

## Vouching

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### Question 1

*How you will vouch/verify the following?*

(a) *Provision for income tax.* (4 Marks, November, 2014)

(b) *Retirement gratuity to employees.* (4 Marks, November, 2014) (6 Marks, May, 2012)

*Or*

*Payment of Retirement Gratuity to employees.* (5 Marks, November, 2007)

### Answer

#### (a) Provision for Income Tax:

- (i) Obtain the computation of income prepared by the auditee and verify whether it is as per the Income-tax Act, 1961 and Rules made thereunder.
- (ii) Review adjustments, expenses, disallowed special rebates, etc. with particular reference to the last available completed assessment.
- (iii) Examine relevant records and documents pertaining to advance tax, self assessment tax and other demands.
- (iv) Compute tax payable as per the latest applicable rates in the Finance Act.
- (v) Ensure that overall provisions on the date of the balance sheet is adequate having regard to current year provision, advance tax paid, assessment orders, etc.
- (vi) Ensure that the requirements of AS 22 on Accounting for Taxes on Income have been appropriately followed for the period under audit.

#### (b) Retirement Gratuity to Employees:

- (i) Examine the basis on which the gratuity payable to employees is worked out. The liability for gratuity may either be worked out on actuarial rules or agreement or on the presumption that all employees retire on the balance sheet date.
- (ii) Verify computation of liability of gratuity on the aggregate basis.
- (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.
- (iv) See that the annual premium has been charged to Statement of Profit and Loss, in case if the concern has taken a policy.

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- (v) Ensure that the basis of computing gratuity is valid.
- (vi) Ensure that the accounting treatment is in accordance with AS 15, "Employee Benefits".
- (vii) Ensure that the following disclosure requirements of Schedule III to the Companies Act, 2013 have been followed-

In respect of Statement of Profit and Loss, a Company shall disclose by way of notes additional information regarding aggregate expenditure and income on the following items:

(i) (a) **Employee Benefits Expense** [showing separately (i) salaries and wages, (ii) contribution to provident and other funds, (iii) expense on Employee Stock Option Scheme (ESOP) and Employee Stock Purchase Plan (ESPP), (iv) staff welfare expenses];

➤ **Long-term provisions:** The amounts shall be classified as: (a) **Provision for employee benefits**; (b) Others (specify nature)

➤ **Short-term provisions:** The amounts shall be classified as: (a) **Provision for employee benefits**; (b) Others (specify nature).

### Question 2

*Casting or totaling is an important tool of audit for an Auditor. (4 Marks, November, 2014)*

### Answer

**Casting or Totaling as an Audit tool:** Casting or totaling is an important tool of audit for an auditor as 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. Similarly, a cashier may misappropriate receipts from customers by under-totalling the receipts column of the cash book. At times, shortages in cash have also been covered up by over totaling. Such frauds can be detected only if the totals of the cash book and the general ledger are checked.

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

Sometimes a fraud is committed in the following manner:

- (a) under casting the receipt side of the cash book;
- (b) Over casting the payment side of the cash;
- (c) 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;
- (d) posting an amount of cash sale to the credit of a party and subsequently withdrawing the amount; and
- (e) wrong totals or balances being carried forward in the cash book or in the ledger.

**Question 3**

*As an auditor what are the essential points to be borne in mind while examining a voucher?*

*(5 Marks, May, 2014)*

**Answer**

**Examining a Voucher:** The essential points to be borne in mind while examining a voucher are -

- (i) that the date of the voucher falls within the accounting period;
- (ii) that the voucher is made out in the client's name;
- (iii) that the voucher is duly authorised;
- (iv) that 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
- (v) that the account in which the amount of the voucher is adjusted is the one that would clearly disclose the character of the receipts or payments posted thereto on its inclusion in the final accounts.

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.

**Question 4**

*State with reasons (in short) whether the following statements are correct or incorrect:*

- (a) *The Whole Time Director of a public company is automatically entitled for remuneration.*
  - (b) *ABC Ltd., a government company came into existence in year 2012, donated ₹ 50,000 to a political party.*
- (2 Marks each, May, 2014)*

**Answer**

- (a) **Correct:** In case of a public company, the whole time directors may be paid remuneration either by way of a monthly payment or at a specified percentage of the net profits of the company or partly by one way and partly by other, subject to the provisions of the Companies Act, 2013.
- (b) **Incorrect:** According to section 182 of the Companies Act, 2013, no government company is allowed to contribute any amount directly or indirectly to any political party.

**Question 5**

*How you will vouch/verify the following?*

- (a) *Preliminary expenses.*  
*(4 Marks, May, 2014) (5 Marks, November, 2008) (4 Marks, November, 2004)*
- (b) *Recovery of bad debts written off.*  
*(4 Marks, May, 2014) (5 Marks, November, 2007) (4 Marks, May, 2004)*

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### Answer

- (a) **Preliminary Expenses:** 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 fees, expenses of printing of memorandum and articles, etc. The following should be checked-
- (i) Check Board's minute book containing the resolution approving the expenses claimed by promoters as having been spent in formation of the company.
  - (ii) Examine supporting papers and vouchers, contracts, agreements, etc. to support the promoters' claims. Also check bills and receipts issued by the printer of the memorandum and articles of association, share certificates, etc.
  - (iii) Check receipt for the registration fee paid for registration of the company.
  - (iv) Verify rates of stamp required to be affixed on the memorandum and articles of association.
  - (v) Examine the compliance of AS 26 with regard to treatment of such preliminary expenses in the books of account.
  - (vi) Check that no expenses other than those what constitutes preliminary expenses are booked under this head, e.g. underwriting commission and brokerage paid.
- (b) **Recovery of Bad Debts Written Off**
- (i) 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.
  - (ii) See that the amount recovered is credited to a separate account recovery of bad debts written off.
  - (iii) Check all notifications from Court or bankruptcy trustee and all correspondence from trade receivables and collecting agencies.
  - (iv) Check credit manager's file for the amount received and see that the amount has been deposited in the bank promptly.
  - (v) Review the internal control system regarding writing off and recovery of bad debts.

### Question 6

*How you will vouch/verify Cut-off arrangement/procedures. (4 Marks, May, 2014)*

*Or*

*Write a short note on Cut-off procedure. (4 Marks, May, 2011) (5 Marks, November, 2007)*

*Or*

*Write a short note on Cut-off arrangements.*

*(4 Marks, November, 2012) (5 Marks, November, 2009)*

**Answer**

**Cut-off Arrangement/Procedure:** 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. The arrangement that is made for this purpose is technically known as "cut-off arrangement". It essentially forms part of the internal control system of the organisation. Accounts, other than sales, purchase and stock are not usually affected by the continuity of the business and therefore, this arrangement is generally applied only to sales, purchase and stock. 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 stock into and out of stores, including documents pertaining to period shortly before and after the cut-off date and check whether stocks represented by those documents were included or excluded as appropriate during stock taking for perfect and correct presentation in the financial statements.

**Question 7**

*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 Marks, May, 2014)*

**Answer**

**Revenue Expenditures which are Capital in Nature:** 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:

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

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Whenever, therefore, a part of the expenditure, ostensibly of a revenue nature, is capitalised 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.

### Question 8

*How will you vouch and verify the following:*

- (a) *Remuneration paid to directors.* (4 Marks, November, 2013)
- (b) *Profit or loss arising on sale of plots held by real estate dealer.* (4 Marks, November, 2013)
- (c) *Advertisement expenses.*  
(4 Marks, November, 2013) (5 Marks, May, 2008) (4 Marks, May, 2005)
- (d) *Purchase with invoice.* (4 Marks, May, 2013)

### Answer

#### (a) Remuneration paid to Directors

- (i) 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.
- (ii) Examine Articles of Association and general meeting resolution to determine the manner of payment-monthly or at a specified percentage of the net profits of the company or partly by one way and partly by the other as per the provisions of Section 197(6) of the Companies Act, 2013.
- (iii) Check agreement with the director.
- (iv) Verify director's attendance in the board meetings.
- (v) Ensure compliance with the provisions of Sections 197, 198 and Schedule V of the Companies Act, 2013, where appropriate.
- (vi) Check computation of the net profits and the commission payable to directors in terms of Schedule III to the Companies Act, 2013.
- (vii) Computation of net profit under section 198 with details of the commission payable as percentage of profits to the directors including Managing Directors/Manager (if any) should be stated by way of note.

**(b) Profit or Loss arising on Sale of Plots held by Real Estate Dealer:** 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-

- (i) 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 and the total cost of the property has been set off against the price realised for it.

- (ii) 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 scrutinised.
  - (iii) If land price lists are available, these should be compared with actual selling prices obtained. And it should be verified that contracts entered into in respect of sale have been duly sanctioned by appropriate authorities.
  - (iv) Where part of the sale price is intended to reimburse taxes or expenses, suitable provisions should be maintained for the purpose.
  - (v) 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. The sale price of different plots of land should be verified on a reference to certified copies of sale deeds executed.
  - (vi) Out of the sale proceeds, provision should be made for the expenditure incurred on improvement of land, which so far has been accounted for.
- (c) **Advertisement Expenses:** The following steps may be taken by the auditor to vouch/verify the different items-
- (i) Ascertaining the value of advertisement expenses to ensure that the said expense has been properly allocated.
  - (ii) Examining that such expenses relate to the client's business.
  - (iii) 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.
  - (iv) Examination of the receipts for amounts paid.
  - (v) Reviewing the contracts with the different agencies and ensuring that the billing conforms to the term and conditions specified therein.
  - (vi) Ensuring that all such outstanding expenses have been properly accounted for.
- (d) **Purchase with Invoice:** While vouching entries for purchases with the invoices, the following points should be specially observed-
- (i) that the date of invoice falls within the accounting period;
  - (ii) that the invoice is made out in the name of the client;
  - (iii) that 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;
  - (iv) that 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;

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- (v) that the cost of purchases has been debited to an appropriate nominal account or accounts;
- (vi) that 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. 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
- (vii) that the manager or some other official, competent to sanction payment, has authorised its payment.

### Question 9

*Comment on the following:*

- (a) *PQR Ltd. include underwriting commission and stamp duty as preliminary expenses.*

*(2 Marks, May, 2013)*

- (b) *Vouching of payment of taxes.*

*(5 Marks, November, 2011)*

### Answer

- (a) **Preliminary Expenses:** The expenditure incidental to the creation and floating of a company includes 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. Therefore, PQR Ltd should include stamp duty as preliminary expense but exclude underwriting commission.
- (b) **Vouching of Payment of Taxes**
- (i) Obtain the computation of income prepared by the auditee and verify whether it is as per the Income Tax Act, 1961 and Rules made there under.
  - (ii) Review adjustments, expenses disallowed, special rebates etc. with particular reference to the last available completed assessment.
  - (iii) Examine relevant records and documents pertaining to payment of advance tax, self assessment tax and other demands.
  - (iv) Payment on account of income-tax and other taxes consequent upon a regular assessment should be verified by reference to the copy of the assessment order, assessment form, notice of demand and the receipted challan.
  - (v) Payments or advance payments of income-tax should also be verified with the notice of demand and the receipted challan acknowledging the amount paid.
  - (vi) 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.

- (vii) Ensure that the requirements of AS 22 on 'Accounting for Taxes on Income' have been appropriately followed for the period under audit.

### Question 10

*Explain, what are the factors to be considered while "Vouching of travelling expenses"?*

*(8 Marks, November, 2012)*

### Answer

**Vouching of Travelling Expenses:** The following factors are to be considered while "Vouching of Travelling Expenses"-

- (i) Travelling expenses are normally payable to staff according to rules approved by directors or partners. Where no rules exist, the auditor should recommend that these be framed for controlling the expenditure. In the absence of T.A. Rules, the expenditure should be vouched on the basis of actual expenditure incurred. A voucher should be demanded for all items of expenses incurred, except those which are capable of independent verification.
- (ii) As regards travelling expenses claimed by directors the auditor should satisfy himself that these were incurred by them in the interest of the business and that the directors were entitled to receive the amount from the business.
- (iii) The voucher for travelling expenses should normally contain the under mentioned information:
  - (1) Name and designation of the person claiming the amount.
  - (2) Particulars of the journey.
  - (3) Amount of railway or air fare.
  - (4) Amount of boarding or lodging expenses or daily allowance alongwith the dates and times of arrival and departure from each station.
  - (5) Other expenses claimed.
- (iv) 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.
- (v) Particulars of boarding and lodging expenses and in the case of halting allowance the rates thereof should be verified.
- (vi) 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. All vouchers for travelling expenses should be authorised by some responsible official. In the case of foreign travel or any extraordinary travel, the expenses, before being paid, should be sanctioned by the Board.
- (vii) 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.

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- (viii) Unless the articles specifically provide or their payment has been authorised by a resolution of shareholders, directors are not entitled to charge travelling expenses for attending Board Meetings.

### Question 11

*Write short notes on the following:*

- (a) *Audit of discounted bills receivable dishonoured.*  
(b) *Examination in depth.* *(4 Marks each, November, 2012)*

### Answer

#### (a) Audit of Discounted Bills Receivable Dishonoured

- (i) Obtain the schedule of discounted bills receivable dishonoured.
- (ii) Check the entry in bank statement regarding the amount of bills dishonoured and see that the bank has debited the account of client.
- (iii) Verify the bills receivable returned by the bank along with bank's advice.
- (iv) See that the dishonoured bills have been noted and protested by following the proper procedure and the account of the drawee or the account receivable is also debited.
- (v) Check that bank commission, if any, charged by the bank has been recovered from the party.

- (b) **Examination in Depth:** It implies examination of a few selected transactions from the beginning to the end through the entire flow of the transaction, i.e., from initiation to the completion of the transaction by receipt of payment of cash and delivery or receipt of the goods. This examination consists of studying the recording of transactions at the various stages through which they have passed. At each stage, relevant records and authorities are examined; it is also judged whether the person who has exercised the authority in relation to the transactions is fit to do so in terms of the prescribed procedure. For example, if payment to a trade payable is to be verified "in depth", it would be necessary to examine the following documents-

- (i) The invoice and statement of account received from the supplier.
- (ii) The entry in the stock record showing that the goods were received.
- (iii) The Goods Received Note and Inspection Certificate showing that the goods on receipt were verified and inspected.
- (iv) The copy of the original order and authority showing that the goods in fact were ordered by an authority which was competent to do so.

It is to be emphasized that, so far as the management is concerned, the internal control should have willing acceptance at the hands of the employees and there should exist proper mechanism for such motivation.

**Question 12**

*Write a short note on Preliminary Expenses.*

*(4 Marks, May, 2012)*

**Answer**

**Preliminary Expenses:** This term is applied to expenses incurred in connection with the formation of a limited company. They generally include the following expenses-

- (i) Legal costs in drafting the memorandum and articles of association;
- (ii) Capital duty and other fees on registration of the company;
- (iii) Cost of printing the memorandum and articles of association;
- (iv) Cost of statutory documents, companies seal, etc; and
- (v) Any other expense incurred to bring into existence the company.

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. The bills and statements supporting each item of preliminary expenses should be checked. It should be seen that no expenses other than those which constitutes preliminary expenses are booked under this head. The auditor can cross check the amount of preliminary expenses with that disclosed in the prospectus, statutory report etc. Any amount paid in excess of the amount disclosed in the prospectus should have been approved by the shareholders.

**Question 13**

*List out some examples of fraud that can be done by ledger keeper in Bought ledger and sales ledger.*

*(8 Marks, May, 2011)*

**Answer****Ledger Keeper and Frauds**

Examples of frauds that can be done by ledger keeper in **bought ledger**-

- (i) 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.
- (ii) 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.

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- (iii) 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-

- (i) Teeming and Lading: Amount received from a customer being misappropriated; also to prevent its detection the money received from another customer subsequently being credited to the account of the customer who has paid earlier. Similarly, moneys received from the customer who has paid thereafter being 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 either send out a statement of account to him or communicate with him.
- (ii) Adjusting an unauthorised 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.
- (iii) Writing off the amount receivable from a customer's bad debt account and misappropriating the amount received in payment of the debt.

### Question 14

*Give various factors which result in increase in Gross profit.*

*(8 Marks, May, 2011)*

### Answer

#### Factors which increase the Gross Profit:

- (i) Undervaluation of opening inventory; it may be either the effect of non-inclusion of certain items of inventories or that of valuation of the inventory at a rate lower than that warranted by the basis of valuation adopted or miscalculation of the value of one or more items of inventory. In such a case, the increase in the rate of gross profit would be preceded by a fall in the rate of gross profit in the previous year.
- (ii) Overvaluation of closing inventory, either by the inclusion therein of fictitious items of inventory or over-statement of values of some of them.
- (iii) 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.
- (iv) Increase in the value of some of the items included in the opening inventory above cost, on account of which the unsold inventory of these items at the close of the year is valued at cost.
- (v) Under-statement of opening inventory or over-statement of closing inventory, due to adjustment of the amount of sales, when goods sold but not delivered are included in the closing inventory or when goods were delivered and taken out of inventory last year, but sales invoices is raised in the current year.
- (vi) Entry of fictitious purchases to boost up the profits, if such a practice has been resorted to, it would have the effect of reducing the rate of gross profit in the ensuing year.

- (vii) Inclusion in the closing inventory of goods returned awaiting despatch to supplier, the cost of which has been debited to them or goods returned by customers, the cost whereof has not been credited to parties.
- (viii) Inclusion in the closing inventory of goods received for the sale on approval or on a consignment basis.
- (ix) Treatment of goods sent out for sale on consignment basis as regular sales.
- (x) 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.
- (xi) 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.

**Question 15**

*Write a short note on "Verification of credit sales".*

*(4 Marks, November, 2010)*

**Answer**

**Verification of the Credit Sales:** The credit sales should be verified by reference to copies of invoices issued to customers and, in the process, attention should be paid to the following matters-

- (i) that each item of sales relates to the period of account under audit;
- (ii) that the goods are those that are normally dealt in by the concern;
- (iii) 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 Despatch Note showing the date and mode of despatch of goods are attached with the invoice;
- (iv) that the amount of the invoice has been adjusted in an appropriate account; and
- (v) 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.

**Question 16**

*What points shall an auditor keep in mind while auditing an account of Bought Ledger having a debit balance?*

*(4 Marks, November, 2010)*

**Answer**

**Auditing an account of Bought Ledger:** The structure of every account in the Bought Ledger is - opening balance, credits on account of goods purchased and debits raised in respect of returns, allowances and discount receivable, advances paid against goods, payments and transfers.

An account in the Bought Ledger may be in debit. The balance may represent the amount receivable on account of goods returned, rebate allowed by the supplier or advance paid

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against an order. The auditor should 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 or will be received, for such an advance may represent a disguised loan to accommodate a business associate. The book balance also may represent the cost of goods purchased wrongly debited to the account of the supplier, instead of the Purchase Account.

In each such case, it should be ascertained that the book balance is good and recoverable and if it is not considered recoverable, a provision against the same has been made. The book balances should be appropriately classified for purposes of disclosure in the Balance Sheet.

If the debit balance represents a loan to a director or officer of the company, either jointly or severally with another person or it is a debit due by a firm or a private company in which the director is a partner or a member, the same should be separately disclosed in the Balance Sheet in accordance with the provisions contained in Schedule III to the Companies Act, 2013. The maximum amount due from the directors or other officers of the company at any time during the year and debts due from companies under the same management should also be disclosed along with the names of companies (Part I, Schedule III to the Companies Act, 2013).

### Question 17

*State with reasons (in short) whether the following statements are True or False:*

- (i) *The auditor compares entries in the books of accounts with vouchers and if two agree, his work is done.*
- (ii) *Confirmations received by the auditor directly from third parties are conclusive evidence in support of a transaction. (2 Marks each, May, 2010)*

### Answer

- (i) **False:** The totalling of entries in the books with vouchers shows fairness of financial statements. But auditor has to determine reliability of annual statement of accounts alongwith the truth and fairness.
- (ii) **False:** Confirmations received directly from the third parties by the auditor are more reliable but same cannot be treated as conclusive evidence.

### Question 18

*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 Marks, May, 2010)*

### Answer

There are three steps involved in such an assignment:

- A. Study and evaluation of internal control system

B. Vouching of purchase transactions

C. Analytical procedures

**A. Study and evaluation of internal control system**

This involves the following steps:

- (i) **Internal check:** It should consist of the segregation of duties at the following points:
  - (a) **Requisitioning the goods:** Specified employees from the stores department or from the production department's store unit should prepare and approve a purchase requisition for raw materials or goods used in production. The purchase requisition is sent to the purchase department.
  - (b) **Ordering the goods requisitioned:** The purchase department is responsible for negotiating the best prices, fixing delivery dates with suppliers and ensuring that appropriate quality goods are obtained. It should prepare a serially numbered purchase order.
  - (c) **Receiving the goods ordered:** Goods ordered should be inspected and counted by the receiving department. If satisfied, it prepares serially numbered receiving report or goods received note and forwards its notification copies to the stores, purchase department and finance department.
  - (d) **Preparing the payment voucher:** The accounts payable department or accounts payable unit of finance department will receive the invoices and process for its payment and accounting.
- (ii) **Physical controls**
  - (a) Physical controls over inventory include locked warehouses and store-rooms and limiting access to them to authorised personnel and
  - (b) Printed and pre-numbered forms should be used for purchase requisitions, purchase orders, receiving reports and vouchers.
- (iii) **Authorised procedures**
  - (a) Re-order points should be established for various inventory items that may trigger a manual request.
  - (b) Authorisation procedures should be designed for all the four control points – requesting the goods, ordering the goods requisitioned, receiving the goods ordered and preparing the payment voucher.
- (iv) **Internal review**
  - (a) It should ensure that there is adequate separation of duties and proper authorisation procedures with regard to processing and recording of purchase transactions.
  - (b) Paid invoices should be reviewed to ascertain the accuracy of the recording of these invoices and if possible, these invoices should be traced back to purchase requisition through receiving reports or goods received notes and purchase orders.

**B. Vouching of purchases transactions**

The auditor should vouch credit purchases in the following manner:

- (i) **Examine purchase book:** The auditor should examine the transactions recorded in the purchase book with reference to related purchase invoice.
- (ii) **Examine purchase invoices:** The auditor should select a small sample of vendors' invoices at random and should conduct in-depth audit on them i.e., trace the transaction from placing the order to the entries in inventory goods for actual receipt and payment made to the suppliers. In respect of imports, documents such as bill of lading, customs clearance, etc. should be examined. The auditor should ensure that subsidies, rebates, duty drawbacks or other similar items have been properly accounted for.
- (iii) **Examine the numerical sequence of source documents:** The auditor should ensure the numerical sequence of source documents such as purchase requisitions, purchase orders, receiving reports and vouchers have been maintained and missing numbers have been duly accounted for.
- (iv) **Examine cut off points:** In order to ensure that purchases were recorded at that point of time when title was passed to the client, the auditor should examine cut-off points on pre-numbered purchase requisitions, purchase orders and goods received notes. The auditor should, then, trace the goods received notes pertaining to a few days before the end of the period under audit to the related purchase invoices. Such a comparison would ensure that purchases represented by such invoices have been recorded as the purchases of the period under audit.
- (v) Examine transition with related parties carefully.

**C. Analytical procedures**

The auditor should 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.

**Question 19**

*How will you vouch and verify "Goods sent out on Sale or Return Basis".*

*(5 Marks, November, 2009)*

**Answer**

**Goods Sent Out on Sale or Return Basis**

- (i) Check whether a separate memoranda record of goods sent out on sale or return basis is maintained. The party accounts are debited only after the goods have been sold and the sales account is credited.
- (ii) See that price of such goods is unloaded from the sales account and the trade receivable's record. Refer to the memoranda record to confirm that on the receipt of

acceptance from each party, his account has been debited and the sales account correspondingly credited.

- (iii) Ensure that the goods in respect of which the period of approval has expired at the close of the year either have been received back subsequently or customers' accounts have been debited.
- (iv) Confirm that the inventory of goods sent out on approval, the period of approval in respect of which had not expired till the close of the year lying with the party, has been included in the closing inventory.

#### Question 20

*On 31.12.2008, 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, 2009, 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. (6 Marks, June, 2009)*

#### Answer

##### Recognition of Interest on Deposits:

- (i) Accounting Standard 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. Such revenues should only be recognised when no significant uncertainty as to measurability or collectability exists.
- (ii) 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.
- (iii) Though the interest becomes due for payment only at maturity date, it accrues each quarter. Interest accrued but not due should be shown under current assets in the balance sheet as per Schedule III Part I requirement of the Companies Act, 2013.
- (iv) As such, the profits and current assets are understated and true and fair view of the accounts are thus vitiated.
- (v) On considerations of materiality of the item, the auditor may appropriately decide to qualify the audit report.

#### Question 21

*How will you vouch and verify the following:*

- (a) *Production incentive paid to workers. (5 Marks, June, 2009)*
- (b) *Bad debt. (5 Marks, June, 2009)*
- (c) *Proposed dividend. (5 Marks, June, 2009)*

**Answer**

**(a) Production Incentive Paid to Workers**

- (i) 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.
- (ii) The auditor should get the details of incentive scheme from the management and see that it is approved and updated by a competent authority.
- (iii) The auditor should check the production figures from independent source and should correlate them with the incentive payment working computed by the accounts department.
- (iv) He should check list of payment and also acquitted disbursement slips of select departments/periods for scrutiny of various data generated in the fields for their accuracy and completeness.
- (v) 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.

**(b) Bad Debts**

- (i) The amount of bad debts should be traced to the schedule of bad debts written off during the year.
- (ii) Major amount of bad debts in the schedule be taken for scrutiny.
- (iii) Check that the amount considered in write off had been overdue for long and scrutinize the correspondence files.
- (iv) Check the authority for write off and the level of authority is sufficient higher than the executive involved in collection.
- (v) The bad debts should be properly disclosed in Statement of Profit and Loss according to its materiality.
- (vi) If provision had already been created for bad debts, see that to the extent of actual bad debts written off, the provision is released.

**(c) Proposed Dividend**

- (i) Proposed dividend is to be provided for even though it is proposed and is to be declared after the end of the accounting period in terms of AS 4 and also schedule III disclosure requirements.
- (ii) The Auditor should check the minutes of the Board for the amount of dividend proposed to be considered for its declaration in general meeting.
- (iii) The auditor should check the amount of paid up share capital and verify the quantum of dividend proposed by checking the calculations.

- (iv) The interim dividend if any paid should be checked and ascertained that the proposed dividend is properly computed by adjustment to it, if the same had been reckoned for the total dividend.
- (v) Dividend tax payable on proposed dividend should be provided for.
- (vi) The account should be properly disclosed in Statement of Profit and Loss and also in balance sheet according to the requirements of AS 4 and Schedule III to the Companies Act, 2013.

**Question 22**

*How will you vouch and verify the following:*

- (a) *Insurance Claim.* (5 Marks, November, 2008)
- (b) *Customs Duty.* (5 Marks, November, 2008)

**Answer**

- (a) **Insurance Claims:** Insurance claims may be in respect of fixed assets or current assets. While vouching the receipts of insurance claims-
  - (i) The auditor should examine a copy of the insurance claim lodged with the insurance company correspondence with the insurance company and with the insurance agent should also be seen. Counterfoils of the receipts issued to the insurance company should also be seen.
  - (ii) 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.
  - (iii) The copy of certificate/report containing full particulars of the amount of loss should also be verified.
  - (iv) 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 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) **Custom 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.

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- (iv) 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.
- (v) Lastly, the auditor verifies the duty drawback.

### Question 23

*How will you vouch and verify Sale of Scrap.*

*(5 Marks, May, 2008)*

### Answer

#### Sale of Scrap

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

### Question 24

*State with reasons (in short) whether the following statements are True or False:*

- (a) *Cut-off procedures are generally applied to trading transactions.*
- (b) *An unexplained decrease in the Gross profit ratio may result due to fictitious sales.*

*(2 Marks each, May, 2007)*

### Answer

- (a) **True:** They cover the areas of purchases, sales, inventories to ensure that transaction of one year do not get recorded in the following year or preceding year to ensure 'matching' and true and fair view of the accounts.
- (b) **False:** A fictitious sale will increase the gross profit ratio instead of decreasing it. G.P. Ratio normally comes down if there are unrecorded sales or fictitious purchase or decrease in closing stock.

### Question 25

*How will you vouch and verify the following:*

(a) *Rental Receipts.*

*(5 Marks, May, 2007)*

(b) *Cash Sales.*

*(5 Marks, May, 2007)*

**Answer****(a) Rental Receipts**

- (i) Check copies of bills or rent receipt issued to the tenant with reference to tenancy agreement and bills of charges paid by the landlord on behalf of tenants.
- (ii) The entries in the rental register in respect of rent accrued should be traced with reference to copies of rental bills.
- (iii) Scrutinize the account of collecting agent when the rent is collected by such agent.
- (iv) Vouch the entries for rent received in advance and ensure proper adjustment is made.
- (v) Investigate into abnormal rent outstanding.
- (vi) Reconcile the outstanding rent and see that proper provision is made if unrecoverable.
- (vii) 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.

**(b) Cash Sales**

- (i) Examine the system of internal check to ascertain any loopholes therein.
- (ii) Ascertain the practice followed in the matter of issuing cash memos and trace the memos into cash sale summary.
- (iii) Ensure that the date of cash memos tally with the entry in the cash book/summary.
- (iv) Verify that prices of goods sold have been correctly recorded and check the calculation.
- (v) Verify the entry in the goods outward book with the sales summary.
- (vi) See that the cancelled cash memos are not removed from the receipt book.

**Question 26**

*What is meant by external confirmation? Mention four situations where external confirmation may be useful for auditors. (6 Marks, November, 2006)*

**Answer**

**External Confirmations:** SA 505, "External Confirmations", lays down standards for external confirmation of balances. As per the Standard, External Confirmation means audit evidence obtained as a direct written response to the auditor from a third party (the confirming party), in paper form, or by electronic or other medium. The objective of the auditor, when using external confirmation procedures, is to design and perform such procedures to obtain relevant and reliable audit evidence.

SA 500, "Audit Evidence", indicates that the reliability of audit evidence is influenced by its source and by its nature, and is dependent on the individual circumstances under which it is obtained. That SA also includes the following generalisations applicable to audit evidence:

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- (i) Audit evidence is more reliable when it is obtained from independent sources outside the entity.
- (ii) Audit evidence obtained directly by the auditor is more reliable than audit evidence obtained indirectly or by inference.
- (iii) Audit evidence is more reliable when it exists in documentary form, whether paper, electronic or other medium.

Accordingly, depending on the circumstances of the audit, audit evidence in the form of external confirmations received directly by the auditor from confirming parties may be more reliable than evidence generated internally by the entity. SA 505 is intended to assist the auditor in designing and performing external confirmations procedures to obtain relevant and reliable audit evidence.

Following are the examples of situations where external confirmation may be useful:

- (i) Bank balance & other information from bankers,
- (ii) Accounts receivable balances,
- (iii) Inventory held by third parties,
- (iv) Property Title Deed held by third parties,
- (v) Investments purchased but delivery not taken,
- (vi) Loan from lenders,
- (vii) Accounts payable balances,
- (viii) Long outstanding share application money.

### Question 27

*How will you vouch and/or verify the following:*

- (a) *Goods sent on Consignment.*
- (b) *Expenditure on Foreign Travelling.*
- (c) *Premium paid for insurance of a Motor car.* *(4 Marks each, November, 2006)*

### Answer

- (a) **Goods sent on Consignment:** Such transaction should be vouched and verified as under-
  - (i) Verify the accounts sales submitted by the consignee showing goods sold and inventory of goods in hand.
  - (ii) Reconcile the figure of the goods on hand, as given in the last accounts sales, with the Performa invoices and accounts sales received during the year. If any consignment inventory was in the hands of the consignee at the beginning of the year, the same should be taken into account in the reconciliation.

- (iii) Obtain confirmation from the consignee for the goods held on consignment on the balance sheet date. Verify the terms of agreement between the consignor and the consignee to check the commission and other expenses debited to the consignment account and credited to the consignee's account. The accounts sales also must be correspondingly checked.
  - (iv) Ensure that the quantity of goods in hand with the consignee has been valued at cost plus proportionate non-recurring expenses, e.g., freight, dock dues, customs due, etc., unless the value is lower. In case net realisable value is lower, the inventory in hand of the consignee should be valued at net realisable value. Also see that the allowance has been made for damaged and obsolete goods in making the valuation.
  - (v) See that goods in hand with the consignee have been shown distinctly under inventories.
- (b) Expenditure on Foreign Travelling**
- (i) Examine Travelling Allowance bills submitted by the employees stating the details of tour, details of expenses, etc.
  - (ii) Verify that the tour programme was properly authorised by the competent authority.
  - (iii) Check the T.A. bills along with accompanying supporting documents such as air tickets, travel agents bill and hotel bills with reference to the internal rules for entitlement of the employees and also make sure that the bills are properly passed.
  - (iv) See that the tour report accompanies the T.A. bill. The tour report will show the purpose of the tour. Satisfy that the purpose of the tour as shown by the tour report conforms to the authorisation for the tour.
  - (v) Check Reserve Bank of India's permission, if necessary, for withdrawing the foreign exchange. For a company the amount of foreign exchange spent is to be disclosed separately in the accounts as per requirement of Schedule III to the Companies Act, 2013 and Accounting Standard 11 "The Effects of Changes in Foreign Exchange Rates".
- (c) Premium paid on Insurance of a Motor Car**
- (i) Check insurance cover note issued by the Insurance Company. Verify car no., period of Insurance coverage etc.
  - (ii) Verify that "No claim Bonus" is given, where entitled, by the Insurance Company.
  - (iii) Ensure that proper adjustment is made for pre-paid insurance premium.

#### Question 28

*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.* (12 Marks, November, 2006)

**Answer**

**Decrease in Rate of Gross Profit on Sales:** When rate of Gross Profit on Sales of a manufacturing company has sharply decreased in comparison to the previous year, the auditor should satisfy the reasons for the same. Following factors should be considered which might cause decrease in the Gross Profit of the manufacturing company-

- (i) Undervaluation of closing inventory or overvaluation of opening inventory either due to wrong valuation of inventory or mistake in inventory taking.
- (ii) Change in the basis of inventory valuation. For example, opening inventory was valued at market price above cost when closing inventory valued at cost which is below the market price.
- (iii) Inclusion in the current year, the amount of goods purchased in the previous year, that were received and taken in the same year.
- (iv) Reversal of fictitious sale entries recorded in the previous year to boost up profit.
- (v) Sales return entry passed two times or entry for purchase return has not been passed whenever goods are returned to suppliers.
- (vi) Excess provision for wages or direct expenses have been made.
- (vii) Goods sent out for sale on approval or on a consignment basis not included in closing inventory.
- (viii) Value of unusual inventory of consumable stores (fuel and packing materials) are not shown as inventory or not adjusted from corresponding expenses.
- (ix) Expenses which should be charged in the Profit and Loss Account but wrongly charged to the Trading Account.
- (x) Insurance claim received in respect of goods lost in transit or destroyed by fire, not credited in Trading Account.
- (xi) Goods sold or given as samples or destroyed, not accounted for.

**Question 29**

*As an auditor, comment on the Travelling expenses of Rs. 2.25 lakhs shown in Profit and Loss Account 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*

*(5 Marks, May, 2006)*

**Answer**

**Personal Expenses charged to Revenue Account:** The auditor should check the service contract, minutes of board meeting, etc., to check the authorisation for such expenditure.

As per the provisions of Section 143(1) of the 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.

In this case, the auditor should examine documentary evidence in support of the travelling expenses of ₹ 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. In case, the answer is negative, the auditor should make a report thereon and qualify his audit report.

**Question 30**

*How will you verify/vouch "Purchase return"?*

*(4 Marks, May, 2006)*

**Answer****Purchase Returns**

- (i) 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.
- (ii) Verify by reference to relevant corresponding record in good outward book or the stores records. Further, the figures in these documentary evidences should be compared with the supplier's original invoices for rates and other charges and calculation should also be checked.
- (iii) 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.
- (iv) Cross-check with reference to original invoices any rebates in price or allowances if any given by suppliers on strength of their Credit Notes.

**Question 31**

*Write a short note on "Scrutiny of General Ledger".*

*(4 Marks, May, 2006)*

**Answer****Scrutiny of General Ledger**

- (i) 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.
- (ii) 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.
- (iii) 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.

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- (iv) 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 prerecorded income is properly adjusted; and (b) on a consideration of the legal provisions which are applicable to the concern.
- (v) The balances in the General Ledger should be traced to the trial balance and from the trial balance to the final accounts.

### Question 32

*How will you vouch and/or verify the following:*

(a) *Sales Commission Expenditure.*

(b) *Sales Return.*

*(4 Marks each, November, 2005)*

### Answer

#### (a) Sales Commission Expenditure

- (i) 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.
- (ii) Check evidence of services rendered by the party to whom commission is paid with reference to correspondence etc.
- (iii) Ensure that the sales in fact have taken place and the same has been charged to Statement of profit and loss.
- (iv) Compare the amount incurred in previous years with reference to total turnover.
- (v) Check entries regarding TDS on commission at the time of credit to Payee's Account or payment whichever is earlier.
- (vi) Ensure that the payment has been made through cheque only if limit as stated in the clause of tax audit is exceeded.

#### (b) Sales Return

- (i) Examine the accounting basis for such transactions with reference to corresponding Debit Note to Debit Note. The relevant correspondence may also be examined.
- (ii) Verify by reference to relevant corresponding record in good inward book or the stores records. Further, the figures in these documentary evidences should be compared with the original invoices for rates and other charges and calculation should also be checked.
- (iii) Examine in depth to eliminate the possibility of fictitious sales returns for covering bogus sales recorded earlier when such returns outwards are in substantial figure either at the start or end of the accounting year.
- (iv) Cross-check with reference to original invoices any rebates in price or allowances if any given by buyers on strength of their Debit Notes.

**Question 33**

*Write a short note on "Vouching".*

*(4 Marks, November, 2005)*

**Answer**

**Vouching:** The act of examining vouchers is referred to as vouching. It is the practice followed in an audit, with the objective of establishing the authenticity of the transaction recorded in the primary books of account. It essentially consists of verifying a transaction recorded in the books of account with the relevant documentary evidence and the authority on the basis of which the entry has been made; also confirming that the amount mentioned in the voucher has been posted to an appropriate account which would disclose the nature of transaction on its inclusion in the final statements of account. After examination, each voucher is marked in a manner to ensure that it may not be presented again in support of another entry. The following points need careful consideration while examining a voucher-

- (i) that the date of the voucher falls within the accounting period;
- (ii) that the voucher is made out in the client's name;
- (iii) that the voucher is duly authorised;
- (iv) that 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
- (v) that the account in which the amount of the voucher is adjusted is the one that would clearly disclose the character of the receipts or payments posted thereto on its inclusion in the final accounts.

**Question 34**

*How will you vouch and verify Wages paid to seasonal labourer.*

*(4 Marks, May, 2005)*

**Answer****Wages paid to Seasonal Labourers**

- (i) Ascertain and evaluate the internal control system for recruitment and usage of seasonal labourers.
- (ii) Examine that these labourers are hired on proper authority and the rates of pay are authorized at appropriate levels.
- (iii) Ensure that the attendance is properly checked by the Time Keeping Department.
- (iv) 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.
- (v) Check the computation of wages payable to the labourers, after taking into account the deductions.
- (vi) Confirm that all the payments to the labourers have been acknowledged.

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- (vii) See the time and job records, to ensure that the labourers have been paid for time worked. See the treatment of abnormal idle time.
- (viii) 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. This assumes greater importance, if the seasonal labourers are hired on temporary basis, and not on permanent payroll.

### Question 35

*How will you vouch and/or verify Personal expenses of directors met by the company.*

*(4 Marks, November, 2004)*

### Answer

#### Personal Expenses of Directors

- (i) Check the articles of association, service contract, minutes of general meeting, etc., to check the authorisation for such payment.
- (ii) 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.
- (iii) Ascertain compliance with disclosure according to requirements of Schedule III to the Companies Act, 2013.
- (iv) Check documentary evidences to examine the payments reimbursed.

### Question 36

*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.*

*(12 Marks, November, 2004)*

### Answer

**Causes for increase in the Rate of Gross Profit on Sales:** There are several possible causes of the sharp increase in the rate of gross profit on sales as compared with that of the previous year, the most likely causes are as under-

- (i) **Increase in Sales Prices:** The selling price of the finished products may have been increased. Enquiries should be made by auditor as to whether there have been general or specific price increase and the reasons for the same. The auditor should obtain copies of the company price lists prevailing at different point of time and make the relevant comparison.
- (ii) **Reduction in Cost of Manufacturing:** The cost of manufacturing may have reduced substantially. The auditor should examine the inventory and purchases records in respect of large purchases of raw materials, comparing current costs with those in the previous year and detailed information supporting the possibility should be sought from the company.

- (iii) **Alteration in Sales-mix:** The mix of sales may have been altered, resulting in the sales of more profitable items. Detailed sales analysis should be made for the period in order to ascertain whether the more profitable lines constituted a large proportion of the total sales.
- (iv) **Impact of Automation:** The mechanisation or automation of certain manufacturing processes may have resulted in considerable saving in labour cost and this possibility could be easily verified by comparisons of wages records.
- (v) **Adherence to Cut-off Procedures:** The company cut-off procedures as regards closing inventory 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. It should also be seen that the procedure laid down has been observed by the concerned personnel and rightly adhered to. The auditor should test relevant transaction and ensure that everything is incorporated in the financial statement.
- (vi) **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.

#### Question 37

*Give your comments on "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".*

*(4 Marks, May, 2004)*

#### Answer

**Verification of Sale Proceeds of Scrap:** An 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. Normally speaking, in the ordinary course of his duties the auditor would expect that scrap generated in the company, if any, are properly accounted for. The existence of an accounting and costing system would provide evidence about the adequacy and reliability of accounting records. The records should adequately show the details of sale of scrap. 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.

Therefore, just because the sale proceeds are not significant and the company has a good accounting and costing system, the auditor cannot overlook other aspects.

#### Question 38

*How will you vouch and/or verify Excise Duty.*

*(4 Marks, May, 2004)*

#### Answer

**Excise Duty:** Excise duty is levied on manufacture. The liability for duty arises only at the point of time at which manufacturing is complete. The point of time at which duty is collected may be determined by consideration of administrative convenience. Normally excise duty is

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paid before the issue of excisable goods from the factory. For this, the auditor should take into consideration-

- (i) Ensure that excise duty is paid at the time of issue of excisable goods from the godown at factory of the producer. The duplicate copy of the challan as issued by the bank is forwarded for the purpose of issue of the excisable goods.
- (ii) Verify the amount of duty paid with the corresponding value of the goods issued from the inventory register of the producer by applying test check. In case where the client maintains an advance deposit with Excise Department, the auditor should see that the permits are issued for delivery of the goods against the advance deposit and corresponding adjustment.
- (iii) 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.
- (iv) 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.
- (v) The auditor may also physically verify RG 1 with actual and see reconciliation of financial records with sales tax records.