer Answer of Q. No. 44
	6(b)	Purpose of Providing Depreciation	4	Refer Answer of Q. No. 4
M-15	3(c)	How will you verify the following: Work in Progress	4	Refer Answer of Q. No. 18
N-15	3(d)	How will you verify the following: Intangible Assets	4	Refer Answer of Q. No. 12(a)
M-16	3(c)	How will you verify the following: Floating Assets	4	Refer Answer of Q. No. 47
N-16	2(v)	Correct/incorrect: Capital Reserve and Reserve Capital are the same.	2	Refer Answer of Q. No.48(3)
	2(ix)	Correct/incorrect: All intangible assets are not required to be amortized.	2	Refer Answer of Q. No.48(4)
	4(b)	Mention the purpose for which capital expenditure is incurred.	6	Refer Answer of Q. No. 3A
	6(b)	Is there any statutory necessity to make disclosure of depreciation in company's accounts?	6	Refer Answer of Q. No. 4A

* Compulsory Questions

QUESTIONS and ANSWERS**6.1 - CAPITAL AND REVENUE EXPENDITURE**

Q.1 Indicate Expenses which are essentially of a revenue nature, if incurred for creating an asset, are also regarded as expenditure of capital nature. **[May 14 (4 Marks)]**

Answer: Expenses of Revenue Nature regarded as Capital Expenditure:

1. Material and wages when expended on the construction of a building or erection of machinery.
2. Legal expenses incurred in connection with the purchase of land or building.
3. Freight when incurred in respect of purchase of plant and machinery.
4. Major repairs of a fixed asset that increases its productivity.
5. Wages paid on installation costs incurred in Plant & Machinery.
6. Interest paid for the qualifying period as per AS-16 i.e. before the asset is constructed.

Q.2 Write short note on: **Deferred Revenue Expenditure.**

Answer: Deferred Revenue Expenditure:

- Revenue expenditure, whose benefit extends to more than one accounting period are known as deferred revenue expenditure.
- As per accountancy principles only that part of the expenditure which is pertaining to the accounting period can be charged to the Statement of Profit and Loss of the year, remaining amount should be carried forward in the Balance Sheet and it should be written off against the future income.
- Part of such revenue expenditure which is not yet charge to Statement of Profit and Loss is to be treated as assets for the purpose of disclosure in the balance sheet for the time till the benefit of such expenditure is fully exhausted.
- Examples of deferred revenue expenditure are expenditure on an advertisement campaign to launch a product in the market, discount allowed on subscription to debentures, development expenses in the case of mines and plantations, etc.
- While verifying deferred revenue expenditure, the auditor must satisfy himself that:
 1. it is proper to defer the expenditure;
 2. the period of amortisation of the expenditure is reasonable;
 3. the expenditure shown to have been incurred during the year actually occurred during the year and there is proper authority for the expenditure and for its deferral;
 4. the criteria which previously justified the deferral of the expenditure continue to be met and the expected future revenue / other benefits related to the expenditure continue to exceed the amount of unamortized expenditure.
 5. the necessary principles laid down under AS 26 "Intangible Assets" have been examined, to ensure whether such kind of deferment is allowed to be made or not.

Q.3 Distinguish between Capital expenditure and Deferred revenue expenditure. **[Nov. 07 (4 Marks)]**

Answer: Capital Expenditure vs. deferred Revenue Expenditure

- (a) Capital expenditure result in acquisition of new fixed assets or increase in future benefits from existing fixed assets beyond pre-assessed level.
Deferred revenue expenditure are expenditure of a revenue nature which bring in future benefits without creating a tangible or intangible fixed assets or by way of improvement in the existing assets.
- (b) Capital expenditure adds to the net worth of the concern. Deferred revenue expenditure is not considered in calculating net worth.

- (c) Capital expenditure is shown under the head non current assets in balance sheet. Deferred revenue expenditure is shown under the head "Miscellaneous expenditure not written off or adjusted". However in case of a company, entire amount need to be charged to Statement of Profit and Loss as there is no heading of Misc. expenditure in Schedule III to Companies Act, 2013.

Q.3A **Mention the purpose for which capital expenditure is incurred.**

[Nov. 16 (6 Marks)]

Answer: Purpose for which capital expenditure is incurred:

A capital expenditure may be incurred for the under mentioned purposes-

- Acquiring fixed assets, i.e., assets of a permanent or a semi-permanent nature, which are held not for resale but for use with a view to earning profits.
- Making additions to the existing fixed assets.
- Increasing earning capacity of the business.
- Reducing the cost of production.
- Acquiring a benefit of enduring nature of a valuable right.

The different forms that capital expenditure takes are: (i) land; (ii) building; (iii) plant and machinery; (iv) electric installations; (v) premium paid for the lease of a building; (vi) development expenditure on land; and (vii) goodwill; etc.

6.2 - DEPRECIATION

Q.4 **Define Depreciation and discuss various purposes of providing depreciation.**

[May 11 (8 Marks)]

Or

Write short note on: Purposes of providing depreciation.

[Nov. 14 (4 Marks)]

Answer: Depreciation and purpose of providing depreciation:

AS 10 "Property, Plant and Equipment" defines depreciation as the systematic allocation of the depreciable amount of an asset over its useful life. Depreciable amount is the cost of an asset, or other amount substituted for cost less, its residual value.

Purposes of Providing depreciation:

- To provide the funds for the replacement of assets:** This is accomplished by retaining the amount of depreciation charged in the profit and loss account in the business.
- To determine true cost of manufactured goods:** As the value of fixed assets depletes gradually by consumption during the process of production, it is necessary that such consumption of value be charged in the accounts for determination of the true cost of production.
- To determine the profit or loss for the year:** Depreciation being an expense represented by the loss in value of fixed assets arising on use, it is charged to the profit and loss account for determining the profit or loss during a year
- To show a true and fair value of entity's assets in the balance sheet:** since the original costs of fixed assets gradually decreases due to use and other factors, it is improper to continue to carry such assets at original costs. Therefore, the amount of depreciation charged in the profit and loss account representing the loss in value of the assets is deducted from the original cost on a cumulative basis so as to reflect in the balance sheet a true and fair value of the fixed assets.

Q.4A Is there any statutory necessity to make disclosure of depreciation in company's accounts?

[Nov. 16(6 marks)]

Answer: Disclosure of depreciation in company's accounts

Disclosure of depreciation in the accounts is a statutory necessity due to below mentioned provisions:

- Schedule II to the Companies Act, 2013 needs disclosure in the financial statements about the depreciation method used and the useful lives of the assets for computing depreciation, if they are different from the life specified in the Schedule II.
- Schedule III "General Considerations for preparation of Balance Sheet and Statement of Profit and Loss of a Company", to the Companies Act, 2013, requires separate disclosure of depreciation charged and impairment losses/reversals along with 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 and other adjustments.
- AS 6 requires following information to be disclosed in the financial statements;
 - (i) the historical cost or other amount substituted for historical cost of each class of depreciable assets;
 - (ii) total depreciation for the period for each class of assets; and
 - (iii) the related accumulated depreciation.
- AS 6 also requires disclosure of below mentioned information in the financial statements alongwith the disclosure of other accounting policies:
 - (i) depreciation method used; and
 - (ii) the useful lives of the assets for computing depreciation, if they are different from the life specified in the Schedule.

6.3 – RESERVES AND PROVISIONS

Q.5 Distinguish Between: Reserves and Provisions.

[May 07, May 12 (5 Marks)]

Answer: Reserves and Provisions:

Reserves	Provisions
(a) It is an appropriation of profit	(a) It is a charge against Profit.
(b) They are not intended to meet any liability, contingency or diminution in the value of assets, though may be made for some specific purposes, like redemption of debentures.	(b) They are made to provide for depreciation, renewal or a known liability or a disputed claim
(c) Reserves cannot be created unless there is a profit except a few like revaluation reserve	(c) They must be created whether or not there is profit
(d) Reserves are generally optional except few ones like creation of CRR, DRR, etc	(d) Provisions are not optional and have to be made as per generally accepted accounting principles.

Q.6 Write a short note on "Provisions versus Specific Reserves".

Answer: Provisions:

- Provisions are amounts charged against revenue to provide for depreciation, renewal or diminution in the value of assets or a known liability the amount of which cannot be determined with substantial accuracy or a claim which is disputed.
- Amounts contributed or transferred from profits to make good the diminution in assets values due to the fact that some of them have been lost or destroyed, as a result of some natural calamity or debts have proved to be irrecoverable are also described as provisions.
- Provisions are normally charged to the Statement of Profit and Loss before arriving at the amount of profit.

Specific Reserves:

- Specific reserves are created for some definite purpose out of the profits of the company. The purpose may be anything connected with the business which the Article of Association or, the directors want to be provided for, such as dividend equalization, replacement of fixed assets, expansion of the organization, Income-tax liability for future foreign exchange fluctuation etc.
- Though the concerned amounts are carried under the earmarked heads, these are available for distribution as dividend on the recommendation of directors but subject to the approval of shareholders, since these are created by appropriation of profits.
- To create any specific reserve, existence of profit is essential.
- Some of the specific reserves may be required under the contractual obligations or legal compulsion, for example: (i) funds for redemption of debentures and (ii) development rebate reserve.

6.4 – VERIFICATION OF ASSETS

Q.7 Write short note on: General Principles of Verification of Assets.

[May 06 (4 Marks)]

Answer: General Principles of Verification of Assets:

Verification of assets is an audit procedure, normally carried out at the year end to confirm the ownership, valuation and existence of items at the Balance Sheet date. Primarily verification of assets is the responsibility of the management.

The auditor, however, should verify the assets so as to confirm the followings:

- Existence:** to ensure that the assets were in existence on the date of Balance Sheet.
- Purpose:** to ensure that the assets have been acquired for the purpose of the business and under a proper authority.
- Ownership:** to ensure that the right of ownership of the assets vested in or belonged to the undertaking.
- Charge:** to ensure that assets were free from any lien or charge not disclosed in the Balance Sheet.
- Valuation:** to ensure that assets have been correctly valued having regard to their physical condition; and
- Disclosure:** to ensure that their values are correctly disclosed in the Balance Sheet.

Q.8 Distinguish between: Vouching and Verification.**Answer: Vouching vs. Verification:**

Vouching	Verification
(a) It examines the entries relating to the transactions recorded in the books of account.	(a) It examines the assets and liabilities appearing in the balance sheet of the enterprise.
(b) It ensures completeness, accuracy and validity of transactions.	(b) It confirms existence, ownership, valuation and disclosure of B/S items.
(c) It is based only on documentary evidence.	(c) It involves physical examination also.
(d) It is done throughout the year	(d) It is done at the end of year after preparation of balance sheet.
(e) It is not concerned with valuation.	(e) It also includes valuation.

6.5 – VERIFICATION OF NON CURRENT ASSETS**Q.9 How will you vouch or verify: Leasehold properties****[Nov. 09 (5 Marks)]****Or****Write short note on: Verification of assets acquired on lease. [Nov. 11 (5 Marks), Nov. 14 (4 Marks)]****Answer: Verification of Assets acquired on lease:**

1. Inspect the lease agreement to ascertain the amount of premium payable and other terms and conditions and its registration. A lease exceeding one year is not valid unless it has been granted by a registered instrument (Sec. 107 of the Transfer of Property Act, 1882).
2. Ascertain that all the necessary conditions prescribed by the lease, are being duly complied with.
3. Examine the counterpart of the tenants' agreements, if part of the leasehold property has been sublet.
4. Ensure that the outlay as well as any legal expenses incurred to acquire the lease which are shown as an asset in the Balance Sheet are being written off at a rate which could completely wipe off the asset over the unexpired term of the lease.
5. Ensure that assets acquired under finance lease are segregated from the assets owned.
6. Ensure compliance of requirements of AS-19 and disclosure requirements of Schedule III to the Companies Act 2013.

Q.10 How will you verify the Building?**[May 14 (4 Marks)]****Answer: Verification of Building:**

1. Examine the title deeds of buildings to ascertain the ownership of the building. If the title deeds are kept in custody of third party, obtain a certificate to that effect and ensure whether there exists any mortgage over the property.
2. Verify the original cost of buildings with reference to the conveyance deed. If the building is self constructed, verify the original cost with reference to the cost as recorded in the books of account.
3. Ensure that appropriate depreciation has been provided. In case depreciation has not provided, a note to this effect should be given in the statement of Profit and Loss.
4. In case of leasehold building, examine lease deed, to ascertain the cost, amortisation, etc. and also ensure compliance of all terms and conditions as contained in the lease deed.

5. Ensure that buildings have been carried at its appropriate value as per the provisions of AS-10 "Property, Plant and Equipment".
6. In case of a company, compliance of requirements of Schedule II and III to the Companies Act, 2013, needs to be ensured.
7. Examine that the relevant particulars of buildings have been entered in the fixed assets record maintained by the client.

Q.11 How will you vouch or verify: Patterns, Dies and Loose Tools Etc.

[May 13 (4 Marks)]

Answer: Verification of Patterns, Dies and Loose Tools:

- (a) Obtain a list of inventory of such assets as well as details of date of acquisition, invoice etc.
- (b) Examine whether the entity exercises appropriate control over its storage and issuance.
- (c) Examine the method of accounting followed by the entity and ensure that the method is followed consistently. In case of any change ensure disclosures in the financial statements.
- (d) Ensure that the inventory does not include any worn out or defective articles the life of which has already run out.

Q.12 How will you verify the following:

[Nov. 15 (4 Marks)]

(a) Intangible Assets

Answer: Verification of Intangible Assets:

1. Auditor should ensure that intangible asset should be recognised only if (a) it is probable that the future economic benefits that are attributable to the asset will flow to the enterprise; and (b) the cost of the asset can be measured reliably.
2. Ensure that at initial stages, intangible asset should be measured at cost. After initial recognition an intangible asset should be carried at its cost less any accumulated amortisation and any impairment losses.
3. Ensure that if an item covered does not meet the definition of an intangible asset, expenditure to acquire it or generate it internally is recognised as an expense when it is incurred.
4. In some cases, an asset may incorporate both intangible and tangible elements that are, in practice, inseparable. Ensure that in determining whether such an asset should be treated under AS 10, "Property, Plant and Equipments", or as an intangible asset under AS 26, "Intangible Assets" appropriate judgement has been taken to assess as to which element is predominant.
5. Auditor should also ensure that proper disclosure is made in the financial statements about the carrying amount, amortisation methods, useful lives, etc. in compliance of AS 26 and Schedule III to the Companies Act, 2013.

(b) Goodwill

[May 05 (4 Marks)]

Answer: Verification of Goodwill:

- (a) Ensure that goodwill has been recognized in the books in compliance of AS 26. As per AS - 26, "Intangible Assets", internally generated goodwill is not to be recognised as an asset, as it is not an identifiable resource controlled by the enterprise that can be measured reliably at cost.
- (b) Examine the vendors' agreement to ascertain the amount of goodwill.
- (c) Ensure that whenever business is acquired at a price, payable in cash or otherwise, which is in excess of the value of net assets taken over, such excess amount is the goodwill.

- (d) Ensure that only the amount paid to the vendors not represented by tangible or intangible assets, the value of which can be measured reliably has been debited to goodwill account.
- (e) Ensure goodwill has not recognised in the books by revaluation of assets or writing back the amount of goodwill earlier written off.
- (f) Ensure that the goodwill not yet written off has been properly disclosed under the head "Non-Current Assets" as per Schedule III requirements.
- (g) Ensure amortisation of goodwill over a reasonable period as a matter of financial prudence.

(c) Patents**[Nov. 04 (4 Marks)]****Answer: Verification of Patents:**

- (a) Obtain a list of patents owned by the client as on the balance sheet date and verify ownership of a patent by inspection of the certificate issued in respect of grant of the patent.
- (b) Examine the agreement if it has been so as to find out the total cost.
- (c) In case of outright purchase of patent rights, the purchase consideration, legal fees and registration charges should be included in cost. When they are developed within the organisation, all costs incurred on their development including legal and registration expenses for registration of the patent should constitute the cost.
- (d) Check that the patent rights are alive and legally enforceable.
- (e) Check that renewal fees have been paid on due dates and being charged to revenue. The last renewal receipt should be examined to ascertain that the patent has not lapsed.
- (f) Ascertain that the rate at which the value of each patent is being written off is adequate since the amount paid in respect of each patent should be amortised over its life or a lesser period if its commercial life is shorter; its value would be completely written off by the time it would cease to have a commercial value.
- (g) Ascertain that only the actual cost incurred in the process has been capitalised.

(d) Trade Marks and Copyrights**Answer: Verification of Trade Marks and Copyrights:**

1. Obtain duly signed schedule of Trade Marks and Copyrights and confirm that all of them are shown in the Balance Sheet.
2. Examine the written agreement in case of assignment of Copyrights or transfer of trade marks.
3. Ensure that trade marks and copyrights have been duly registered under respective laws.
4. Verify existence of copyright by reference to contract between the author & the entity and note down the terms of payment of royalty.
5. See that the value has been determined properly and the costs incurred for the purpose of obtaining the trade marks and copyrights have been capitalised.
6. Ascertain that the legal life of the trade marks and copyrights have not expired.
7. Ensure that amount paid for both the intangible assets is properly amortised having regard to appropriate legal and commercial considerations, as per the provisions of AS 26 on Intangible Assets.

CA IPC (Inter) – "Auditing & Assurance"

Q.13 How will you vouch or verify: Capital Work in progress

Answer: Verification of Capital Work in Progress:

Capital Work-in-Progress represents assets under installation. It may be plant or machinery under construction, or construction project for establishment of a new factory. To verify the same, the auditor should take the following steps:

- (a) Examine Board Meeting minute book to check authorisation of capital expenditure.
- (b) Obtain the break up in details of the amount shown in the Balance Sheet under this head.
- (c) Check amount incurred on purchase of plant, machinery or other assets with reference to the stage of completion, and amount paid to the suppliers.
- (d) Examine the allocation of common costs to the Capital WIP.
- (e) Ensure that the assets already put to commercial use has not been covered under Capital WIP.
- (f) Verify that only expenses incurred up to pre commissioning stage are capitalised under this head.
- (g) Obtain Architect's certificate to ascertain the quantum of the Capital WIP.
- (h) Ensure proper disclosure of Capital WIP in the Balance Sheet under the head Non Current Assets.

Q.14 How will you vouch or verify: Investment in the Shares and Debentures of Subsidiary.

Answer: Verification of Investment in Shares and Debenture of Subsidiary:

1. Obtain a complete schedule of all such investments held, showing particulars as regards the name of the subsidiary company, class of shares or debenture, date of purchase, number of units, book value, dividend received etc.
2. Verify the particulars entered in the schedule with the relevant account in the General Ledger.
3. Examine all the investments by inspection of the securities, share scrips or certificates, debenture bonds, etc. If any of the securities are held by bankers, obtain a certificate from the banker which should also disclose the charge, if they are subject to any such charge.
4. These investments should be shown separately as per the requirements of the provisions contained in Part I of Schedule III to the Companies Act, 2013.
5. The shares or debentures of a subsidiary are valued at cost.
6. Ensure that a provision has been made by the holding company for proportionate amount, in case subsidiary has suffered a loss.

Q.15 How will you vouch or verify:

(a) Endowment Policies

Answer: Verification of Endowment Policies:

1. Ascertain the specific purpose for which the endowment policy is taken, e.g., Sinking Fund policies for redemption of debentures, redemption of leases or policies taken for other similar purposes, etc.
2. Verify the terms and conditions of policies and ensure that all such conditions are in force and being followed.
3. Check that premium has been deposited in time and the policy is in force.
4. Examine that proper disclosures have been made in the financial statement in respect of items for which the policy has been taken.

(b) Assets Abroad**Answer: Verification of Assets Abroad:**

1. In respect of immovable properties situated abroad, examine the title deeds.
2. If title deeds are not available for inspection, a certificate should be obtained from the person in whose custody title deeds are kept.
3. Ensure that certificate obtained clearly discloses that the properties are free from any charge or encumbrance.
4. Ensure that the immovable properties abroad have been properly classified and disclosed.

6.6 – AUDIT OF INVENTORIES

Q.16 Comment on the "Responsibility for properly determining the quantity and value of inventories rests with the management of the entity". **[Nov. 10 (4 Marks)]**

Answer: Responsibility for determination of quantity and value of inventories:

Guidance Note on Audit of inventories specifies the following:

- The responsibility for properly determining the quantity and value of inventories rests with the management of the entity.
- The management satisfies this responsibility by carrying out appropriate procedures which will normally include verification of all items of inventory at least once in every financial year.
- This responsibility is not reduced even where the auditor attends any physical count of inventories in order to obtain audit evidence.
- In any auditing situation, the auditor employs appropriate procedures to obtain reasonable assurance to corroborate the management's assertions regarding the following:
 1. Existence: that all recorded inventories exist as at the year-end.
 2. Ownership: that all inventories owned by the entity are recorded and that all recorded inventories are owned by the entity.
 3. Valuation: that the stated basis of valuation of inventories is appropriate and properly applied, and that the condition of inventories is recognised in their valuation.

Q.17 As an auditor, what would you do in the following situation: The company has sent semi-finished goods to third parties for further processing, which is lying with them at the end of the year.

Answer: Semi-finished good lying with third parties:

Semi-finished goods are the part of inventories and therefore such goods, though, not present with the company, should be included in the closing inventory. The auditor is required to undertake the following steps:

- (i) Ensure that semi-finished goods (WIP) have been included for valuation of inventory.
- (ii) Obtain confirmation letters from third parties in respect of quantity lying with them as at the end of the year. The auditor may also consider carrying out the appropriate audit procedure to obtain assurance about the condition of such inventory as per the requirement of SA 501 "Audit Evidence – Specific considerations for Selected items" .
- (iii) Guidance Note on Audit of inventories recommends that auditor should carefully assess the stage of completion of WIP for assessing the appropriateness of its valuation and may perform the following:
 - Examine the production / costing records
 - Hold discussions with the personnel concerned.
 - Obtain expert opinion wherever necessary.
- (iv) Check that the disclosure requirements as specified in Schedule III to the Companies Act, 2013 and AS 2, "Valuation of Inventories" have been followed.

CA IPC (Inter) – "Auditing & Assurance"

Q.18 How will you vouch/Verify the following: **Work in Progress.**

Answer: Verification of Work in Progress:

To carefully assess the stage of completion of the WIP for assessing the appropriateness of its valuation, the auditor may perform the following:

- examine the production/costing records (e.g., cost sheets),
- hold discussions with the personnel concerned, and
- obtain expert opinion, where necessary.

If physical verification of WIP is impracticable, the auditor should lay greater emphasis on ascertaining whether the system, from which the WIP is ascertained, is reliable.

Cost sheets of WIP should be verified as follows:

- (a) Ascertain that the cost sheets are duly attested by the works manager
- (b) Test the correctness of the cost as disclosed by the cost records by verification of quantities and cost of materials, wages and other charges included in the cost sheets by reference to the records maintained in respect thereof.
- (c) Compare the unit cost or job cost as shown by the cost sheet with the estimated cost.
- (d) Ensure that the allocation of overhead expenses had been made on a rational basis.
- (e) Compare the cost sheet in detail with that of the previous year. If they vary materially, investigate the cause thereof.
- (f) Ensure that the Work-in-Progress as at Balance Sheet date has been appropriately disclosed in Balance Sheet as per the requirements of Schedule III.

Q.19 Write short notes on: **Physical attendance by auditor during inventory taking.** [May 09 (5 Marks)]

Answer: Physical attendance by auditor during inventory taking:

- (a) The physical verification of stock is the responsibility of the management. The auditor may find it appropriate to attend the stock taking, if the inventory value is material in his opinion.
- (b) The extent of participation in inventory taking depends upon the internal control system prevailing, results of examination of inventory records and analytical review procedures.
- (c) When auditor attend inventory taking, he ensure that the instructions given for inventory taking is followed.
- (d) He test checks few items by himself for their existence and quantum. He selects to test high value items importantly.
- (e) The physical conditions of stock – like its age, deterioration, obsolescence etc., are looked into by auditor.
- (f) The auditor reviews stores records and notes down major discrepancies for reconciling them in a subsequent date.
- (g) The cut off arrangement is also looked into ensure that the entity accounts for stock for which liability had been booked and excludes stock which had been sold.

Q.20 State the different types of Analytical Review carried out in verification of inventories.

[May 06 (6 Marks)]

Answer: Analytical Review carried out in verification of Inventories:

1. Reconciliation of quantities of opening stocks, purchases, production, sales and closing stocks;

2. Comparison of closing stock quantities and amounts with those of the previous year;
3. Comparison of the relationship of current year stock quantities and amounts with the current year sales and purchases, with the corresponding figures for the previous year;
4. Comparison of the composition of the closing stock (e.g., raw materials as a percentage of total stocks, WIP as a percentage of total stocks) with the corresponding figures for the previous year;
5. Comparison of current year gross profit ratio with the gross profit ratio for the previous year;
6. comparison of actual stock, purchase and sales figures with the corresponding budgeted figures, if available;
7. comparison of yield with the corresponding figure for the previous year;
8. comparison of significant ratios relating to inventories with the similar ratios for other firms in the same industry, if available;
9. comparison of significant ratios relating to inventories with the industry norms, if available.

Q.21 How will you vouch or verify: Stock Lying with third party. [Nov. 05 (4 Marks), June 09 (5 Marks)]

Answer: Verification of Stock Lying with Third Parties:

As per SA 501 "Audit Evidence – Specific considerations for Selected Items", when inventory is lying under the custody and control of a third party and is material to the financial statements, the auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of that inventory by performing one or both of the following:

- (a) Request confirmation from the third party as to the quantities and condition of inventory held on behalf of the entity.
- (b) Perform inspection or other audit procedures appropriate in the circumstances.

In addition to the procedures prescribed in SA 501, auditor is required to pay attention to the following:

- (a) Evaluate condition of goods and see whether adequate provision has been made.
- (b) Check whether subsequently the goods lying with third party were sold or received back after the expiry of stipulated time period.
- (c) Ensure that the goods have been included in the closing stock though lying with third party.

Q.22 How will you vouch or verify: Inventory lying with subcontractor for fabrication.

Answer: Verification of Inventory lying with subcontractor for fabrication:

1. Obtain a confirmation letter from the sub contractors.
2. Determine the necessity of holding inventory by subcontractor. If the inventory is lying with them for long, the reason for the same should be ascertained.
3. The condition of the inventory should be confirmed by the management.
4. The inventory should be valued at cost or NRV, whichever is less. The processing charges incurred should be added to the cost. The provision for the liability towards unpaid processing charges should be created.
5. The inventory should be disclosed under the head current assets under the sub head inventory.
6. Adjustment in accounts should be made for any discrepancies between inventory confirmed and inventory sent out as per memorandum records.

Q.23 How will you vouch or verify: Goods sent on consignment.

Answer: Verification of Goods sent on Consignment:

- (a) Vouch the Proforma invoice sent with goods to ascertain the quantity and value of goods sent.
- (b) Freight evidences given by the transporter like Challan, Bill, Receipt for freight charged.
- (c) Insurance charge to be verified from cover note and premium paid receipt issued by Insurance Company.
- (d) Account sale sent by consignee, referring to sale price of the goods sold, expenses incurred by him and stock remained unsold.
- (e) Obtain confirmation from consignee for the goods held on consignment on balance sheet date.
- (f) Unsold goods should have been taken in the closing stock valued properly inclusive of expenses (Proportionate) incurred by consignee.
- (g) Journal entries relating to such transaction be verified from the books of the Company.

Q.24 How will you vouch or verify: Loss of Inventory by Theft.

Answer: Verification of Loss of Inventory by theft:

1. The most important evidence for verification will be the First Information Report (FIR) filed in the Police Station.
2. The contents of the FIR need to be cross checked with the financial records and inventory records.
3. If no FIR is lodged, then ascertain the reasons and their genuineness.
4. Ensure that the quantity and value of the stolen inventory is not included in the closing inventory.
5. Verify whether such inventory was insured and whether theft claim was lodged with the insurance company.

6.7 – AUDIT OF TRADE RECEIVABLES, SHORT TERM LOANS AND ADVANCES

Q.25 Give your comments and observations on the following: Balance confirmations from trade receivables/trade payables can only be obtained for balances standing in their accounts at the year-end.

Answer: Balance Confirmations from trade receivables / trade payables:

- Guidance Note on Audit of Debtors, Loans and Advances" recommends that the trade receivables may be requested to confirm the balance either:
 - (i) As at the date of the balance sheet; or
 - (ii) As at any other selected date which is reasonably close to the date of the balance sheet.
- The date should be settled by the auditor in consultation with the entity.
- Where the auditor decides to confirm the trade receivables at a date other than the balance sheet date, he should examine the movements in trade receivable balances which occur between the confirmation date and the balance sheet date and obtain sufficient evidence to satisfy himself that trade receivable balances stated in the balance sheet are not materially mis-stated.
- Therefore, it is not necessary that balances of trade receivables/ trade payables should necessarily be verified only at the end of the year only.

Q.26 Describe "Analytical Review Procedures" in Audit. Briefly discuss analytical procedures for verification of debtors. [May 14 (8 Marks)]

Answer: Refer Q. No. 82 of Chapter No. 10

Q.27 Mention disclosure requirements of Trade Receivables in the financial statements of a company.

Answer: Disclosure requirements of Trade receivable:

1. Aggregate amount of outstanding trade receivables exceeding 6 months should be shown separately.
2. Trade Receivables shall be further classified as:
 - Secured, considered good
 - Unsecured, considered good
 - Doubtful
3. Allowance for bad and doubtful debts disclosed under relevant heads:
4. Debts due from:
 - Directors or other officers of the company
 - Amounts due by firms in which any director is a partner
 - Amounts due by private companies in which any director is a director or member

Q.28 You are the auditor and examining the book debts of a company. Give some indications which leads to doubt about recovery as uncollectable debts from trade receivables and advances.

Answer: Indications leading to doubt about recovery as to uncollectable debts:

1. Non adherence of credit terms.
2. Payments are received in parts in relation to the total outstanding balance.
3. Nonpayment of old bill, while later bills have been fully settled.
4. Dishonour of the cheques received from the trade receivables.
5. The debt is under litigation, arbitration, or dispute.
6. Unwillingness or inability of the trade receivable to pay the dues, e.g., a trade receivable has either become insolvent, or has closed down his business, or is not traceable.
7. Amounts due from employees, who have been terminated from the employment.
8. Collection barred by law of limitation.

Q.29 How will you vouch/verify the following: Bad Debts. [May 09 (5 Marks)]

Answer: Verification of Bad Debts:

1. Obtain a schedule of bad debt written off during the year and trace the amount written off with the accounting records.
2. Major amount of bad debts in the schedule be taken for scrutiny.
3. Check that the amount considered in write off had been overdue for long and scrutinize the correspondence files.
4. Ensure that decision for writing off the debts has been taken by the appropriate authority.
5. The bad debts should be properly disclosed in Statement of Profit and Loss according to its materiality.
6. If provision for bad debts had already been made for bad debts, ensure that to the extent of actual bad debts written off, the provision is reversed.

Q.30 How will you vouch or verify: Advances given to suppliers. [Nov. 04 (4 Marks), Nov. 07 (5 Marks)]

Answer: Verification of Advances given to Suppliers:

1. Examine the bought ledgers to ascertain the debit balance of creditors and trace the corresponding entry to the cash/bank book.
2. Obtain a schedule of advances to suppliers and verify it with balances in bought ledger.
3. Assess the possibility of delivery of goods against advance payment and examine whether provisioning is required.
4. Obtain/resort to direct confirmation procedure.
5. Ensure proper classification in the balance sheet as per requirement of Schedule III.
6. Pay special attention to long outstanding advances and enquire about the reason thereof.

Q.31 How will you verify the following: Balances with Excise authority.

Answer: Verification of Balances with Excise Authority:

Balance with excise authorities in Personal Ledger account (PLA) is a short term advance and may be verified as below:

1. The balance with excise authority in PLA Account should be checked with the statements of accounts/records kept with excise section of the unit.
2. The remittance into the account, the utilization out of it etc should be cross checked with bank book, clearance forms etc.
3. The balance confirmation may be checked.
4. The balance should be shown under current assets and advances in balance sheet.
5. It is to be ensured that the balances in PLA is used only to the extent of liability after adjusting Cenvat credit where available.

6.8 – AUDIT OF CASH AT BANK & CASH IN HAND

Q.32 What procedures an auditor should adopt to test the authenticity of cash at bank. [Nov. 11 (5 Marks)]

Or

How will you verify the following: Bank Balances?

Answer: Verification of Bank Balances:

1. The auditor should advise the entity to send a letter to all its bankers to, directly confirm the balances to the auditor.
2. The auditor should examine the bank reconciliation statement prepared as on the last day of the year to identify cheques issued by the entity but not presented for payment, and cheques deposited but not credited in the bank account and their tracing in subsequent period.
3. The auditor should pay special attention to those items in the reconciliation statements which are outstanding for an unduly long period.
4. Where a large number of cheques has been issued/deposited in the last few days of the year, and a sizeable proportion of such cheques has subsequently remained unpaid/uncleared, this may indicate an intention of understating creditors/debtors or understating/overstating bank balances. In such a case, it may be appropriate for the auditor to obtain confirmations from the parties concerned, especially in respect of cheques involving large amounts. The auditor should also examine whether a reversal of the relevant entries would be appropriate under the circumstances.

5. In respect of fixed deposits, the relevant receipts/certificates, duly supported by bank advices, should be examined.
6. Remittances shown as being in transit should be examined with reference to their credit in the bank in the subsequent period.
7. Where material amounts are held in bank accounts which are blocked, e.g., in foreign banks with exchange control restrictions or any banks which are under moratorium or liquidation, the auditor should examine whether the relevant facts have been suitably disclosed in the financial statements.
8. Where the auditor finds that the number of bank accounts maintained by the entity is disproportionately large in relation to its size, the auditor should exercise greater care in satisfying himself about the genuineness of banking transactions and balances.

Q.33 Mention disclosure requirements of Bank Balances in the financial statements of a company.

Answer: Disclosure Requirements of Bank balances:

1. Cash and Cash Equivalents shall be classified as:
 - Balances with Bank
 - Cheques, Drafts on hand
 - Cash on hand
 - Others (specifying nature)
2. The following shall be shown separately:
 - Earmarked balances with bank.
 - Balances with bank held as margin money or security against borrowing, guarantees and other commitments.
 - Repatriation restrictions, if any, in respect of cash and bank balances.
 - Bank deposits with more than 12 months maturity.

Q.34 "No entry is passed for cheques received by the auditee on the last day of the year and not yet deposited with the bank". Give your comments and observations.

Answer: Cheques Received on the Last Day of Accounting Year:

- Many a times, cheques are received from the customers on the last day of the accounting year and there are chances that these cheques could not be deposited in the bank on the same day.
- Though in general, it is expected that all cheques should be deposited in the bank daily, but there may be a possibility that such cheques which are received particularly during the late hours could not be deposited in the bank.
- In such cases, it becomes important that such cheques should be properly accounted for to avoid any frauds and that the financial statements reflect a true and fair view. For this purpose, an effective internal control system needs to be ensured.
- It should be ensured that a list of such cheques is prepared in duplicate and a copy of the same has been sent to person controlling the trade receivables' ledger and a second copy is handed over to cashier along with the cheques received. The person who is controlling the trade receivables' ledger should ensure that proper accounting entries have been passed by crediting respective trade receivables' accounts.
- The balance of cheques-in-hand should also be disclosed along with the cash and bank balances in the financial statements.

Q.35 State any six important points to be examined by you, as an auditor, in verifying the correctness of bank balance of an Educational Institution which deposits all its collection/receipt in separate collection account of a bank.

Answer: Verification of Bank Balance of an Educational Institution:

For verifying the balances lying with bank in collection account, the auditor should adopt following procedure:

1. Compare the counterfoils of pay-in-slips with the entries in the ledger account.
2. Compare the entries in the ledger account with the pass book or bank statement.
3. Review the bank reconciliation statement for its correctness.
4. Scrutiny the subsequent period bank statement to ensure that items of reconciliation are subsequently cleared.
5. Check the casting, carry forwards and balancing of ledger account.
6. Obtain the balance confirmation certificate from the Bank.

Q.36 Comment on "The cash-book showed a huge cash balance on hand consistently throughout the year".

Answer: Maintenance of Huge Cash Balance:

"Guidance Note on Audit of Cash and Bank Balances" recommends that if, during the course of the audit, it comes to the attention of the auditor that the entity is consistently maintaining an unduly large balance of cash in hand, he may perform the following procedures:

1. He should carry out surprise verification of cash more frequently.
2. If the cash in hand is not in agreement with the balance as shown in the books, he should seek explanations from a senior official of the entity.
3. In case any material difference is not satisfactorily explained, the auditor should state this fact appropriately in his audit report.
4. He should satisfy himself regarding the necessity for such large balances having regard to the normal working requirements of the entity.
5. The entity may also be advised to deposit the whole or the major part of the cash balance in the bank at reasonable intervals.

Q.37 M, Statutory Auditor of ABC Ltd wants to verify cash on hand as on 31st March, 2016. The Management informs Mr. M. that it is not possible to cooperate, as cashier has been hospitalised. Advise Mr. M. on how to deal with the situation.

Answer: Limitation on Scope of Auditor:

- As per "Guidance Note on Audit of Cash and Bank balances" the auditor should carry out physical verification of cash at the date of the balance sheet. However, if this is not feasible, physical verification may be carried out, on a surprise basis, at any time shortly before or after the date of the balance sheet. In the latter case, the auditor should examine whether the cash balance shown in the financial statements reconciles with the results of the physical verification after taking into account the cash receipts and cash payments between the date of the physical verification and the date of the balance sheet.
- In the present case, management refuses for physical verification as cashier has been hospitalised. This refusal amounts to limitation on scope of auditor, which warrant the auditor to express disclaimer of opinion or qualified opinion in his audit report depending upon the circumstances.

Conclusion: Non co-operation of ABC Limited will amount to limitation on scope of auditors and auditor may modify the report based on the circumstances.

6.9 – VERIFICATION OF LIABILITIES

Q.38 How will you vouch/verify: Borrowings from banks?

Answer: Verification of Borrowings from Banks:

1. Reconcile the balances in the overdraft or loan account with that shown in the bank statements.
2. Obtain a certificate from the bank showing the balance in the accounts as at the end of the year.
3. Certificate may also be obtained from the bank showing 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 ROC and recorded in the Register of charges.
4. Verify that the loan or draft has been raised by appropriate authority. In the case of a company, only the BOD is authorised to raise a loan or borrow from a bank.
5. Confirm, in the case of a company, that the conditions prescribed in Sec. 180 of the Companies Act, 2013 as regards the maximum amount of loan that the company can raise has not been contravened.
6. Ascertain the purpose for which loan has been raised and the manner in which it has been utilised and ensure that this has not prejudicially affected the entity.

Q.39 How will you vouch/verify: Bank Overdraft

[Nov. 09 (5 Marks)]

Answer: Verification of Bank Overdraft:

1. Ensure that the overdraft facility is authorized by the board's resolution in case of a company / partner's resolution in case of a partnership firm.
2. Verify the agreement entered into with the bank to ascertain the nature of overdraft (Clean or Secured).
3. Obtain from the bank particulars of assets on which a charge has been created to secure the overdraft.
4. In case Overdraft is secured against hypothecation or pledge of company's property, verify whether charge has been registered with the ROC.
5. Obtain a certificate from the bank confirming the balance at the close of the year as shown in the Bank statement.
6. Examine the bank reconciliation statement to value the cheques issued but not presented for payment and cheques deposited but not credited.
7. Check the interest debited in the accounts has been correctly calculated and properly accounted for.
8. Ensure that overdraft has been appropriately shown in the Balance Sheet as per the requirements of Schedule III.

Q.40 How will you vouch/verify: Amount due to subsidiary companies?

[May 06 (4 Marks)]

Answer: Verification of Amount due to Subsidiary Companies:

1. Examine whether the subsidiary company is authorized by its Memorandum to advance the loan to the holding company.
2. Verify the rate of interest at which the loan has been obtained and particulars of the security that has been furnished and disclosure of the charge in the Balance Sheet.
3. Inspect the documents executed by the holding company which constitute the basis of the loan.

4. Verify by reference to the Balance Sheet of the subsidiary company that the loan is duly reflected in the Balance Sheet as a loan due from the holding company.
5. Amounts due to subsidiary companies may be on account of credit purchases of goods or services which should be verified with the relevant documentary evidences.
6. Confirm the compliance of Section 189 of Companies Act, 2013, wherever applicable.
7. Ensure compliance of disclosure requirements of Schedule III to the Companies Act, 2013.

Q.41 How will you vouch/verify: Trade Creditors**[Nov. 07 (5 Marks)]****Answer: Verification of Trade Creditors:**

- (a) Check the adequacy of cut off procedure to ensure that transaction of next period are not accounted and all transactions of year end are accounted.
- (b) Check posting in the bought ledger from books of prime entry.
- (c) Compare the balances in the schedule of creditors with balances in bought ledger.
- (d) Compare the balances with the confirmation or statement of account received from trade creditors.
- (e) Pay special attention to long outstanding items and enquire about the reason thereof.
- (f) Verify subsequent payments and reversal entries in the bought ledger of year end entries.
- (g) See that trade creditors are classified and shown in the balance sheet as per requirement of Schedule III of the Companies Act, 2013

Q.42 How will you vouch/verify: Bills Payable**Answer: Verification of Bills Payable:**

Bills payable are acknowledgements of debts payable. For their verification, it is necessary to see that bills paid have been cancelled and the liability in respect of those outstanding has been correctly ascertained and disclosed. Steps involved in their verification are:

1. Vouch payments made to retire bills on their maturity or earlier and confirm cancellation of relevant bills.
2. Trace the entries from Bills Payable Book to the Bills Payable Account to confirm that the liability in respect of the bills has been correctly recorded.
3. Reconcile the total of the schedule of bills payable outstanding at the end of the year with the balance in the Bills Payable Account.
4. Obtain confirmation from the drawers or holders of the bills in respect of amount due on the bills accepted by the client that are held by them.
5. Verify that the charge, if any, created on any asset for the due payment of bills has been appropriately disclosed

Q.43 How will you vouch/verify: Liability towards Gratuity**Answer: Verification of Liability towards Gratuity:**

The liability towards gratuity payable to the employees at the time of cessation of service should be ascertained and provided for in the accounts when the employees are in service, it is an ascertained present liability accruing over the period of service but payable upon cessation of service. To verify the liability recognised towards gratuity, auditor shall perform the following:

1. Check the quantification of the gratuity liability to ascertain whether the same had been actuarially determined.

2. Ascertain the basis on which gratuity liability has been ascertained. If the management takes assistance of an expert, perform procedures as prescribed in SA 500, i.e. to check the technical competence of actuary, the input fed to the actuary, the assumptions made by the actuary, the methodology adopted by the actuary, opinion given etc.
3. If auditor is not satisfied with the work of management expert, he may appoint auditor's expert and conduct procedures relevant to checking the opinion of an expert in accordance with SA 620.
4. The auditor should bear in mind the relevant pronouncements of AS 15 "Employee benefits" in this regard.
5. If the contributions are made to outside agency, say the insurance companies, auditor should check the premium paid, the acknowledgement receipts issued by the insurance company, the coverage of policy etc.
6. If the company maintains its trust for gratuity, the auditor may peruse whether the trust is an approved one under income tax law, whether the trust accounts are audited, copy of the latest accounts etc.
7. The contribution should be appropriately disclosed in the accounts as per Schedule III to the Companies Act, 2013.

Q.44 How will you vouch/verify: Provision for Taxation

Answer: Verification of Provision for Taxation:

1. Check whether the computation of income prepared by the client is as per the provisions of Income-tax Act, 1961 and Rules made thereunder.
2. Review the adjustments, expenses, special rebates, etc. with particular reference to the last available completed assessment.
3. Examine relevant records and documents pertaining to advance tax, self assessment tax and other demands.
4. Compute tax payable as per the latest applicable rates in the Finance Act.
5. 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.
6. Ensure that the requirements of AS 22 on Accounting for Taxes on Income have been appropriately followed for the period under audit.

6.10 – VERIFICATION OF CONTINGENT LIABILITIES

Q.45 Write a short note on: Contingent Liability.

Answer: Contingent Liability:

As per AS 29 "Provisions, Contingent Liabilities and Contingent Assets" a contingent liability is:

- (a) a possible obligation that arises from past events and the existence of which will be confirmed only by the occurrence or non occurrence of one or more uncertain future events not wholly within the control of the enterprise; or
- (b) a present obligation that arises from past events but is not recognised because:
 - (i) it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or
 - (ii) a reliable estimate of the amount of the obligation cannot be made.

Recognition Principle of Contingent Liabilities

- An enterprise should not recognise a contingent liability.
- A contingent liability is disclosed, unless the possibility of an outflow of resources embodying economic benefits is remote.
- Contingent liabilities are assessed continually to determine whether an outflow of resources embodying economic benefits has become probable. If it becomes probable that an outflow of future economic benefits will be required for an item previously dealt with as a contingent liability, a provision is recognised in the financial statements of the period in which the change in probability occurs.

Q.46 How will you vouch/verify: Contingent Liabilities**[May 07 (4 Marks)]****Answer; Verification of Contingent Liabilities:**

1. Review minutes of the meetings of the Board of Directors or other similar bodies.
2. Review contracts, agreements and arrangements.
3. Review list of pending law suits and obtain a certificate and opinion of the lawyer dealing with the cases.
4. Review of records relating to contingent liabilities maintained by the company.
5. Review of terms and condition of grants and subsidy availed.
6. Obtain representation from the management that all known contingent liabilities have been included in the accounts and disclosed properly.
7. Ensure that proper disclosure is made of all the contingent liabilities as per the requirements of AS-29 and Schedule III to the Companies Act, 2013.

6.11 – MISCELLANEOUS**Q.47 How will you vouch/verify: Floating Assets****[May 16 (4 Marks)]****Answer: Verification of Floating Assets:**

- Floating assets are those assets which are acquired for resale with a view to earning profits or are those that come into existence during the processes of trade or manufacture. All those, in the normal course of business, are quickly convertible into cash, e.g., inventory, trade receivable, bills receivable, etc.
- These assets are valued either at cost or market value whichever is less.
- The term 'cost' refers to purchase price including duties and taxes, freight inwards and other expenditure directly attributable to acquisition less trade discount, rebates, duties drawbacks and subsidies, in the year in which they are accounted, whether immediate or deferred in respect of such purchase.
- The term 'market value' may either refer to "Net realisable value" or "the replacement cost". Net Realisable value is the estimated selling price in the ordinary course of business less estimated costs of completion and the estimated costs necessarily to be incurred in order to make the sale. Replacement Cost refers to the price which would have to be paid for acquiring the same assets at the current market rate on the date of the Balance-sheet.

Q.48 Objective Type Questions (True/False; Correct/Incorrect)

1 Company can provide lower rate of depreciation than prescribed by Schedule II of the Companies Act, 2013. **[May 13 (2 Marks)]**

Answer: Statement is incorrect.

- It is permissible for the entity to charge depreciation on its assets at rate different from schedule II rates provided those rates are higher than the schedule rates based on technical estimation or otherwise allowed.
- The rates as contained in Schedule II are minimum rates and therefore a company cannot provide lower rate of depreciation than prescribed by Schedule II of the Companies Act, 2013.

2 The Statutory Auditor is required to verify inventory physically. **[Nov. 14 (2 Marks)]**

Answer: Statement is Incorrect.

- Physical verification of inventories is the responsibility of the management of the entity.
- However, as per SA 501 "Audit Evidence-Specific Consideration for Selected Items" where the inventories are material and the auditor is placing reliance upon the physical count by the management, the auditor should attend the stock-taking.

3 Capital Reserve and Reserve Capital are the same. **[Nov. 16 (2 Marks)]**

Answer: Statement is Incorrect.

Both the terms are not same as they carry different meanings.

Capital Reserve means the part of profit reserved by the company for a particular purpose.

Reserve Capital shows the part of the authorized capital that has not yet called up by the company.

4 All intangible assets are not required to be amortized. **[Nov. 16 (2 Marks)]**

Answer: Statement is correct.

Intangible assets other than goodwill may or may not be amortized depending on their useful lives to the entity. Assets with finite lives are amortized; assets with indefinite lives are not. Goodwill is not amortized.