6
Verification of Assets and Liabilities

Question 1

Disclosure requirement relating to Trade Receivables under Revised Schedule VI to the Companies Act, 1956. Discuss. *(5 Marks, November, 2014)*

Answer

This question is redundant in view of the provisions of the Companies Act, 2013.

Question 2

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

The Statutory Auditor is required to verify inventory physically. *(2 Marks, November, 2014)*

Answer

Incorrect: Physical verification of inventories is the responsibility of the management of the entity. However, where the inventories are material and the auditor is placing reliance upon the physical count by the management, the auditor should attend the stock-taking.

Question 3

How you will vouch/verify the following?

(a) Assets acquired on lease. *(4 Marks, November, 2014) (4 Marks, November, 2011)*

(b) Investment in the shares and debentures of subsidiary. *(4 Marks, November, 2014)*

Answer

(a) Verification of Assets acquired on Lease:

(i) Examine the terms and conditions of the lease deed.

(ii) If a part of the leasehold property has been sublet, examine the tenant's agreement.

(iii) Verify relevant document to check the cost of property.

(1) In case of acquisition of an asset is on operating lease, lease payment should be recognized as an expense in the statement of profit and loss on a straight line basis over the lease term;

(2) In case of acquisition of an asset is on finance lease, ensure all the substantial risks and rewards to ownership are transferred, considering the indication as prescribed in AS-19, the lessee should recognize the lease as an asset and as

a liability. Such recognition should be at an amount equal to the fair value of the leased assets at the inception of the lease. Ensure contingent rents are recognized as expense in the statement of profit & loss for the period in case of Finance lease.

(iv) Ensure assets acquired under finance lease are segregated from the assets owned.

(v) Ensure that the assets under lease have been properly disclosed as per requirement of Schedule III to the Companies Act, 2013.

(b) Investment in the Shares and Debentures of Subsidiary:

(i) The auditor should obtain a complete schedule of all such investments held, showing particulars as regards the name of the subsidiary company, class of shares or debenture, date of purchase, number of units and denoting numbers, book value, dividend received etc.

(ii) All the particulars entered in the schedule should be verified with the relevant account in the General Ledger.

(iii) The auditor should, at the same time, examine all the investments by inspection of the securities, share scrips or certificates, debenture bonds, etc. If any of the securities are held by bankers, he should verify them with their certificate which should disclose the charge, if they are subject to any such charge.

(iv) The provisions contained in Part I of Schedule III to the Companies Act, 2013 requires that the shares held in a subsidiary should be shown separately.

(v) The shares or debentures of a subsidiary are valued at cost.

(vi) If the subsidiary has suffered a loss, then a provision for the proportionate part of the loss should be made in the accounts of the holding company.

Question 4

Purpose of providing depreciation. (4 Marks, November, 2014) (5 Marks, November, 2012)

Answer

Purpose of providing Depreciation: The main purpose of providing depreciation is as under-

(i) To keep intact the capital invested in fixed assets - This is accomplished by retaining the amount of depreciation charged in the statement of Profit and Loss in the business.

(ii) To ascertain the true cost of production - As the value of fixed assets depletes gradually by consumption during the process of production, it is necessary that such consumption of value be charged in the accounts for determination of the true cost of production.

(iii) To determine the profit or loss for the year - Depreciation being an expense represented by the loss in value of fixed assets arising on use, it is charged to the Statement of Profit and Loss for determining the profit or loss during a year.

(iv) To present a true and fair value of entity's assets in the balance sheet, since the original costs of fixed assets gradually decreases due to use and other factors, it is improper to continue to carry such assets at original costs. Therefore, the amount of depreciation charged in the Statement of Profit and Loss representing the loss in value of the assets is deducted from the original cost on a cumulative basis so as to reflect in the balance sheet a true and fair value of the fixed assets.

Question 5

How you will vouch/verify - Building. *(4 Marks, May, 2014)*

Answer

Verification of Building

(i) Examine the title deeds of buildings to see whether the client holds the title on the balance sheet date. If the property has been mortgaged, the title deeds will be in the possession of the mortgagee, from whom a certificate should be obtained to that effect.

(ii) Verify the original cost of buildings by reference to the deed of conveyance. If the building is constructed by the client, verify the original cost by reference to the cost as recorded in the books of account of the year in which the construction was completed.

(iii) Verify that appropriate depreciation has been provided against the buildings. In case no depreciation is provided on the buildings, a note to this effect should be given in the Statement of Profit and Loss.

(iv) See the appropriate lease deed, if the building is leasehold, to ascertain the cost, amortisation, etc. Also ensure that all covenants in the lease deed have been fulfilled by the client.

(v) See that the buildings have been valued at cost less depreciation. If any revaluation has taken place, see the basis of revaluation and ensure that the disclosure of the same has been made. In case of a company, the requirements of Schedule II and III to the Companies Act, 2013 have been complied with.

(vi) See that the relevant particulars of buildings have been entered in the fixed assets record maintained by the client.

Question 6

Describe "Analytical Review Procedures" in Audit. Briefly discuss analytical procedures for verification of debtors. *(8 Marks, May, 2014)*

Answer

Analytical Review Procedure: As per SA 520, “Analytical Procedure” means analysis of financial information through analysis of relationship among financial and non-financial data. It includes comparison of the entity’s financial information with comparable information with prior period, anticipated results of the entity like budgets etc or expectations of auditor and similar industry information.

Therefore, an analytical review procedure assists the auditor in planning the nature, timing and extent of other audit procedures. It is an auditing procedure based on ratios among accounts and tries to identify significant changes. Analytical review procedures can be used in the consideration of risks and/or as direct tests of balances. When deciding whether to incorporate analytical review procedures into the examination program as substantive tests of balances, the examiner should consider the extent to which the underlying data should be tested.

Analytical Procedures in case of Trade Receivables: Following are the analytical review procedures which may often be helpful as a means of obtaining audit evidence regarding the various assertions relating to trade receivables-

(i) comparison of closing balances of trade receivables with the corresponding figures for the previous year;

(ii) comparison of the relationship between current year trade receivables balances and the current year sales with the corresponding budgeted figures, if available;

(iii) comparison of actual closing balances of trade receivables with the corresponding budgeted figures, if available;

(iv) comparison of current year's ageing schedule with the corresponding figures for the previous year;

(v) comparison of significant ratios relating to trade receivables with similar ratios for other firms in the same industry, if available;

(vi) comparison of significant ratios relating to trade receivables with the industry norms, if available.

(vii) Check whether there is any change in credit policy of the organization.

(viii) Check the percentage of bad debts of previous years and current year.

(ix) Find the reasons of major variations in the estimated values and actual values.

These are only an illustrative list of analytical review procedures which an auditor may employ in carrying out an audit of trade receivables. The exact nature of analytical review procedures to be applied in specific situation is a matter of professional judgment of the auditor.

Question 7

How will you vouch and verify the following?

(a) Assets acquired on hire purchase. (4 Marks, November, 2013) (5 Marks, May, 2007)

(b) Patterns, dies, loose tools etc. (4 Marks, May, 2013)

(c) Work-in-Progress. (4 Marks, May, 2013) (5 Marks, May, 2008)

Answer

(a) Assets acquired on Hire Purchase

(i) Examine the Board's Minute book approving the purchase on Hire Purchase terms.

(ii) Examine the Hire Purchase Agreement carefully and note the description of the machinery, cost of machinery, hire purchase charges, terms of payment and rate of purchase.

(iii) Assets acquired under Hire Purchase system should be recorded at the full cash value with corresponding liability of the same amount. In case cash value is not readily available, it should be calculated presuming an appropriate rate of interest.

(iv) Hire purchased assets are shown in Balance Sheet with appropriate narration to indicate that the enterprise does not have full ownership thereof. The interest payable along with each installment, whether separately or included therein, should be debited to the interest account, and not to the asset account.

(b) Patterns, Dies, Loose Tools, etc.: Several entities have large investments in such assets which have a relatively short useful life and low unit cost. Evidently, it is a difficult matter, under the circumstances, to prepare a separate account for each such asset although a careful control over such property is necessary.

On these considerations, some entities charge off small tools and other similar items to Production Account as and when they are purchased and do not place any value on the unused inventory on the Balance Sheet. Nevertheless, a record of issues and receipts of tools to workmen is kept, as a check on the same being pilfered and a memorandum inventory account of dies and patterns is also maintained. In other concerns, the cost of tools, dies, etc. purchased is debited to appropriate assets account, and an inventory of the unused items at the end of the year is prepared and valued; the sum total of opening balance and purchase reduced by the value of closing inventory, as disclosed by the inventory, is charged off to Production Account in respect of such assets. On the other hand, some concerns carry such assets at their book values at the end of the first year and charge off the cost of all the purchases in the subsequent year to the Production Account on the plea that they represent cost of replacement.

The most satisfactory method, however, is that of preparing an inventory of serviceable articles, at the close of each year, and revaluing the assets on this basis, the various articles included in the inventory being valued at cost. It should be seen that the inventory does not include any worn out or defective articles the life of which has already run out.

(c) Work-in-Progress: The audit procedures regarding work-in-progress are similar to those used for raw materials and finished goods. However, the auditor has to carefully assess the stage of completion of the work-in-progress for assessing the appropriateness of its valuation. For this purpose, the auditor may examine the production/costing records (i.e., cost sheets), hold discussions with the personnel concerned, and obtain expert opinion, where necessary. The auditor may advise his client that where possible the work-in-

progress should be reduced to the minimum before the closing date. Cost sheets of work-in-progress should be verified as follows-

(i) Ascertain that the cost sheets are duly attested by the works engineer and works manager.

(ii) Test the correctness of the cost as disclosed by the cost records by verification of quantities and cost of materials, wages and other charges included in the cost sheets by reference to the records maintained in respect thereof.

(iii) Compare the unit cost or job cost as shown by the cost sheet with the standard cost or the estimate of cost expected to be maintained.

(iv) Ensure that the allocation of overhead expenses had been made on a rational basis.

(v) Compare the cost sheet in detail with that of the previous year. If they vary materially, investigate the cause thereof.

(vi) Ensure that the Work-in-Progress as at Balance Sheet date has been appropriately disclosed in Balance Sheet as per the requirements of Part I of Schedule III to the Companies Act, 2013.

Question 8

Write a short note on Impairment of Assets. *(4 Marks, May, 2013)*

Answer

Impairment of Assets: Besides charging annual depreciation on assets by the reason of normal wear and tear, effluxion of time and obsolescence to reinstate the correct value of the assets considering the future cash flows that the assets can generate, impairment loss needs to be provided. The difference between the carrying amount of an asset and recoverable amount is termed as impairment loss. The treatment of impairment loss is similar to depreciation except the fact that it can be reinstated in future, if the recoverable amount of the asset exceeds the carrying amount.

The auditor must ensure that the provisions of AS 28 "Impairment of Assets" are followed.

Question 9

Comment on the following:

(a) Company can provide lower rate of depreciation than prescribed by Schedule XIV of the Companies Act, 1956. *(2 Marks, May, 2013)*

(b) What procedure an auditor should adopt to test the authenticity of cash at bank.

(5 Marks, November, 2011)

Answer

(a) This question is redundant in view of the provisions of the Companies Act, 2013.

(b) Verification of Cash at Bank: While testing the authenticity of cash at bank, the following areas may be considered by the auditor-

(i) Apart from comparing the entries in the cash book with those in the Pass Book the auditor should obtain a certificate from the bank confirming the balance at the close of the year as shown in the Pass Book.

(ii) Examine the bank reconciliation statement prepared as on the last day of the year and see whether (a) cheques issued by the entity but not presented for payment, and (b) cheques deposited for collection by the entity but not credited in the bank account have been duly debited/credited in the subsequent period.

(iii) Pay special attention to those items in the reconciliation statements which are outstanding for an unduly long period. The auditor should ascertain the reasons for such outstanding items from the management. He should also examine whether any such items require an adjustment write-off.

(iv) Examine relevant certificates in respect of fixed deposits or any type of deposits with banks duly supported by bank advices.

(v) The auditor should examine the possibility, that even though the balance in an apparently inoperative account may have remained stagnant, transactions may have taken place in that account during the year.

(vi) In relation to balances/deposits with specific charge on them, or those held under the requirements of any law, the auditor should examine that suitable disclosures are made in the financial statements.

(vii) Remittances shown as being in transit should be examined with reference to their credit in the bank in the subsequent period. Where the auditor finds that such remittances have not been credited in the subsequent period, he should ascertain the reasons for the same. He should also examine whether the entity has reversed the relevant entries in appropriate cases.

(viii) The auditor should examine that suitable adjustments are made in respect of cheques which have become stale as at the close of the year.

(ix) Where material amounts are held in bank accounts which are blocked, e.g. in foreign banks with exchange control restrictions or any banks which are under moratorium or liquidation, the auditor should examine whether the relevant facts have been suitably disclosed in the financial statements. He should also examine whether suitable adjustments on this account have been made in the financial statements in appropriate cases.

(x) Where the auditor finds that the number of bank accounts maintained by the entity is disproportionately large in relation to its size, the auditor should exercise greater care in satisfying himself about the genuineness of banking transactions and balances.

Question 10

Distinguish between Reserves and Provisions. *(5 Marks, May, 2012) (5 Marks, May, 2007)*

Answer

Reserves and Provision

(i) Reserve is an appropriation of profit whereas provision is a charge against Profit.

(ii) Reserves are not intended to meet any liability, contingency or diminution in the value of assets. Provisions are made to provide for depreciation, renewal or a known liability or a disputed claim.

(iii) Reserves cannot be created unless there is a profit except revaluation reserve and capital subsidy. Provisions must be created whether or not there is profit.

(iv) Reserves are generally optional except in certain situations – Capital Redemption reserve, Debenture Redemption Reserve etc. Provisions are not optional and have to be made as per generally accepted accounting principles.

(v) Reserves are shown on the liability side. Provisions for depreciation and provision for doubtful debts are shown as deduction from respective assets. Provision for liability is shown on the liability side.

Question 11

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

(8 Marks, May, 2012)

Answer

Indications of Doubtful and Uncollectible Debts: The term 'book debts' suggests particularly amounts recoverable from customers, but in practice it is applied to a wide range of claims which a business may carry as an asset in its books. Advances or loans cannot, however, be included under this head.

The following are some of the indications of doubtful and uncollectible debts, loans and advances-

(i) The terms of credit have been repeatedly ignored.

(ii) There is stagnation or lack of healthy turnover in the account.

(iii) Payments are being received but the balance is continuously increasing.

(iv) Payments though being received regularly are quite small in relation to the total outstanding balance.

(v) An old bill has been partly paid (or not paid), while later bills have been fully settled.

(vi) The cheques received from the trade receivables have been repeatedly dishonoured.

(vii) The debt is under litigation, arbitration, or dispute.

(viii) The auditor becomes aware of unwillingness or inability of the trade receivable to pay the dues, e.g., a trade receivable has either become insolvent, or has closed down his business, or is not traceable.

(ix) Amounts due from employees, which have not been repaid on termination of employment.

(x) Collection is barred by statute of limitation.

Question 12

Disclosure requirements of debtors in the financial statements. *(5 Marks, November, 2011)*

Answer

Disclosure Requirements of Trade Receivables in Financial Statements: Note 6(P) of Part I of Schedule III to the Companies Act, 2013 requires that company shall disclose "Trade Receivables" in notes to accounts as follows-

(i) Aggregate amount of Trade Receivables outstanding for a period exceeding six months from the Date they are due for payment should be separately stated.

(ii) Trade receivables shall be sub-classified as:

  (a) Secured, considered good;

  (b) Unsecured considered good;

  (c) Doubtful.

(iii) Allowance for bad and doubtful debts shall be disclosed under the relevant heads separately.

(iv) Debts due by directors or other officers of the company or any of them either severally or jointly with any other person or debts due by firms or private companies respectively in which any director is a partner or a director or a member should be separately stated.

Question 13

Write a short note on Audit of sale of Investments. *(4 Marks, November, 2011)*

Answer

Audit of Sale of Investments

(i) See that sale of investment has been made on the proper authorisation of Board or other competent authority.

(ii) Ascertain the method of selling investments. It may be either through broker, directly or through a bank. See the broker's sold note.

(iii) See that the difference between the carrying amount and the sales proceeds, net of expenses, is recognised in the Statement of Profit and Loss. 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.

(iv) See that proper disclosures as required by AS 13 are made as follows:

(1) Interest, dividends, rentals on investments are to be shown in Statement of Profit and Loss at Gross Value and TDS as advance tax paid.

(2) Showing separately profit & Loss on disposal and changes in carrying amount of current and long term investments.

Question 14

Define depreciation and discuss various purposes of providing depreciation.(8 Marks, May, 2011)

Answer

Depreciation Definition: According to AS-6 "Depreciation Accounting" issued by the Institute of Chartered Accountants of India "Depreciation is a measure of the wearing out, consumption or other loss of value of a depreciable asset arising from use, effluxion of time, obsolescence through technology and market charges. Depreciation is allocated so as to charge a fair proportion of the depreciable amount in each accounting period during the expected useful life of the asset. Depreciation includes amortisation of assets whose usefulness is predetermined".

The term "depreciable amount" of a depreciable asset as per the standard is its historical cost, or other amount substituted for historical cost in the financial statements less the estimated residual value.

The accounting standard recommends that the depreciable amount of a depreciable asset should be allocated on a systematic basis to each accounting period during the useful life of the asset.

Purpose of Providing Depreciation:

(i) To keep capital intact: It will be evident that one of the effects of providing for depreciation on an asset is to retain an amount (equal to the proportion of the cost of the asset employed in the business that has run off, estimated on the basis of the period of its working life and its scrap value) in the business out of the profits in each year.

(ii) To ascertain cost accurately: Unless a proper charge on account of depreciation is included in the Statement of Profit and Loss, the true cost of manufacture of different products will not be ascertained. This is because depreciation is as much a charge against revenue as any other expenditure and must be included in accounts irrespective of the fact whether the final result of a working is profit or loss.

(iii) To charge initial costs against earnings: The cost of a machine less its scrap value can, in effect, be regarded as the price for use of the machine paid in advance for the period it will be rendering service. According to this view unless an appropriate part of this price is charged to the profits of the business each year, the profit earned on its working will not be correctly ascertained.

(iv) To prepare true and fair statements: Unless depreciation is provided, the assets will be shown at an amount higher than their true value and the profit shown will be more than

the real profit. In other words, the Balance Sheet and the Statement of Profit and Loss will not be true and fair.

Question 15

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

(i) A company can not declare dividends without providing for depreciation.

(ii) The Investments made by the company in Government Securities like NSC, Government Bonds, etc. should be kept in personal custody of Financial Controller of the Company.

(2 Marks each, May, 2010)

Answer

(i) True: On account of the provisions under Section 123 of the companies Act, 2013, no dividend shall be declared except out of profits arrived at after providing for depreciation in accordance with the provisions of the Act. It has become obligatory for every company distributing dividend to make a provision for depreciation.

(ii) False: There should be existence of a proper system for safe custody of all the securities with adequate internal control measure and documentation.

Question 16

State the information to be disclosed in the financial statements according to the requirements of AS 6. *(5 Marks, November, 2009)*

Answer

Requirements of AS 6: AS 6 "Depreciation Accounting" requires following information to be disclosed in the financial statements-

(i) Historical cost or other amount substituted for historical cost of each class of depreciating asset;

(ii) Total depreciation for the period for each class of assets;

(iii) The related accumulated depreciation.

It also requires following disclosure of information in the financial statements along with the disclosure of other accounting polices:

(i) Depreciation method used, and

(ii) The useful life of the assets for computing depreciation, if any, if they are different from the life specified in the Schedule.

Question 17

How would you vouch/verify the following:

(a) Leasehold Property. *(5 Marks, November, 2009)*

(b) Bank Overdraft. *(5 Marks, November, 2009)*

(c) Goods lying with third party. *(5 Marks, June, 2009)*

Answer

(a) Lease Hold Property: Following are the main steps involved in verification/vouching of lease hold property-

(i) Inspect the lease agreement to ascertain the amount of premium, if any, for securing the lease and terms and conditions. A lease exceeding the period of one year is not valid unless it has been registered by an instrument. Hence this has to be ensured.

(ii) Ascertain that all the conditions, the failure of which may result in cancellation of the lease have been complied with, e.g. payment of ground rent, insurance premium, maintenance of lease and property in satisfactory state etc.

(iii) Ensure that due provisions for any claims that might arise under the dilapidation clause on the expiry of the lease have been made. If such provision has not been made, the auditor should draw the client's attention to it.

(iv) Ensure that the outlay and legal expenses incurred to acquire lease property have been capitalised. The property must be written off in such a way that it completely wipes off the asset at the end of the lease period.

(v) He should ascertain that the clause entitles the lessee to sub let any part of the leased property and ensure its proper compliance.

(b) Bank Overdraft

(i) The auditor should ensure that the facility of overdraft is authorised by the Board's resolution / partner's resolution.

(ii) Pursue the agreement with the bank and see whether the overdraft is clean or against hypothecation or pledge of company's property.

(iii) Verify the register of charges and ensure that the charge has been registered with Registrar of Companies.

(iv) Verify the rate of interest and other terms and conditions from the agreement.

(v) Verify the amount of overdraft from the books of accounts and compare it with the passbook.

(vi) If the overdraft is against hypothecation of assets like inventories, a certificate from the bank should be obtained.

(vii) If the overdraft is against hypothecation of assets or pledge of company's property, see that overdraft is properly shown under 'secured loans' and nature of security has been property disclosed.

(c) Goods lying with Third Party

(i) The auditor should check that the materiality of the item under this caption included in inventories.

(ii) He should obtain confirmation of the amount of goods lying with them. The confirmation may be directly obtained by auditor or be produced by client depending upon the situation.

(iii) He should inquire into the necessity of sub contractor retaining the inventory. He should ensure the process that they do are related to the business requirement and there is no ground for suspicion on this score.

(iv) The goods lying with them for the very long period would merit auditors' special attention for making provision.

(v) The records, voucher/slips for the regulating the movement of inventory into and out of entity for sub-contracting work be reviewed by vouching for few transaction for ensuring existence and working of internal control system for them.

(vi) The excise gate pass, entry in such records, information in returns, be also cross-verified.

(vii) The valuation of inventories should be correctly made for including material cost on appropriate inventory valuation formulae and also for inclusion of proportionate processing charges for the work in process with the contractors.

(viii) The provision should be created for work done, billed for processing and also for incidence of any applicable levy like service tax payable.

Question 18

State with reasons (in short) whether the following statement is True or False:

"The fixed deposit held with bank by a company is to be shown under the head investments in Balance Sheet as per the requirements of part I of schedule VI to the Companies Act, 1956".

(2 Marks, June, 2009)

Answer

This question is redundant in view of the provisions of the Companies Act, 2013.

Question 19

Sri Limited charged depreciation on its plant and machinery comprised in fixed assets at rates different from what had been specified in schedule XIV, to the Companies Act, 1956. The auditor insisted that the rates of depreciation adopted should be mentioned in the notes to the account, else, he would make qualification in his audit report. The Management of the company contended that there is no impact in profits due to its omission to disclose the fact and hence on considerations of principle of materiality, the auditor is wrong in mentioning this omission in his report by way of qualification. Comment. (8 Marks) (June, 2009)

Answer

This question is redundant in view of the provisions of the Companies Act, 2013.

Question 20

XYZ Ltd. has purchased plant and machinery costing ₹ 1 crore in the month of October, 2008 out of working capital limits sanctioned by Bank.

What are reporting requirements by Statutory Auditors of the Company in this regard, keeping in mind the provisions of CARO 2003. *(4 Marks, June, 2009)*

Answer

This question is redundant in view of the provisions of the Companies Act, 2013.

Question 21

Write a short note on "Physical attendance by auditor during inventory taking".

(5 Marks, June, 2009)

Answer

Attendance at Inventory Taking: According to SA 501 "Audit Evidence - Specific Considerations for Selected Items", management ordinarily establishes procedures under which inventory is physically counted at least once a year to serve as a basis for the preparation of the financial statements and, if applicable, to ascertain the reliability of the entity's perpetual inventory system.

Attendance at physical inventory counting involves-

- Inspecting the inventory to ascertain its existence and evaluate its condition, and performing test counts;
- Observing compliance with management's instructions and the performance of procedures for recording and controlling the results of the physical inventory count; and
- Obtaining audit evidence as to the reliability of management's count procedures.

These procedures may serve as test of controls or substantive procedures depending on the auditor's risk assessment, planned approach and the specific procedures carried out.

Observing the performance of management's count procedures, for example those relating to control over the movement of inventory before, during and after the count, assists the auditor in obtaining audit evidence that management's instructions and count procedures are adequately designed and implemented. In addition, the auditor may obtain copies of cut off information, such as details of the movement of inventory, to assist the auditor in performing audit procedures over the accounting for such movements at a later date.

Inspecting inventory when attending physical inventory counting assists the auditor in ascertaining the existence of the inventory (though not necessarily its ownership), and in identifying, for example, obsolete, damaged or ageing inventory.

Performing test counts, for example by tracing items selected from management's count records to the physical inventory and tracing items selected from the physical inventory to management's count records, provides audit evidence about the completeness and the

accuracy of those records.

In addition to recording the auditor's test counts, obtaining copies of management's completed physical inventory count records assists the auditor in performing subsequent audit procedures to determine whether the entity's final inventory records accurately reflect actual inventory count results.

Question 22

State with reasons (in short) whether the following statement is True or False:

Secret reserve strengthens financial position, hence they are allowed.(2 Marks, November, 2008)

Answer

False: A secret reserve is that whose existence is not disclosed on the face of the Balance Sheet. Its existence strengthens the financial position. However, in the light of Provisions Contained in Schedule III to the Companies Act, 2013, it is not allowed.

Question 23

In a company Fixed Assets have been revalued and there has been resulting surplus of ₹ 2,00,000, which is transferred to revaluation reserve. The Company has a Debit balance in Profit and Loss account ₹ 1,20,000 as accumulated brought forward losses. The company has adjusted this loss balance against Revaluation reserve. As an Auditor, how would you react?

(8 Marks, November, 2008)

Answer

Treatment of Reserve created on Revaluation of 'Fixed Assets': The guidance Note on Treatment of Reserve created on Revaluation of 'Fixed Assets' advises that the accumulated losses must not be adjusted against revaluation reserve as it would amount to setting off actual losses against unrealized gains.

In the given problem ₹ 2 lakhs transferred to revaluation reserve is unrealized gain whereas ₹ 1.20 lakh being debit balance in Statement of Profit and Loss is actual accumulated loss. This loss cannot be adjusted from unrealized gain raised as revaluation reserve.

Question 24

How would you vouch/verify "Trade Marks and Copy rights". *(5 Marks, November, 2008)*

Answer

Trademark and Copyright: The existence of a trademark is verified by an inspection of the certificate as regards grant of the trademark. Where it has been purchased, the agreement surrendering it in favour of the client should be examined. It must also be observed that the rights are alive and legally enforceable. Copyrights are also acquired by surrender of rights and they also should be verified similarly. The auditor should obtain a schedule of trademarks and copyrights and verify that renewal fee have been paid and charged to revenue. The last renewal receipt should, in each case, be examined to ascertain that the trade mark has not lapsed. Copyrights and trademarks are generally revalued at cost less amortization charges till

date. If copyright and trademarks are generally revalued at cost less amortization charges till date. If copyright and trademarks were purchased, the cost includes purchase price and registration charges. If it has been developed by the client, the cost should include cost of developing outlays, design costs and other associated direct cost. The cost of trademarks and copyright should be amortized over the period of legal validity or useful commercial life, whichever is short. Where auditor finds that any publication has ceased to command sale, he should have the amount of its copyright written off to revenue. AS 26 has suggested a useful life of 10 years unless and until there is clear evidence that useful life is longer.

Question 25

Write a short note on "Impairment of Assets". *(5 Marks, November, 2008)*

Answer

Impairment of Assets: Besides charging annual depreciation on assets by the reason of normal wear and tear, affluxion of time and obsolescence to re-instate the correct value of the assets considering the future cash flows that the assets can generate, impairment loss needs to be provided. The difference between the carrying amount of an asset and recoverable amount is termed as impairment loss. The treatment of impairment loss is similar to depreciation except the fact that it can be re-instated in future, if the recoverable amount of the asset exceeds the carrying amount.

The auditor must ensure that the provisions of AS 28 "Impairment of Assets" are followed.

Question 26

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

(i) Interest accrued but not due on "Secured loans" is required to be shown under appropriate sub-heads under the head "Secured loans".

(ii) The term 'fund' and 'reserve' can be used interchangeably. *(2 Marks, May, 2008)*

Answer

(i) False: As per Part-I, Schedule III to the Companies Act, 2013 interest accrued but not due on secured loans is required to be shown through notes to accounts under the head "Other Current Liabilities".

(ii) False: The term 'fund' in relation to any reserve should be used only where such reserve is specifically represented by earmarked investments.

Question 27

How will you vouch and verify Borrowings from Bank. *(5 Marks, May, 2008)*

Answer

Borrowings from a Bank: Borrowings from a bank may be either in the form of overdraft limits; or short term or medium term or long term loans. The audit procedures which an auditor may adopt are outlined below-

(i) Ensure that balance as per books of the client and the bank statement tally. In case of difference between the two amounts, reconciliation statement prepared by the client should account for reasons.

(ii) Examine whether borrowings from the bank have been duly authorized.

(iii) Examine documents to ensure that statutory requirements, if any, with regards to creation and registration charges have been met.

(iv) Examine the loan agreement and ensure that the terms therein have been duly complied with.

(v) Ascertain the purpose for which loan has been raised and examine whether end use of the funds have been accordingly made.

Question 28

Distinguish between Capital expenditure and Deferred revenue expenditure.

(4 Marks, November, 2007)

Answer

Distinction between Capital Expenditure and Deferred Revenue Expenditure: They differ in the following manners-

(a) Capital expenditure result in acquisition of new fixed assets or increase in future benefits from existing fixed assets beyond pre-assessed level.

Deferred revenue expenditure are expenditure of a revenue nature which bring in future benefits without creating a tangible or intangible fixed assets or by way of improvement in the existing assets.

(b) Capital expenditure adds to the net worth of the concern.

Deferred revenue expenditure is not considered in calculating net worth.

(c) Capital expenditure is shown under the head fixed assets in balance sheet.

Deferred revenue expenditure is recognized as an expense in the year of incurring and therefore not shown in the Balance sheet.

Question 29

How will you vouch and verify the following:

(a) Trade Creditors. *(5 Marks, November, 2007)*

(b) Advances to suppliers. *(5 Marks, November, 2007)*

Answer

(a) Trade Creditors

(i) Check the adequacy of cut off procedure to ensure that transaction of next period are not accounted and all transactions of year end are accounted.

(ii) Check posting in the bought ledger from books of prime entry.

(iii) Compare the balances in the schedule of trade payables with balances in bought ledger.

(iv) Compare the balances with the confirmation or statement of account received from trade payables.

(v) Pay special attention to long outstanding items and enquire about the reason thereof.

(vi) Verify subsequent payments and reversal entries in the bought ledger of year end entries.

(vii) See that trade payables are classified and shown in the balance sheet as per the requirement of Schedule III to the Companies Act, 2013.

(b) Advances to Suppliers

(i) Examine the bought ledgers to ascertain the debit balance of trade payables and trace the corresponding entry to the cash/bank book.

(ii) Obtain a schedule of advances to suppliers and verify it with balances in bought ledger.

(iii) Assess the possibility of delivery of goods against advance payment and examine whether provisioning is required.

(iv) Obtain/resort to direct confirmation procedure.

(v) Ensure proper classification in the balance sheet as per requirement of Schedule III to the Companies Act, 2013.

(vi) Pay special attention to long outstanding advances and enquire about the reason thereof.

Question 30

How will you vouch and verify Contingent Liabilities.(5 Marks, May, 2007) (4 Marks, May, 2004)

Answer

Contingent Liabilities: Accounting Standard (AS) 29 on 'Provisions, Contingent Liabilities and Contingent Assets', defines 'Contingent Liability' as a possible obligation that arises from past events and the existence of which will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise; or as a present obligation that arises from past events but is not recognised because it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation, or a reliable estimate of the amount of the obligation cannot be made.

The auditor may take following steps to vouch or verify the contingent liabilities:

(i) Inspect the minute books of the company to ascertain all contingent liabilities known to the company.

(ii) Examine the contracts entered into by the company and the likelihood of contingent liabilities emanating therefrom.

(iii) Scrutinise the lawyer's bills to track unreported contingent liabilities.

(iv) Examine bank letters in respect of bills discounted and not matured.

(v) Examine bank letters to ascertain guarantees on behalf of other companies or individuals.

(vi) Discuss with various functional officers of the company about the possibility of contingent liability existing in their respective field.

(vii) Obtain a certificate from the management that all known contingent liabilities have been included in the accounts and they have been properly disclosed.

(viii) Ensure that proper disclosure has been made as per Schedule III to the Companies Act, 2013 and AS 29, "Provisions, Contingent Liabilities and Contingent Assets".

Question 31

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

(6 Marks, May, 2006)

Answer

Analytical Procedures for Verification of Inventories: The auditor can adopt the following analytical procedures to verify the stock of inventories-

(i) Quantitative reconciliation of opening inventories, purchases, production, sales and closing inventories.

(ii) Comparison of closing inventory quantities and amounts with those of the previous year.

(iii) Comparison of the inventory turnover ratios for the current year with that of the previous year and with industry standards if available.

(iv) Comparison of the closing inventory (Raw materials, closing work-in-progress and finished goods are percentage of total inventories) with the corresponding figures of the previous year.

(v) Comparison of current year gross profit ratio of the previous year.

(vi) Comparison of actual inventory, purchase and sales figures with the budgeted figures if available.

(vii) Comparison of raw-material yield/wastage with previous year figures.

Question 32

How will you vouch and verify the following:

(a) Purchase of quoted investment. *(4 Marks, May, 2006)*

(b) Discounted bill receivable dishonoured. *(4 Marks, May, 2006)*

(c) Amount due to subsidiary companies. *(4 Marks, May, 2006)*

Answer

(a) Purchase of Quoted Investment

(i) Ascertain the date of purchase, rate of purchase, nature of investments purchased and nature of transaction, i.e., error cum-dividend/interest/right/bonus.

(ii) Compare the rate of purchase with quotation available. Obtain suitable explanations in case of significant variations.

(iii) Verify the amount paid towards purchase of investments.

(iv) Trace the amount in the cheque book counterfoils and bank statements.

(v) Obtain a schedule of investment from Management for physical verification at the year end.

(vi) Verify the investment certificate to confirm title.

(vii) Confirm compliance with statutory provisions such as 143(1) of the Companies Act, 2013.

(viii) Verify whether investments are duly disclosed in financial statements in accordance with recognized accounting policies and practices and relevant statutory requirements.

(b) Discounted Bill 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 trade receivable is also debited.

(v) Check that bank commission, if any, charged by the bank has been recovered from the party.

(c) Amounts Due to Subsidiary Companies

(i) Examine whether the subsidiary company is authorized by its Memorandum of Association to advance the loan to the holding company.

(ii) Verify the interest rate at which the loan has been obtained and particulars of the security that has been furnished for confirming the amount of interest and disclosure of the charge in the Balance Sheet.

(iii) Inspect the documents executed by the holding company which constitute the basis of the loan and the provision in the Memorandum under which the loan has been raised.

(iv) Verify by reference to the Balance Sheet of the subsidiary company that the loan is duly reflected in the Balance Sheet as a loan due from the holding company.

(v) Amounts due to subsidiary companies may be on account of credit purchases at goods or services which should be verified with the relevant documentary evidences.

(vi) Confirm whether the provisions of section 189 of the Companies Act, 2013 (related to maintenance of register of contracts or arrangements), wherever applicable, have been complied with.

(vii) Verify that the loan has been properly reflected in the Balance Sheet as per the requirements of Schedule III to the Companies Act, 2013.

Question 33

Write a short note on "General Principles of Verification of Assets". *(4 Marks, May, 2006)*

Answer

General Principles of Verification of Assets: Verification of assets is an important audit process. Primarily verification of assets is the responsibility of the management since the management is expected to have a greater intimate knowledge of the assets of the business as regards location, use, conditions, etc. than what an outsider might be able to acquire on their inspection.

It is not sufficient for the auditors only to verify correctness of the amount of assets shown in the balance sheet, he must verify them by actual inspection or otherwise and establish the existence of assets. Points requiring auditor's attention for verification are as under-

(i) Cost - In regard to assets, verification procedure need not generally be extended to determination of the correctness of costs and authority to incur costs unless the items concerned were purchased during the accounting period under review. In such cases the auditor should check the correctness of costs through normal vouching method. He should ensure that adequate distinction has been made between 'revenue' and 'capital' nature of costs.

(ii) Ownership - Where ownership of assets is evidenced by documents of title etc. as in the case of immovable property, a reference should be made to such documents. If the documents are held by third person the auditor should either obtain a certificate directly from that party or arrange to inspect them at the third party's place of business.

(iii) Valuation - It must be ascertained that all assets are valued in accordance with appropriate accounting policy. For the valuation made, the basis must be consistently applied, unless circumstances necessitated a change. Even then a disclosure is required for the change and its monetary effect.

(iv) Existence - Physical inspection should be done wherever possible. Where physical inspection is not possible, the possibility of obtaining indirect evidence be considered e.g. machinery imported held in customs godown or materials sent to subcontractor for job

work or fabrication. In such circumstances certificating of such parties should be obtained and if considered necessary even physical verification may be requested.

(v) Presentation in accounts - Material assets must be properly disclosed and correctly described in the accounts. It should be seen that the description given to them is clear and complete and is not misleading e.g. stating loans on the assets side of the balance sheet "as dependent upon realization" is just misleading as was held in the case of London and General Bank Ltd. care must be taken to see that disclosures required under the statute or statement issued by ICAI are complied with.

Question 34

SK Ltd. has fully computerised its accounting operations. The stock records are maintained up to date with timely entries passed for all receipts and issues. The company has hired a professional security agency, which monitors and implements a close vigilance over the operations of the company. As such, the company had dispensed with the practice of taking stock of their inventories at the year end as in their opinion the exercise is redundant, time consuming and intrusion to normal functioning of the operations. As an auditor, comment.

(4 Marks, November, 2005)

Answer

Verification of Inventories – Auditor's Duties: The audit procedures to be performed by an auditor to obtain sufficient appropriate audit evidence in relation to inventories have been recommended in the Guidance Note on Audit of Inventories issued by ICAI. On the basis of his evaluation of the effectiveness of the internal controls, the auditor should carry out appropriate substantive procedures in relation to inventories. These substantive procedures include examination of records, attendance at inventory-taking, examination of valuation and disclosure of inventories, carrying out analytical procedures, and obtaining confirmations from third parties and representations from the management.

In view of above, an auditor should insist on the company to do physical verification of inventory. Verification must be done at least yearly, if not more frequently within a year. Dispensing with physical verification altogether is unacceptable. It is not enough that the company had installed good control procedures. It must be tested, for example, in case of inventory, physically verifying the same as to see that no discrepancy exists. Pilferage, misappropriation is not the only cause for discrepancies. Inherent product qualities like shrinkage, evaporation, handling loss, etc. may also account for discrepancies. The auditor should require the management to conduct physical verification by or near the year end. If the management does not accept to the auditor's view the auditor may appropriately make modification in his audit report.

Additionally, as per clause (ii) of Para 3 of Companies (Auditor's Report) Order, 2015 [CARO 2015], the auditor has to report on whether physical verification of inventory has been conducted at reasonable intervals by the management; are the procedures of physical verification of inventory followed by the management reasonable and adequate in relation to the size of the company and the nature of its business. If not, the inadequacies in such

procedures should be reported. It also requires the auditor to report on whether the company is maintaining proper records of inventory and whether any material discrepancies noticed on physical verification have been properly dealt with in the books of account.

Question 35

How will you vouch and verify the following:

(a) Stock lying with Third Party. *(4 Marks, November, 2005)*

(b) Purchase of Motor Car. *(4 Marks, November, 2005)*

Answer

(a) Stock lying with Third Party

(i) Obtain confirmations from the third party including the time period and reasons thereof.

(ii) Evaluate condition of goods and see whether adequate provision has been made.

(iii) Check whether subsequently the goods lying with third party were sold or received back after the expiry of stipulated time period.

(iv) Ensure that the goods have been included in the closing inventory though lying with third party.

(b) Purchase of Motor Car

(i) Ascertain whether the purchase of car has been properly authenticated.

(ii) Check invoice of the car dealer to confirm purchase price.

(iii) Examine registration with Transport Authorities to verify the ownership.

(iv) Ensure that all expenses relating to purchase of car have been properly capitalized and the same have been disclosed properly in the balance sheet.

Question 36

Give your comments on "The CC Ltd., a Pharmaceutical Company, while valuing its finished stock at the year end wants to include interest on Bank Overdraft as an element of cost, for the reason that overdraft has been taken specifically for the purpose of financing current assets like inventory and for meeting day to day working expenses". *(5 Marks, May, 2005)*

Answer

Cost of Inventories: As per Accounting Standard 2 "Valuation of Inventories", cost of inventories comprises all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition. However, it makes clear that interest and other borrowing costs are usually not included in the cost of inventories because generally such costs are not related in bringing the inventories to their present location and condition. Therefore, the proposal of CC Ltd. to include interest on bank overdraft as an element of cost is not acceptable because it does not form part of cost of production.

Question 37

How will you vouch and verify the following:

(a) Goodwill. *(4 Marks, May, 2005)*

(b) Capital work-in-progress. *(4 Marks, May, 2005)*

Answer

(a) Goodwill: Goodwill arises from business connections, trade name or reputation of an enterprise. AS 26, "Intangible Assets", states that internally generated goodwill is not to be recognised as an asset, as it is not an identifiable resource controlled by the enterprise, that can be measured reliably at cost. As per AS 10, "Accounting for Fixed Assets", goodwill should be recorded in the books, only when some consideration in money or money's worth has been paid for it. In light of the above discussions, the following points are to be noted for verification of goodwill-

(i) Examine the vendors' agreement on the basis of which assets of the running business have been acquired by the company as per the books of account or a specific amount has been paid for the goodwill.

(ii) Ensure that whenever business is acquired at a price, payable in cash or otherwise, which is in excess of the value of net assets taken over, such excess amount is the goodwill.

(iii) Ensure that only the amount paid to the vendors not represented by tangible or intangible assets, the value of which can be measured reliably has been debited to goodwill account.

(iv) See that goodwill has not been shown in the company's books by writing up the value of its assets, on revaluation, or by writing back the amount of good will earlier written off.

(v) Ensure that the goodwill not yet written off has been properly disclosed under the head "Intangible Assets" as per Schedule III requirements.

(vi) See that the goodwill is being amortised as per financial prudence over a reasonable period.

(b) Capital Work-in-Progress: Capital Work-in-Progress denotes assets under installation. This could either be plant or machinery under construction, or that construction project for establishment of a new factory is under progress. The auditor should take the following steps to verify the same-

(i) Ensure that the capital project is authorised by the Board. See the relevant Board Minutes for the purpose.

(ii) Obtain the break up in details of the amount shown in the Balance Sheet under this head.

(iii) Check purchase cost of plant machinery or other assets with reference to the contract with, and amount paid to the suppliers.

(iv) Examine the allocation of common costs to the Capital Work-in-Progress in case such items have been constructed internally.

(v) Ensure that the assets already put to commercial use are not included under Capital Work-in-Progress.

(vi) Verify that only expenses incurred up to pre commissioning stage are capitalised under this head.

(vii) Obtain the certificate of the engineering department to ascertain the quantum of the Capital Work-in-Progress, and whether the value is correctly represented in the Balance Sheet, and its transfer to Fixed Assets on completion of the projector installation of the plant.

(viii) See that Capital Work-in-Progress is properly disclosed in the Balance Sheet under the head "Fixed Assets" as per the presentation and disclosure requirements of Schedule III to the Companies Act, 2013.

Question 38

How will you vouch and verify the following:

(a) Patents. *(4 Marks, November, 2004)*

(b) Advances given to suppliers. *(4 Marks, November, 2004)*

Answer

(a) Patents

(i) Obtain the schedule containing particulars of the patents owned by the client as on the balance sheet date. The particulars should contain the dates of registration of the patents with the related authorities and the dates in respect of the last renewal.

(ii) See that the total of the values of the patent rights shown in each list agree with the values shown in the respective ledger accounts.

(iii) Examine the cost of patent rights. In case of outright purchase of patent rights, the purchase consideration, legal fees and registration charges should be included in cost. When they are developed within the organisation, all costs incurred on their development including legal and registration expenses for registration of the patent should constitute the cost. Capitalised value should be amortised over the life of the patent.

(iv) See that the renewal fees in respect of the patent rights have been paid and the same has been treated as a revenue charge.

(v) Examine the valuation of the patent rights. It should be seen that the patent rights have been valued at cost less depreciation attributable to the expired legal life of the patent rights. However, if it is found that the patent rights have already lost substantial part of their commercial value, it would be proper to value it at their residual commercial value, when it is less than the book value for their unexpired legal life. In case the product covered by the patent rights does not have any sale

value then patents should be shown at nil valuation notwithstanding any residual life. Reference to compliance with the provisions of AS 26 may also be made.

(b) Advances given to Suppliers

(i) Obtain schedule of debit balances in trade payables' account and pay particular attention to the age of the balances. Also scrutinise the bought ledger.

(ii) Enquiry should be made for long unadjusted outstandings and check as to whether any of them would require provisioning.

(iii) Examine that the advances have not been shown as deposits in balance sheet as per section 143(1) of the Companies Act, 2013.

(iv) Confirmation of balances should be obtained and reconciliation be done in case of any discrepancies.

Question 39

Write a short note on "Disclosure requirements of bank balances of a limited company".

(4 Marks, November, 2004)

Answer

Disclosure Requirements for Bank Balance: As per Part I of Schedule III to the Companies Act, 2013, the disclosure of bank balances is under the head "Cash and Cash Equivalents" in Current Assets as-

(i) Balances with Banks.

(ii) Earmarked balances with banks (for example, for unpaid dividend).

(iii) Balances with banks to the extent held as margin money or security against borrowings, guarantees, other commitments.

Question 40

As an auditor, comment on the following situations/statements:

(a) The method of depreciation on Plant and Machinery is to be changed from SLM basis to WDV basis from the current year. (4 Marks, May, 2004)

(b) The Finance Manager of Belt Ltd. is of the opinion that before declaration of dividends it would not be necessary to set off the carried forward amount of debit balance in the Profit and Loss Account against current revenue profit but the same could be set-off against existing revaluation reserve. Do you agree? (5 Marks, May, 2004)

(c) The company has sent semi-finished goods to third parties for further processing which is lying with them at the end of the year. (4 Marks, May, 2004)

Answer

(a) This question is redundant in view of the provisions of the Companies Act, 2013.

(b) Adjustment of Carried Forward Losses against Revaluation Reserves: The Guidance Note on "Treatment of Reserve Created on Revaluation of Fixed Assets" recommends that the accumulated losses should not be adjusted against such revaluation reserve, since this would amount to setting of actual losses against unrealised gains. However, in arriving at divisible profits, the provisions of Section 123 of the Companies Act, 2013 read with the Companies (Declaration and payment of Dividend) Rules, 2014 should be kept in view. The amount of loss and depreciation not provided should be set off against current revenue profit before declaration of dividends.

Since, mere revaluation of assets does not result in realised gain, and, thus, as per the sound accounting practice, the accumulated losses should not be adjusted against revaluation reserve because this would amount to setting off actual losses against unrealised gains. Therefore, if the debit balance in Statement of Profit and Loss is set off against revaluation reserve, and then dividend is declared from out of revenue profits, it would amount to payment of dividend out of capital without making good the amount of loss and depreciation. Such a declaration will be violation of the provisions of Section 123 of the Companies Act, 2013. Hence, the opinion of the finance Manager of Belt Ltd. is not correct.

(c) Semi-Finished Goods lying with Third Parties: Semi-finished goods are the assets of the company and therefore such goods, though, at present not with the company, should be included in the closing inventory under the head "inventory with processors". The auditor shall be required to undertake the following steps in respect of inventories lying with third parties-

(i) Ensure that semi-finished goods have been included for valuation of inventory since these belong to the company.

(ii) Obtain confirmation letters from such third parties in respect of quantity lying with them at the end of the year. The auditor may also consider carrying out the appropriate audit procedure to obtain assurance about the condition of such inventory.

(iii) Examine the basis of valuation. In this case, it shall have to be done on the basis of the cost of work-in-progress and having regard to stage of completion and accordingly accounting for conversions costs.

(iv) Check that the disclosure requirements as specified in schedule III to the Companies Act, 2013 and AS 2, "Valuation of Inventories" have been followed.

Question 41

How will you vouch and verify Endowment Policies. *(4 Marks, May, 2004)*

Answer

Endowment Policies

(i) Ascertain the specific purpose for which the endowment policy is taken, e.g., Sinking Fund policies for redemption of debentures, redemption of leases or policies taken for other similar purposes, etc.

(ii) Verify the terms and conditions of policies and ensure that all such conditions are in force and being followed.

(iii) Check that premium has been deposited in time and the policy is in force.

(iv) Examine that proper disclosures have been made in the financial statements in respect of items for which the policy has been taken.

Question 42

Write short notes on the following:

(a) Intangible Assets

(b) Floating Charge. *(4 Marks each, May, 2004)*

Answer

(a) Intangible Assets: An intangible asset is that asset which does not have a physical identity but which is used by the enterprise for production or supply of goods or for retails to other or for administrative purpose. Such assets do not have any physical existence but their presence in the business is indicated with a value placed thereon. These assets include rights and benefit to owners subject to their being useful. For example: goodwill, patents, copyright etc. AS 26, "Intangible Assets", applies to, among other things, expenditure on advertising, training, start-up, research and development activities. Research and development activities are directed to the development of knowledge. Therefore, although these activities may result in an asset with physical substance (for example, a prototype), the physical element of the asset is secondary to its intangible component, that is the knowledge embodied in it. This standard also applies to rights under licensing agreements for items such as motion picture films, video recordings, plays, manuscripts, patents and copyrights. An intangible asset should be measured at cost. After initial recognition an intangible asset should be carried at its cost less any accumulated amortisation and any impairment losses.

Auditor should also ensure that proper disclosure is made in the financial statements about the carrying amount, amortisation methods, useful lives, etc.

(b) Floating Charge: Floating charge refers to a general charge on some or all the assets of an enterprise which is not attached to any specific assets and is given as a security against a debt. It has the effect of creating an immediate charge on the property of the company leaving the company to deal with the same in the ordinary course of business, but subject to the limitations imposed in the instrument of creating the charge. The floating charge, however, becomes fixed or crystallised and the trade payable becomes entitled to proceed against the assets on which the charge was created, on violation of any of the terms of the instruments creating the charge. This charge is also required to be registered within 30 days of its creation under section 77 of the Companies Act, 2013.