7. VOUCHING

Q.No.1. Define the word "Vouching" and what are the essential points to be kept in mind while examining a voucher. (A)
(PM, M15 RTP, M16 RTP, M 17 RTP, M14 – 5M, M16 – 4M)

VOUCHING: Vouching may be defined as an act of examining vouchers to check the authenticity of the transactions recorded in the primary books of account. Vouchers are the supporting documents for the transactions entered in the books.

- Vouching is one of the substantive procedures 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

ESSENTIAL POINTS TO BE KEPT IN MIND WHILE EXAMINING A VOUCHER:(N 17 – 2M)

1. The voucher should be numbered serially.
2. the date of the voucher falls within the accounting period;
3. the voucher is made out in the client's name;
4. The transactions should relate to the business of the client.
5. the voucher is duly authorized by the concerned official;
6. the voucher comprised all the relevant documents which could be expected to have been received or brought into existence on the transactions having been entered into, i.e., the voucher is complete in all respects; and
7. Transaction has been recorded in proper account with appropriate amount disclosing clearly nature of receipt or payment.
8. Verify whether internal control in relation to recording of transactions is functioning properly.
9. After the examination is over, each voucher should be either impressed with a rubber stamp or initialed so that it may not be presented again in support of another entry.

Apart from genuineness, vouching also helps the auditor to know the regularity and validity of the transaction in the context of the client's business, nature of the organization and organizational rules.

Thus, vouching which has traditionally been the backbone of auditing. It does not merely involve checking arithmetical accuracy but goes much beyond and aims to check the genuineness as well as validity of transactions contained in accounting records.

SIMILAR QUESTIONS:

1. **'In vouching payments, the auditor does not merely check proof that money has been paid away.' Discuss. (PM)**
2. **"Vouching which has traditionally been the backbone of auditing does not merely involves checking arithmetical accuracy but goes much beyond and aims to check the genuineness as well as validity of transactions contained in the accounting records". Explain**
3. **State the factors to be considered to verify validity of any transaction?**

A. Refer above answer for all the three questions.

4. As an auditor, what are the essential points to be borne in mind while examining a voucher? (PM)

A. Refer essential points in above answer.

5. Write a short note on "Vouching". (PM)

A. Refer above answer.

PART 1: AUDIT OF PAYMENTS

Q.No.2. Payment of revenue expenses. (C) (PM)

1. See that all payments have been duly authorized by a competent authority.
2. Ensure that all payments relate to business and they also relate to the period under audit.
3. Ensure that all payments have been received by the correct payee and acknowledged by a receipt note or in the voucher itself.
4. Ensure that no personal expenses are charged as business expenditure.
5. See that all payments have been correctly recorded in the books under appropriate sub-head.
6. See mode of Payment cash, cheque etc., and relate to corresponding entry in cash or Bank book.
7. Ensure that if any payment relates to period that extends to next year, a proportionate amount is carried forward as prepaid expenses.

Q.No.3. Remuneration paid to directors. (A) (PM, N 13 - 4M, N15 - 4M)

1. **Appointment and terms of appointment:** Refer to General Meeting or Board meeting resolution for the appointment and terms of appointment of the director as per Section 196 of the Companies Act, 2013.
2. **Examine the Entitlement:** 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. **Manner of payment:** Examine AOA and general meeting resolution to determine the manner of payment whether monthly or at a specified percentage of the net profits of the company or partly by monthly and partly by specified percentage of profits.
4. **Maximum remuneration:** Overall remuneration that can be paid to directors of a company (other than a private company) should not exceed 11% of net profits.
5. **Computation of Net profits:** Net profits should be calculated as per the provisions of section 198 i.e., net profits should be computed before deducting such remuneration from the profits.
6. **Inadequacy or absence of profits:** In case of no profits or in adequate profits, remuneration may be paid in accordance with the provisions of Schedule V.
7. **Sitting fees:** Amount of sitting fees paid to directors shall not exceed Rs. 1 lakh per board meeting or any other committee meeting. The auditor should check the attendance records for payment of sitting fees.
8. **Statutory compliances:** Ensure compliance with the provisions of Sections 197, 198 and Schedule V to the Companies Act, 2013. In case remuneration is paid in excess of the limits prescribed, then prior approval of CG needs to be obtained.
9. **Reporting and disclosures:** The auditor should also consider the reporting requirements under CARO, 2016 and disclosure requirements of schedule III

SIMILAR QUESTIONS:

1. **How will you vouch remuneration paid to directors in case of public limited company?**

A. Refer above answer.

Q.No.4. Payment for acquisition of assets. (A) (PM, N 15 - 4M)

1. **Authorization:** It must also be verified that the assets were purchased only by a person who had the authority to do so. For example BOD in case of companies as per Companies Act, 2013.
2. **Invoice or Receipt:** The purchase of an asset must be duly supported by the receipt for the amount paid.
3. **Registration requirements:**
   a) **Immovable properties:** In case of an immovable property the auditor must also inspect the title deeds. It is therefore essential for an auditor to see that property has been registered in the buyer's name.
   b) **Movable properties:** In the case of movable property requiring registration of ownership, e.g., a car or a ship, it must be verified that such a registration has been made in favour of the purchaser.
   - It is necessary for the auditor to satisfy himself generally as regards existence, value and title of the any assets acquired.
4. **Value of assets acquired:** Check that the cost of the asset purchased has been properly capitalized in the books of account after deducting any rebates, refundable duties and taxes etc.
5. **Value of self-constructed assets:** In the case of self-constructed assets, it must be verified that the only cost incurred is capitalized but no profits should be capitalized.
6. **Repairs and additions:** It must also be seen that expenses on repairs and maintenance have not been capitalized and the cost of additions to assets not charged off as revenue expenses.
7. **Compliance with Standards and schedule III:** Ensure compliance with provisions of AS 10 "Property, Plant and Equipment" and disclosure requirements of Schedule III.

Q.No.5. Payment of Income tax or Provision for Income tax? (A)
(PM, N11 – 5M, N14 – 4M, N15 – 4M)

1. **Checking the Relevant documents:** Check the relevant records and documents pertaining to advance tax, self-assessment tax and other demands. And also examine income tax returns submitted by the enterprise and examine the TDS certificates.
2. **Computation of Tax:** Obtain the computation of taxes prepared by the auditee and verify whether it is as per
   i) The Income Tax Act/ Rules/ Notifications/ Circulars etc.
   ii) The latest applicable rates in the Finance Act
3. **Provision for tax:** Ensure that overall provisions created on the date of the balance sheet is adequate having regard to current year provision, advance tax paid etc.
4. **Payment of Tax:**
   a) **Demand notice and challan:** Examine the payment of income tax including advance tax by reference to notice of demand and the challan.

b) **Deductions:** See that tax has been paid after taking into account the tax paid during the financial year by way of advance tax and tax deducted at source, if any.

c) **E-payment:** The assesse can also make electronic payment of taxes from the account of any other person. Therefore, it should be verified that the challan for making such payment is clearly indicating the PAN No /TIN No. etc. of the assesse.

5. **Disputed dues:** Ascertain that in case of dispute about the amount of duty payable, a provisional amount may be paid in lieu of final amount. In such cases, the final amount determined as payable should be verified. If the provisional payment was more than the actual amount, the refund of such excess amount should be vouched.

6. **Interest on excess or deficiency of tax paid:** The interest allowed on advance payments for income tax should be included as income and penal interest charged for non-payment should be debited to such interest account.

7. **CARO requirements:** In the case of Companies, ascertain that undisputed taxes are paid regularly as required by CARO, 2016.

8. **Schedule III requirements:** See that the disclosure requirements of Sch.III, Part II and provisions of AS 22 on Accounting for Taxes on Income have been complied with or not.

SIMILAR QUESTIONS:

1. **How will you vouch payment of taxes? (PM)**

A. Refer above answer.

Q.No.6. Payment of excise duty (A) (PM, M15 RTP, M16 RTP, M16 – 4M)

1. **Checking the Relevant documents:** The auditor should physically verify requisite registers maintained with actual and see reconciliation of financial records with sales tax records.

2. **Computation of excise duty:**

   i) See that amount of excise duty has been computed in accordance with the provisions of the central excise act, 1944 and Central excise tariff act, 1985.

   ii) Test check the accuracy of the amount of duty computed by multiplying the rate of excise duty with the value of goods issued as per the client's inventory register.

3. **Payment of excise duty:**

   a) Verify payment of excise duties by examining the duly paid as per Challans with reference to the quantity of goods in respect of which issue permits have been received.

   b) Ensure that in every case CENVAT credit has been adjusted and only net excise duty has been paid.

4. **Provision for excise duty:** In respect of excisable goods manufactured but remaining to be released, ensure that necessary provision for unpaid excise duty has been made.

5. **Disputed dues:** Ascertain that in case of dispute about the amount of duty payable, a provisional amount may be paid in lieu of final amount. In such cases, the final amount determined as payable should be verified. If the provisional payment was more than the actual amount, the refund of such excess amount should be vouched.

6. **CARO requirements:** In the case of Companies, ascertain that undisputed taxes are paid regularly as required by CARO, 2016.

7. **Schedule III requirements:** See that the disclosure requirements of Schedule III Part II have been complied with or not.

Q.No.7. Payment of customs duty? (A) (PM, M16 RTP, M16 – 4M)

1. **Computation of excise duty:** See that the provisions of the Customs Act, 1962 and Customs tariff act, 1975 have been complied with in computing the amount of duty.
2. **Payment of duty:**
   - **i)** Examine the cash book to ensure payment of custom duty with reference to Bill of entry to check whether the amount was calculated correctly.
   - **ii)** If the duty has been paid by clearing and forwarding agent, examine bill of entry with reference to agent's bill.
   - **iii)** If the duty has been paid by the client directly, examine bill of entry together with receipt evidencing payment of custom duty.
3. **Disputed dues:** Make a list of disputed cases to have knowledge of the amount of duty payable and the provisional payment. The auditor should determine the duty payable and ensure any additional duty to be paid or refund expected should have been adjusted.
4. **Duty drawback:** Lastly, the auditor verifies the duty drawback with reference to acknowledgment issued by custom authorities.
5. **CARO requirements:** In the case of Companies, ascertain that undisputed taxes are paid regularly as required by CARO, 2016.
6. **Schedule III requirements:** See that the disclosure requirements of Sch.III, Part II have been complied with or not.

Q.No.8. Travelling expenses or Foreign travel expenses. (A) (PM, M15 RTP, N 16 RTP, M16 RTP, N 12 - 8M, N16 - 4M)

1. **Rationale of expenditure:** As regards travelling expenses claimed by directors the auditor should satisfy himself that these were incurred by them in the interest of the business.
2. **Authorization:**
   - **i)** Verify that the tour program and all the vouchers for travelling expenses of tour are authorized by some responsible official.
   - **ii)** Verify whether travelling expenses are paid according to rules approved by authorized personnel. In the absence of T.A. Rules, the expenditure should be vouched on the basis of actual expenditure incurred.
3. **Checking the voucher:** The voucher for travelling expenses should normally contain the under mentioned information:
   - **a)** Name and designation of the person claiming the amount.
   - **b)** Particulars of the journey.
   - **c)** Amount of railway or air fare.
   - **d)** Amount of boarding or lodging expenses or daily allowance along with the dates and times of arrival and departure from each station.
   - **e)** The evidence in regard to sundry expenses claimed is generally not attached to T.A. bills. So long as the amount appears to be reasonable it is usually not questioned.
4. **Checking the tickets:** If the journey was undertaken by air, the counterfoil of the air ticket should be attached to the voucher; this should be inspected. For travel by rail or road, the amount of the fare claimed should be checked from some independent source.
5. **Foreign travel:**
   - **i)** **Sanction:** Verify whether it should be sanctioned by the competent authority,

ii) **Purpose:** Verify the purpose of the tour by reference to tour report submitted.

iii) **RBI permission:** Check RBI's permission, if necessary, for withdrawing the foreign exchange.

iv) **AS – 11 and Schedule III:** Verify whether the amount of foreign exchange spent is to be disclosed separately in the accounts as per Schedule III and AS 11.

6. **Travelling advance:** The travelling advance taken, if any, should be settled on receipt of final bills. At the year end, the amount not settled should be shown appropriately in the Balance Sheet.

7. **For attending Board meetings:** Unless the articles specifically provide or their payment has been authorized by a resolution of shareholders, directors are not entitled to charge travelling expenses for attending Board Meetings.

REFER PRACTICAL QUESTION – 1

Q.No.9. Repairs to assets. (A) (PM, M16 RTP, M15 - 4M)

1. **Checking the documents:**

i) **AMC:** If the work of repairs is based on Annual maintenance contract (AMC). See that the payments are made as per the agreement.

ii) **Voucher or receipt:** if the work of repair is carried out without AMC, then inspect the voucher or receipt issued by repairer.

2. **Segregation of expenditure**:

i) It may sometimes be possible to determine this on a consideration of the nature of repairs carried out whether it is renewal of assets to treat it as revenue or it is any addition to assets to treat it as capital and add to the value of asset.

ii) The proportion of the charges which had the effect of increasing the value of an asset or enhancing its capacity or life should be treated as capital expenditure.

iii) Where it is not possible to form an opinion accurately on the basis of evidence as regards the nature of repairs, a certificate from the engineer under whose supervision the repairs were carried out, confirming the classification of expenditure should be obtained.

3. **Schedule III requirements:** It should be ensured that Repairs to have been separately disclosed as per the requirements of Schedule III to the Companies Act, 2013.

Q.No.10. Preliminary expenses. (A) (PM, MTP N17, M12, M14, M 16 - 4M)

MEANING: It is the expenditure incurred incidental to the creation, formation and floating of a company.

It consists of stamp duties, registration fees, legal costs, consultant's fees, expenses of printing of memorandum and articles, etc.

ASPECTS TO BE VERIFIED:

1. **Checking the main documents:**

i) **Contract:** The contracts relating to preliminary expenses should be examined.

ii) **Articles and Board resolution:** If preliminary expenses incurred by promoters have been reimbursed to them by the company, the resolution of the Board of Directors and the power in the Articles to make such reimbursement should be seen.

iii) Prospectus:

- The auditor can cross check the amount of preliminary expenses with that disclosed in the prospectus and the balance sheet.
- Any amount paid in excess of the amount disclosed in the prospectus should have been approved by the shareholders.

2. Checking the supporting documents:

i) Check receipt for the registration fee paid for registration of the company.

ii) Examine supporting papers and vouchers, contracts, agreements, etc. to support the promoters' claims.

iii) Also check bills and receipts issued by the printer of the memorandum and articles of association, share certificates, etc.

3. No unrelated expense:

i) It should be seen that no expenses other than those which constitutes preliminary expenses are booked under this head.

ii) Underwriting commission and brokerage paid for shares and debentures should not be included under the head preliminary expenses.

4. Compliance with AS 26: Expenditure in connection with the preliminary expenses should be treated as an expense in the year of incurring and not to be carry forwarded for writing off in future years as per the compliance of AS 26.

Q.No.11. Salaries and Wages (C)

1. Internal control system: The auditor should examine the internal control system with respect to the recruitment of employees, recording attendance of workers etc.

2. Checking the salary vouchers:

i) By reference to the record of attendance, schedule of rates, sanctioned by the management for different classes of employees.

ii) By taking into account the deduction on account of PF, TDS etc.

iii) By tracing recoveries out of loans and advances, outstanding against employees into the Employees Loans and Advances Register.

iv) By reference to the Annual Return of Salaries, etc., submitted to the Income-tax Authorities and that of wages with Employee's State Insurance Cards.

3. No dummy workers: See that names of the same persons do not appear on the list of unpaid wages to ensure that there are no dummy workers.

4. Schedule III- Disclosure requirement to the Statement of Profit & Loss:

A Company shall disclose separately by way of notes on the face of the Statement of Profit and Loss additional information regarding aggregate expenditure on Employee benefits expenses as under:

Employee Benefits Expense:

a) Salaries and Wages

b) Contribution to Provident and Other Funds

c) Expenses on Employee Stock Option Scheme (ESOP) and Employee Stock Purchase Plan (ESPP)

d) Staff Welfare Expenses.

5. Compliance with AS 15: Ensure compliance with AS 15 "Employee benefits"

Q.No.12. Petty cash (B) (M16 RTP)

1. **Amount of imprest:** Auditor should also verify whether the amount of petty cash imprest is fixed. Is this amount reasonable considering the total amount of petty cash payments made during a month or not?
2. **Entries in cash book:** Trace the amounts advanced to the petty cashier for meeting petty office expenses from the Cash Book in the Petty Cash Book.
3. **Vouchers:** Vouch payments with docket vouchers which must be supported, wherever possible, by external evidence.
4. **Postage expenses:** Trace payments made for the purchase of postage stamps recorded in the Postage Book. The totals of the Postage Book should be test checked.
5. **Proper carry forwards:** See where a columnar Petty Cash Book is maintained, that the extension have been carried forward into appropriate amount columns.
6. **Proper postings:** Trace posting of the various columns in which payments are classified to the respective ledger accounts.
7. **Castings and balances:** Check the column totals and cross totals and verify the petty cash balance in hand.

SIMILAR QUESTIONS:

1. **Describe how the payments from petty cash should be verified.**

A. Refer above answer.

Q.No.13. Advertisement expenses or expenditure incurred for promotion of products. (A) (PM, N13 - 4M)

1. **Checking the nature and purpose of advertisement: (N17 – 4M)**
   - **i)** Ascertain the nature of advertisement expenses to ensure that the same have been charged properly. i.e., revenue or capital nature.
   - **i)** The expenditure incurred for promotion of new or existing product may entail future benefits. It may include sales exhibition, participation in trade fair, issue of promotional pamphlets, free gifts etc.
2. **Checking the documents:**
   - **i)** Obtain the complete list of advertisement, media wise, i.e., newspapers, slides, hoardings, magazines, television, radio, etc. showing the dates, exact location, timings, etc., along with the amounts paid in respect of each category.
   - **ii)** Ascertain whether there is a regular contract with an advertising agency and he should read the contract with advertisement agencies, promotional policies decided by the management from the board minutes etc.
   - **iii)** See that regular statements are obtained from the agency showing the advertising media and amounts debited to the client. Discounts, if any, should be properly adjusted and disclosed in the bills.
3. **Checking the bill/ invoice:**
   - **i)** Verify the bill/invoice from advertising agency to ensure that rates charged for different types of advertisement are as per contract.
   - **ii)** See that advertisement expenses relate to the client's business.
   - **iii)** He should ascertain whether tax had been deducted in accordance with the tax law provisions if any applicable in this regard.

4. **Prepaid or Outstanding expense:** Ascertain the period for which payment is made and see that pre-paid is carried forward to balance sheet and any outstanding advertising expenses have been properly disclosed on the liabilities side of the balance sheet.
5. **Compliance with AS-26:** 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.No.14. Payment of Retirement gratuity to employees or Liability towards Gratuity (A) (PM, RTP N17, M17 RTP, M12 - 6M, N 14 - 4M)

1. **Check the computation of gratuity:**
   - **i)** Examine the basis on which the gratuity payable to employees is calculated.
   - **ii)** 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.
   - **iii)** Check the amount of gratuity paid to employees who retired during the year with reference to number of years of service rendered by them.
2. **Using the work of Actuary:** If the company decides to use the work of actuary to provide liability for gratuity, then the auditor should 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. **Manner of making contributions:**
   - If the contributions are made to outside agency, say the insurance companies, he should check the premium paid, the acknowledgement receipts issued by the insurance company, the coverage of policy etc.
   - 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.
4. **Compliance with AS- 15:** Ensure that the accounting treatment is in accordance with AS-15 “Employee Benefits” and compliance with The Payment of Gratuity Act, 1972.
5. **Schedule III requirements:** The contribution should be appropriately disclosed in the accounts as per Schedule III to the Companies Act, 2013.

SIMILAR QUESTIONS:

1. **“The management has obtained a certificate from an actuary regarding provision of gratuity payable to employees”. Comment as an auditor.**

A. Refer above answer.

Q.No.15.Sales Commission Expenditure. (A) (PM, N 16 RTP)

1. Ascertain agreement, if any, in respect of sales transaction actually occurred during the year carried out by authorized parties on its behalf. If yes, the commission should be in accordance with the terms and conditions as specified.
2. Check evidence of services rendered by the party to whom commission is paid with reference to correspondence etc.
3. Ensure that the sales in fact have taken place and the same has been charged to Statement of Profit and Loss.
4. Compare the amount incurred in previous years with reference to total turnover.

5. Check entries regarding TDS on commission at the time of credit to Payee's Account, or payment, whichever is earlier.
6. Ensure that the payment has been made through cheque only, if limit as stated in the clause of tax audit is exceeded.

Q.No.16. Production Incentive Paid to Workers. (B) (PM, M 09 - 5M)

1. The auditor should trace the total production incentive paid to workers from Statement of Profit and Loss to prime records/division wise/dept wise records.
2. The auditor should get the details of incentive scheme from the management and see that it is approved and updated by a competent authority.
3. The auditor should check the production figures from independent source and should correlate them with the incentive payment working computed by the accounts department.
4. He should check list of payment and also disbursement slips of select departments/periods for scrutiny of various data generated in the fields for their accuracy and completeness.
5. The auditor should make an overall analytical procedure of ensuring the expense booked is commensurate in quantum with statistical data on production and strength of workers.

Q.No.17. Wages Paid to Seasonal Labourers. (B) (PM, RTP N17)

1. Ascertain and evaluate the internal control system for recruitment and usage of seasonal labourers.
2. Examine that these labourers are hired on proper authority and the rates of pay 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 payments 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, to ensure that there are no ghost workers.

Q.No.18. Bad debts. (A) (PM, M 09 - 5M)

1. The amount of bad debts should be traced to the schedule of bad debts written off during the year.
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. Check the authority for write off and the level of authority is sufficient higher than the executive involved in collection.
5. The bad debts should be properly disclosed in Statement of Profit and Loss according to its materiality.
6. If provision had already been created for bad debts, see that to the extent of actual bad debts written off, the provision is released.

Q.No.19. Personal Expenses Of Directors Met By The Company. (PM, MTP N17)

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 camouflaged in any other revenue items as contemplated under section 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.

PART 2: AUDIT OF RECEIPTS

Q.No.20. Income from investments or Interests and dividend receivables (B)

1. Examine the investments register, if any maintained by the entity.
2. Vouch the dividend income by reference to the counterfoils of Dividend Warrants and the interest on securities by reference to the tax-deduction certificates, issued by the Reserve Bank of India.
3. Afterwards the amounts collected are traced into the Investment Register; it is scanned to find out whether interest or dividend, relating to any investment, has remained unrealized. If so, the reasons thereof are ascertained.
4. The auditor should examine the separate ledger accounts kept for each investment or loan given.
5. The dates on which dividends or interest payments generally fall due should also be noted.
6. Where investments are sold ex-dividend, it should be seen that the dividends are subsequently received. Similarly when a purchase is on cum dividend basis, the receipt of dividend should be checked.
7. In case of interest on deposit with banks, verification should be done by reference to the bank statement and the agreed rate of interest.
8. The receipts of dividends and interest should be addressed to the bank statement for encashment.
9. It should be ensured that the interest and dividend received are credited to the respective account in full i.e., before deduction of tax at source and the tax deducted at source should be debited to an appropriate account.
10. Ensure provisions of "AS 9 Revenue Recognition" has been complied with.

REFER PRACTICAL QUESTION - 2

Q.No.21. Rental receipts (A) (PM, M 15 - 4M)

1. Ascertain the particulars of total accommodation available for being let out, in different buildings, belonging to the client.
2. Examine the rental agreement.
3. An overall check over rental receipts is also necessary.
4. The amounts collected from tenants on account of rent should be checked by reference to receipts issued to them. These afterwards should be traced into the Rental Register.
5. Amount collected may include the amount of rent and any other charges paid by landlord on behalf of tenant e.g. Water tax, electricity etc. Therefore they should be checked by comparing the receipts issued with the rental agreement.

6. Scrutinize the account of collecting agent when the rent is collected by such agent.
7. Vouch the entries for rent received in advance and ensure proper adjustment is made.
8. Investigate into abnormal rent outstanding and see that proper provision is made if unrecoverable.
9. It should be verified that every available accommodation has been let out and rental income has been duly accounted for. If it is reported that one or more buildings have remained vacant, a certificate in respect thereof should be obtained from the client.
10. 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.

Q.No.22. Bankruptcy Dividends: (C)

1. Examine the correspondence with the official receiver or Assignee to ascertain whether the company has proved the existence of the debt and the amount there of.
2. The amounts of claim admitted are received subsequently, usually in parts, which are referred to as dividends.
3. For the verification of these part amounts, it is necessary to 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.
4. The advice, if any, received from the same authority along with the payment should be referred to
5. Verify the amount receivable has been written off as bad debt earlier.
6. Trace the receipt in the bank statement.

Q.No.23. Sale of Investments. (A) (PM, N 11 - 4M)

1. See that sale of investment has been made on the proper authorisation of Board or other competent authority.
2. Ascertain the method of selling investments. It may be either through broker, directly or through a bank. The sale proceeds of investments are vouched by reference to Brokers' Sold Note.
3. Ensure that the dividend has been received and recorded subsequently, when the investments are sold ex-dividend.
4. See that the difference between the carrying amount and the sales proceeds, net of expenses, is recognised in the Statement of Profit & Loss or in some earmarked fund account in case sale of earmarked investments.
5. Ensure that when only a part of the holding of an individual investment is sold, the carrying amount is allocated on the basis of average carrying amount of the total holding of the investments.
6. Verify appropriate adjustment or cancellation entries in Investment register.
7. See that proper disclosures as required by AS 13 on Accounting for Investments are made as follows:
   a) Interest, dividends (showing separately dividends from subsidiary companies), and rentals on investments showing separately such income from long term and current investments. Gross income should be stated, the amount of income tax deducted at source being included under Advance Taxes Paid
   b) Showing separately profit & Loss on disposal and changes in carrying amount of current and long term investments.

Q.No.24.Sale of Assets. (B)

1. See that sale of investment has been made on the proper authorization of Board or other competent authority.
2. Ensure that the sale proceeds of the asset have been fully accounted for.
3. Ascertain the basis of sale, whether by auction or by negotiation, for determining whether the asset was sold at the maximum price.
4. Ensure that sale proceeds have been credited to an appropriate head of account.
5. Check that the amount of profit arising out of it has been segregated between revenue profits and capital profits, if any, accordingly appropriate accounts are credited,
6. Verify where there is a loss, the same should be written off to profit and loss account.
7. Verify appropriate adjustment or cancellation entries in Assets register.
8. Ensure compliance with "AS 10 Property, Plant and Equipment" and disclosure requirement of Schedule III.

Q.No.25. Royalties received. (B) (PM, N 16 - 4M)

1. Verify the relevant contract and ascertain the provisions relating to the conditions of royalty such as rate, mode of calculation and due date.
2. Verify the periodical statements received from the publisher in respect of books printed, sold and inventory lying at different locations and
3. Check the computation in the royalty statement and ensure that any deduction or adjustment made from the royalty due is as per agreement conditions.
4. Royalties due but not yet received should have been properly accounted for at the end of the year.
5. Ensure compliance with provisions of AS 9 "Revenue Recognition" and disclosure requirements of Schedule III.

Q.No.26. Insurance claims (A) (PM, M 15 - 4M)

Insurance claims may be in respect of fixed assets or current assets. While vouching the receipts of insurance claims-

1. The auditor should examine a copy of the insurance claim lodged with the insurance company.
2. Examine correspondence with the insurance company and with the insurance agent.
3. Check the counterfoils of the receipts issued to the insurance company.
4. The auditor should also determine the adjustment of the amount received in excess or short of the value of the actual loss as per the insurance policy.
5. The copy of certificate/report containing full particulars of the amount of loss should also be verified.
6. The accounting treatment of the amount received should be seen particularly to ensure that revenue is credited with the appropriate amount and that in respect of claim against an asset.
7. The Statement of Profit and Loss is debited with the shortfall in claim received with the actual loss incurred.
8. If the claim was lodged in the previous year but no entries were passed, entries in current year Statement of Profit and Loss should be appropriately described.

Q.No.27. Sale proceeds of junk materials or sales proceeds of scrap. (A) (PM, N14 RTP, M 17 RTP, N 15 - 4M)

1. Vouch sales, with invoices raised, advertisement for tender, rate contract with scrap dealers.
2. Review the internal control on junk or scrap materials, as regards its generations, storage and disposal and see whether it was properly followed at every stage.
3. Ascertain whether the organization is maintaining reasonable records for the sale and disposal of junk or scrap materials.
4. Review the production and cost records for the determination of the extent of junk or scrap materials that may arise in a given period.
5. Compare the income from the sale of junk or scrap materials with the corresponding figures of the preceding three years.
6. Check the rates at which different types of junk or scrap materials have been sold and compare the same with the rates that prevailed in the preceding year.
7. See that all junk or scrap materials sold have been billed and check the calculations on the invoices.
8. Ensure that there exists a proper procedure to identify the junk or scrap materials and good quality material is not mixed up with it.
9. Make an overall assessment of the value of the realization from the sale of junk or scrap materials as to its reasonableness.

Therefore, just because the sale proceeds of scrap or junk materials are not significant and the company has a good accounting and costing system, the auditor cannot overlook verifying the sale proceeds of scrap.

SIMILAR QUESTIONS:

1. **"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". Comment. (PM)**

A. Refer above answer.

Q.No.28. Recovery of bad debts written-off. (A) (PM, M15 RTP, M 14 - 4M, M 16 - 4M)

1. Review the internal control system regarding writing off and recovery of bad debts.
2. Ascertain the total amount lying as bad debts.
3. Examine notification from the court, bankruptcy trustee and all correspondence from debtors and collecting agencies.
4. Verify the relevant correspondence with the trade receivable whose accounts were written off as bad.
5. Ensure that all recoveries of bad debts have been properly recorded in the books of account.
6. See that the amount recovered is credited to a separate account recovery of bad debts written off
7. Vouch acknowledgement receipts issued to debtors.

Q.No.29. Refund of General insurance premium paid. (A) (PM, N 15 - 4M)

The refund of insurance premium may be because of earlier provisional payment of premium or may be a policy might have been cancelled at a later date. The auditor should take following steps while vouching such refunds:

1. Ascertain the reasons for refund of insurance premium.
2. Examine insurance policy or cover note to find out the amount of premium.
3. Verify advice of refund received from the insurance company. When refund is admitted, the insurance company sends the advice. This will be evidence as a covering letter to the cheque for the refund.
4. Scrutinize 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.No.30. Receipt of Capital Subsidy. (A) (PM, RTP N17, M 10 - 5M, N 16 - 4M)

1. Refer to 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. See that conditions to be fulfilled and other terms especially whether the same is for a specific asset or is for setting up a factory at a specific location.
4. Check relevant entries for receipt of subsidy.
5. Check compliance with requirements of AS 12 on “Accounting for Government Grants” i.e. whether it relates to specific amount or in the form of promoters’ contribution and accordingly accounted for as also compliance with the disclosure requirements.

Q.No.31. Receipt of Special Backward Area Subsidy from Government. (B) (PM)

1. The claim for backward area subsidy submitted to the authorities should be studied.
2. It should be ascertained whether the grant is of a capital nature for funding an assets 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 checked with bank statement, remittance challan etc.
6. The conditions attached to grant should be fulfilled by the company. The auditor should check whether any liability or refund of grant for breach of conditions could arise.

Q.No.32. Grant received for reimbursement of revenue expenditure. (PM)

Grant Received for Reimbursement of Revenue Expenditure:

1. Check the amount of receipt, donor details etc. from relevant voucher.
2. Study the terms of grant for its utilization and check whether they had been complied with.

3. Check the nature of grant, amounts have been duly disclosed in accounts in accordance with Accounting Standard 12.
4. Check the provisions of law, if any, affecting foreign contributions if the grant comes from abroad.

Q.No.33. Profit or Loss Arising on Sale of Plots Held by Real Estate Dealer. (A) (PM, N 13 - 4M)

The land holding in the case of real estate dealer will be a current asset and not a fixed asset. The same should, therefore, be valued at cost or market value, whichever is less. Profit or loss arising on sale of plots of land by Real Estate Dealer should be verified as follows-

1. Each property account should be examined from the beginning of the development 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.
2. This 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 should be scrutinized.
3. If land price lists are available, these should be compared with actual selling prices obtained.
4. And it should be verified that contracts entered into in respect of sale have been duly sanctioned by appropriate authorities.
5. Where part of the sale price is intended to reimburse taxes or expenses, suitable provisions should be maintained for the purpose.
6. The prices obtained for various plots of land sold should be checked with the plan map of the entire tract and any discrepancy or unreasonable price variations should be inquired into.
7. The sale price of different plots of land should be verified on a reference to certified copies of sale deeds executed.

PART 3: AUDIT OF PURCHASES

Q.No.34. What are the factors which increase the Gross Profit? (A) (PM, M 11 - 8M)

FACTORS WHICH INCREASE THE GROSS PROFIT:

1. Undervaluation of opening inventory.
2. Overvaluation of closing inventory.
3. Alteration of the basis of valuation of closing inventory, e.g., where the opening inventory was valued at cost or market rate whichever was lower, valuing the closing inventory at the market price which is higher than cost.
4. Increase in the values of some of the items included in the opening inventory (which were valued at market rate which was lower than cost) above cost, on account of which the unsold inventory of these items at the close of the year is valued at cost.
5. Under-statement of opening inventory or over-statement of closing inventory for example goods sold but not delivered are included in the closing inventory.
6. Inclusion in the closing inventory
   - Goods returned awaiting dispatch to supplier, the cost of which has been debited to supplier or

- Goods returned by account receivables, the cost where of has not been credited to customers.
- Goods received for the sale on approval or on a consignment basis.

7. Treatment of goods sent out for sale on consignment basis as regular sales.

8. No provision or under-provision in the expenses accounts included in the Trading Account. For example, purchase may be understated; provision for outstanding wages or carriage inward may not have been made.

9. Wrong allocations of expenses, e.g., carriage inwards either in whole or in part may be wrongly taken to the Statement of Profit and Loss.

<u>SIMILAR QUESTIONS:</u>

1. 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? (PM)

A. Refer above answer.

Q.No.35. What are the factors which decrease the Gross Profit? (A) (N 15 - 6M)

1. Over valuation of the opening inventory or

2. Undervaluation of closing inventory.

3. Alteration of the basis of valuation of inventory e.g., closing inventory having been valued at cost, which is below the market price, when the opening inventory was valued at market price above cost.

4. Inclusion in the year of the amount of goods purchased in the previous year, that were received and where taken in the same year.

5. Reversal of the fictitious sale entries recorded in the previous year to boost up profit.

6. Entry of sales returns twice or failure to account for purchase returns when the goods in question have been sent back.

7. Excessive provisions have been made for wages or direct expenses.

8. Failure to include in closing inventory goods sent out for sale on approval or on a consignment basis.

9. Omission to adjust the value of unused inventory of consumables stores, such as fuel and packing material or inclusion in Trading Account expenses which should have been included in the Profit in the Loss Account.

10. Failure to take credit for the amount of an insurance claim in respect of a consignment of goods lost in transit or destroyed by fire.

11. Failure to account for goods sold or destroyed or given away as samples.

<u>SIMILAR QUESTIONS:</u>

1. 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. (PM)

A. Refer above answer.

Q.No.36. Purchase with Invoice. (A) (PM, M10 - 10M, M 13 - 4M)

While vouching entries for purchases with the invoices, the following points should be specially observed -

1. The date of invoice falls within the accounting period;
2. The invoice is made out in the name of the client;
3. the supplier's account has been credited with the full amount of the invoice and that the deduction in the amount of the invoice, if any, has been made on a proper basis;
4. The goods purchased are those that are regularly dealt in by the concern or required for the process of manufacture carried on by it and that the price payable has been correctly arrived at;
5. The cost of purchases has been debited to an appropriate nominal account or accounts;
6. The invoice is signed by the accountant to show that he has verified it as well as the store-keeper to indicate that the delivery of goods have been taken by him.
7. If the invoice relates to the purchase of a technical store or a chemical, the price whereof is dependent on its quality, a copy of the report of a technical person showing that the article purchased is of the specification for which the order has been placed; and
8. The manager or some other official, competent to sanction payment, has authorised its payment.

SIMILAR QUESTIONS:

1. **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? (PM)**

A. Refer above answer.

Q.No.37. Purchase returns. (B) (N17 – 4M) (PM)

1. Examine the correspondence with the party, the quantities and value of goods purchased and those returned out of them also should be verified.
2. Examine debit note issued to the supplier for purchase returns.
3. Also examine the credit note issued by the supplier acknowledging the purchase returns.
4. Verify the movement of goods in the good outward book or the stores records in comparison with the supplier's original invoices for rates and other charges.
5. 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.
6. Cross - check with reference to original invoices any rebates in price or allowances if any given by suppliers on strength of their Credit Notes.
7. Ensure disclosure requirement of Schedule III has been complied with.

Q.No.38. Loss of inventory by theft. (PM)

Loss of Inventory by Theft:

1. The most important evidence for verification will be the First Information Report(FIR) filed with the police for this theft.

2. The contents of the FIR will be cross checked with the financial books and inventory records.
3. If no FIR is lodged, then deeper analysis will be required including satisfaction of the reasons for not filing FIR.
4. The quantity and value of the stolen inventory is not included in the closing inventory will be ensured.
5. Verify whether such inventory was insured and whether theft claim was lodged with the insurance company.

PART 4: AUDIT OF SALES

Q.No.39. Cash Sales (A) (PM, M16 RTP)

1. The system of internal check should be examined with the objective of finding out loopholes therein, if any, whereby cash sales could be misappropriated.
2. Cash sales usually are verified with carbon copies of cash memos
3. If sales are quite voluminous then a Cash Sales Summary Book is maintained and the cash memos are traced into it.
4. Check the arithmetical accuracy of cash memos with reference to price charged, discount allowed, rate of vat etc.
5. The totals of the Summary Book are verified and the daily totals of the Summary book traced into the Cash Book.
6. Dates on the cash memos should tally with those entered in the Cash Book/summary book.
7. If a cash memo has been cancelled, its original copy should be inspected to ensure that they are not removed from the receipt book. .
8. Ensure the provisions of "AS 9 Revenue Recognition" and disclosure requirements of Schedule III has been complied with.

Q.No.40. Credit sales (A) (PM, N15 RTP, N 10 - 5M)

1. The credit sales should be verified by reference to copies of invoices issued to customers.
2. Check that each item of sales relates to the period of account under audit;
3. Verify that the goods are those that are normally dealt in by the concern.
4. Ensure that the sale price has been correctly arrived at and the copy of the requisition slip issued by the Sales Department and the copy of the Dispatch Note showing the date and mode of dispatch of goods are attached with the invoice.
5. The additional charges recovered along with the sale price should be credited to separate accounts, appropriately headed, and not to the Sales Account.
6. Ensure that the sale has been authorized by a responsible official and also that any alteration in the invoice has been attested by the same person.
7. When a trade discount is allowed, the amount thereof should be deducted from the sale price. Where any special trade discount has been allowed, the reason thereof should be ascertained.
8. In the case of sales to directors as well as to associate concerns, it should also be verified that these have been made at market rates.

9. The sale of goods on hire-purchase basis of the goods sent out on sale or return basis or on consignment basis should be separately recorded.
10. Auditor should ensure disclosure requirements of Schedule III have been complied with.

Q.No.41. Goods Sent Out on Sale or Return Basis. (A) (PM, N15 RTP, N 09 - 5M, N16 - 4M)

1. Examine whether the Memoranda record of goods sent out on sale or return basis are kept.
2. Check whether memoranda entries are made in this book.
3. The auditor should refer the memoranda record to confirm that on receipt of acceptance from each party, his account is debited and corresponding sales account is credited.
4. Ensure that the goods, in respect of which period of approval has expired, are either received back subsequently or customer's accounts debited by writing as sales.
5. He should ensure that for the inventory of goods sent out on approval, the period of approval, in respect of which had not expired till the close the year, are included in closing inventory at cost.

Q.No. 42. Sales returns. (B) (PM)

1. Examine the correspondence with the party, the quantities and value of goods supplied and those returned out of them also should be verified.
2. Examine Credit note issued to the debtors for sales returns.
3. Also examine the Debit note issued by the customer for acknowledging the sales returns.
4. Verify the movement of goods in the good inward book or the stores records in comparison with the original invoices for rates and other charges.
5. Examine in depth to eliminate the possibility of fictitious sales returns for covering bogus sales recorded earlier when such returns inwards are in substantial figure either at the beginning or end of the accounting year.
6. Cross-check with reference to original invoices any rebates in price or allowances if any given on strength of their Debit Notes and to ensure that rebates and allowances have been allowed in accordance with the policies and practices of the business.
7. When there is long time lag between the dates of the sale and that of return of the goods, the reasons for the same as well as the conditions, in which the goods have been received back, should be ascertained.
8. The credit given to allied or associated concerns on account of goods returned by them should be specially examined to verify that the goods have been returned due to some valid reasons and the credit does not represent the reversal of fictitious sales earlier entered in their account.
9. Ensure disclosure requirement of Schedule III has been complied with.

Q.No. 43. Sale of empties. (B)

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. Examine the products which are supplied along with the container or empties.
2. Verify whether Separate account of issue and receipt of empties has been prepared.

3. Check how many empties lies in warehouse and how many are with customers which may be returned by them 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 inventory.
7. If the empties are sold on credit, ask for direct confirmation from purchasing party and confirm the sale.

Q.No.44. Consignment sales or Goods sent on consignment: (A)
(PM, N 16 RTP, M16 RTP)

1. Verify the accounts sales submitted by the consignee showing sale price of goods sold, expenses incurred by the consignee and inventory of goods in hand.
2. Verify credits in the Consignment Account with the help of the Account Sales received from the consignee. The gross sale proceeds should be credited to the Consignment Account and debited to the consignee's account.
3. Verify the terms of agreement between the consignor and the consignee to check the commission and other expenses debited to the Consignment Account and credited to the Consignee's A/c. The Account Sales also must be correspondingly checked.
4. Ensure that the goods consigned are not treated as ordinary sales. In cases it is so, the auditor should see that necessary adjustments are made at the year-end in respect of the unsold goods, commission and the expense incurred by consignee.
5. The balances in the Consignment Ledger, at the end of the year in such a case, would represent the cost of unsold goods, including a proportion of non-recurring expenses incurred on their transport and insurance. No profit should be taken for the profit on goods remaining in the hands of the consignee.
6. The consignee should not be shown as a trade receivable for unsold goods and in valuation of inventory, these goods should be included in inventory at cost worked out on a consistent basis.
7. Obtain confirmation of the balance in the account of the consignee from the consignee.
8. Sometimes, the goods are consigned not at cost but at an inflated price. The auditor should see that the necessary adjustments to remove the loading are made at the end of the year.

PART 5: AUDIT OF LEDGERS

Q.No.45. Discuss the important points that you would look into while carrying Scrutiny of General Ledger? (B) **(PM, M15 RTP, N16 - 4M)**

1. The General Ledger contains all the balances which are ultimately included in the Statement of Profit and Loss and the Balance Sheet. Its examination therefore is undertaken last of all.
2. The scrutiny of General Ledger should be carried out with due care in as much as it is the final review of balances which, on inclusion in Final Accounts, cumulatively reflect the financial position of the concern.
3. Entries in the General Ledger usually are posted in a summary form from the books of original entries such as Cash Book, Journal, Sales Book, Purchase Book and other subsidiary books. Therefore, it should be confirmed that all the postings on various accounts have been verified, totals, etc. checked.

4. It should also be ascertained that balances in all the income and expense accounts have been adjusted:
   a) According to standard accounting practices (i.e., all unpaid, prepaid expenses have been adjusted and accrued Income and pre-recorded income is properly adjusted); and
   b) On a consideration of the legal provisions which are applicable to the concern.
5. The balances in the General Ledger should be traced to the trial balance and from the trial balance to the final accounts.

SIMILAR QUESTIONS:

1. Write a short note on "Scrutiny of General Ledger". (PM)

A. Refer above answer.

Q.No.46. List out some examples of fraud that can be done by ledger keeper in Bought Ledger, Sales Ledger and Nominal Ledger. (C) (PM, M 11 - 8M)

Examples of frauds that can be done in bought ledger -

1. Crediting the account of a supplier on the basis of a fictitious invoice, showing that certain supplies have been received from the firm, whereas in fact no goods have been received or on the basis of duplicate invoice from a supplier, the original amount whereof has already been adjusted to the credit of the supplier in the Bought Ledger, and subsequently misappropriating the payment made against the credit in the supplier's accounts.
2. Suppressing a credit note issued by a supplier in respect of return or an allowance and misappropriating an amount equivalent thereto out of the payment made to him. For if a credit note issued by a supplier either in respect of goods returned to him or for an allowance granted by him, is not debited to his account, the balance in his account in the Bought Ledger would be larger than the amount actually due to him. The ledger-keeper thus will be able to misappropriate the excess amount standing to the supplier's credit.
3. Crediting an amount due to a supplier not in his account but under a fictitious name and misappropriating the amount paid against the credit balance.

Examples of frauds that can be done in sales ledger:

1. **Teeming and Lading:**
   a) The amount received from the first customer is misappropriated;
   b) And to prevent its detection, the money received from the second customer subsequently being credited to the account of the first customer.
   c) Similarly, money received from the third customer who has paid thereafter, will be credited to the account of the second customer and such a practice is continued so that no one account is outstanding for payment for any length of time which may lead the management to send reminder letter to the debtors
2. Adjusting an unauthorized credit or fictitious rebate, allowance, discount, etc. in the account with a view to reduce the balance and when payment is received from the trade receivable, misappropriating an amount equivalent to the credit.
3. Writing off the amount receivable from a customer's bad debt account and misappropriating the amount received in payment of the debt.

Examples of frauds that can be done in Nominal ledger:

1. Allocating an item of income or expenditure wrongly, e.g., an item of capital expenditure being charged as revenue and vice versa; and
2. Understating or overstating the value of inventories, amount of prepaid expenses or liability.

PART 6: SOME IMPORTANT CONCEPTS

Q.No.47. CUT - OFF ARRANGEMENT. (A)
(PM, N 16 RTP, M 11 - 4M, M 14 - 4M, N 09 - 5M, N 12 - 4M)

a) Accounting is a continuous process because the business never comes to halt. It is, therefore, necessary that transactions of one period would be separated from those in the ensuing period so that the results of the working of each period can be correctly ascertained.

b) The arrangement that is made for this purpose is technically known as “cut-off arrangement”.

c) It essentially forms part of the internal control system of the organization.

d) This arrangement is generally applied only to sales, purchase and inventory.

e) The auditor satisfies by examination and test-checks that the cut-off procedures are adequately followed and ensure that:

- **i)** Goods purchased, property in which passed on to the client, have in fact been included in the inventories and that the liability has been provided for in case credit purchase.
- **ii)** Goods sold have been excluded from the inventories and credit has been taken for the sales. If the value of sales is to be received, the concerned party has been debited.

The auditor may examine a sample of documents, evidencing the movement of inventory into and out of stores, including documents pertaining to period shortly before and after the cut-off date and check whether inventories represented by those documents were included or excluded as appropriate during inventory taking for perfect and correct presentation in the financial statements.

SIMILAR QUESTIONS:

1. “It is necessary that transactions of one period be separated from those in the ensuing period so that the results of the working of each period can be correctly ascertained.” Explain.

A. Refer above answer.

Q.No.48. Casting or totaling is an important tool of audit for an Auditor. Comment. (A)
(PM, N14 - 4M)

CASTING OR TOTALING AS AN AUDIT TOOL:

1. Casting or totaling is an important tool of audit for an auditor.

2. Because sometimes the totals of a wage bill are inflated by over totaling the column in which the wages payable are entered. Such a fraud can be detected only if the totals of the wage bill are checked.

3. Similarly, a cashier may misappropriate receipts from account receivables by under-totaling the receipts column of the cash book. At times, shortages in cash have been also covered up by over totaling. Such frauds can be detected only if the totals of the cash book and the general ledger are checked.

4. On these considerations, where totals of the cash book or the ledger are found to have been be made in pencil, the book keeper should be asked to ink the totals before their verification is commenced. This would prevent him from altering the totals on the totaling mistakes being discovered.

5. Sometimes a fraud is committed in the following manner-

- **i)** under casting the receipt side of the cash book;

ii) Over casting the payment side of the cash;

iii) 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;

iv) Posting an amount of cash sale to the credit of a party and subsequently withdrawing the amount; and

v) Wrong totals or balances being carried forward in the cash book or in the ledger.

Q.No.49. Indicate expenses which are essentially of a revenue nature, if incurred for creating an asset, are also regarded as expenditure of a capital nature. (B)
(PM, M 14 - 4M) (For Students Self - Study)

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

Examples -

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

Whenever, therefore, a part of the expenditure, ostensibly of a revenue nature, is capitalized, it is the duty of the auditor not only to examine the precise particulars of the expenditure but also the considerations on which it has been capitalised.

Q.No.50. Manipulation of Accounts. (B) (PM, M 09 - 6M) (For Students Self - Study)

Frauds are always intentional, for a predetermined purpose and are generally committed either by the owners or top management personnel or senior officers of the business. This type of fraud is generally committed-

a) To avoid incidence of income-tax or other taxes by showing profits at a lower figure.

b) For delaying a dividend when there are insufficient profits by showing profits at inflated figures.

c) To withhold declaration of dividend even there is adequate profit.

d) For receiving higher remuneration where managerial remuneration is payable by reference to profits.

Such frauds are difficult to be detected as they are committed by persons holding position of trust and use carefully guarded by them. Such frauds are generally of the following nature-

i) Recording fictitious sales or omission of sales.

ii) Recording fictitious purchases or suppression of purchases.

iii) Over valuation or under valuation of inventory.

iv) Recording fictitious expenses or omission of expenses.

v) Revenue expenses changed to capital and vice-versa.

AUDITOR'S RESPONSIBILITY:

a) SA 240 deals with the auditor's responsibilities for the detection of material misstatement resulting from fraud and error.

b) It requires a considerable skill and vigilance on the part of an auditor. An auditor, who uses adequate skill and reasonable care, is legally exempt from liability if he fails to discover a well concealed detection.

SIMILAR QUESTIONS:

1. **As an auditor of a Limited Company, you observe that during the month of March, 2016, sales invoices were not recorded in books of accounts. You also observe that payment of wages was much higher compared to last year. Keeping in mind the above, analyse possible ways of manipulation of accounts. (PM)**

A. Refer above answer.

QUESTIONS FOR ACADEMIC INTEREST – SELF STUDY

Q.NO.51. "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. (C) (PM, N 14 RTP, N 16 RTP)

CHEQUES RECEIVED ON THE LAST DAY OF ACCOUNTING YEAR:

1. It is a quite normal that in any ongoing business entity many a times cheques are received from the customers on the last day of the accounting year. It is also quite likely, that cheques received on the last day of the accounting year could not be deposited in the bank.
2. Though normally speaking, 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.
3. Therefore, it is quite important to ensure that the system of internal control is effective and such cheques should be properly accounted for to avoid any frauds and that the financial statements reflect a true and fair view.
4. As far as internal control system is concerned, 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.
5. The person who is controlling the trade receivables' ledger should ensure that proper accounting entries have been passed by crediting respective trade receivables' accounts.

Conclusion: The balance of cheques-in-hand should also be disclosed along with the cash and bank balances in the financial statements.

Q.No.52. How will you vouch and/or verify the premium paid for insurance of a motor car? (C) (PM)

Premium Paid for Insurance of a Motor Car: Vouch from the following-

a) Insurance cover note issued by the insurance company verifying the car no. and period of insurance coverage.

b) Verify that "no claim bonus" is given, where entitled, by the Insurance Company.

c) Ensure that proper adjustment is made for prepaid insurance premium.

Q.No.53. Write a short note on Misappropriation of Goods? (C)

<u>MISAPPROPRIATION OF GOODS:</u> Goods can be anything in the premises. It may include inventory of raw materials, finished goods and even the daily necessities of the office like stationery.

The goods may be removed by subordinate employees or even by persons quite higher up in the management.

MANAGEMENT'S MEASURES TO PREVENT MISAPPROPRIATION OF GOODS:

Fraud in the form of misappropriation of goods is still more difficult to detect; for this management has to rely on various measures.

a) Proper maintenance of <u>record keeping</u> w.r.t the physical quantities and values and periodical checking of records.
b) Proper <u>rules and procedures</u> for allowing persons inside the area where goods are kept.
c) There should be external <u>security arrangements</u> to see that no goods are taken out without proper authority.

AUDITOR'S MEASURES TO DETECT PREVENT MISAPPROPRIATION OF GOODS:

Auditors can detect this by type of fraud by undertaking the following measures:

a) Thorough and strenuous checking of records followed by physical verification process.
b) By performing ratio analysis.

For example, Gross profit ratio, Input - output ratio etc.

PRACTICAL QUESTIONS

Q.NO.1. "Travelling expenses of Rs. 2.25 lakhs shown in statement of profit and loss of X ltd., including a sum of Rs. 1.10 lakhs spent by a director on his foreign travel for company's business accompanied by his mother for her medical treatment". Comment. (PM)

PERSONAL EXPENSES CHARGED TO REVENUE ACCOUNT:

Provisions of law: The auditor should check the service contract, minutes of board meeting, etc., to check the authorization for such expenditure. As per the provisions of Section 143(1) of Companies Act, 2013, the auditor shall enquire whether personal expenses have been charged to revenue account and make a report to the members in case he is not satisfied with the answer.

Analysis: In this case, the auditor should examine documentary evidence in support of the travelling expenses of Rs. 1.10 lakhs incurred by the director and ascertain the personal component thereof. Then, he should enquire as to whether such personal expenses incurred by the company are covered by contractual obligations or by any accepted business practices.

Conclusion: In case, the answer is negative, the auditor should make a report thereon and qualify his audit report.

Q.NO.2. On 31.12.2015, Amudhan Company Limited invested Rs. 45 lakhs in cumulative fixed deposits of Algar Bank Ltd. The deposits carry interest @10% per annum compoundable quarterly and amount of interest is added to the principal and is due and payable on the maturity date which is 5 years from the date of investments. For the year ended 31st March, 2016, the company did not book any revenue of interest on the ground that interest amount is not available at their disposal till maturity date of investment. Comment. (PM)

1. AS 9 on Revenue Recognition requires that the revenue arising from interest should be recognised on a time proportion basis taking into account the amount outstanding and the rate applicable.
2. Such revenues should only be recognised when no significant uncertainty as to measurability or collectability exists.
3. Further, according to Section 128 of the Companies Act, 2013 books are to be maintained on accrual basis. Again, accrual method of accounting is a fundamental assumption of accounting policies.
4. Though the interest becomes due for payment only at maturity date, it accrues each quarter. Interest accrued but not due should be shown as per Schedule III Part I requirement of the Companies Act, 2013.
5. As such, the profits and current assets are understated and true and fair views of the accounts are thus vitiated.
6. On considerations of materiality of the item, the auditor may appropriately decide to qualify the audit report.

THE END