PAPER – 2 : AUDITING

Answer Question Nos. 1 and 2 and any four questions from the rest.

Question 1

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

(a) SMT Enterprises entered into a contract for sale of its goods worth Rs. 24 lacs with ST Ltd. The goods were inspected, approved and finalised by the inspection team of ST Ltd. ST Ltd. made the whole payment of Rs. 24 lacs. However, it requested SMT Enterprises to dispatch the goods in six equal monthly instalments from October, 2005 to March, 2006. In the month of January,2006, due to natural calamity, ST Ltd. informed SMT Enterprises to stop dispatches of the remaining three instalments until further notice. At the time of finalising its accounts for the financial year 2005-06, SMT Enterprises booked sales amounting to Rs. 12 lacs and showed remaining Rs. 12 lacs as Advance Against Sales. (5 Marks)

(b) X Ltd. had a major break down in its plant in the month of February, 2006. In the month of March, 2006 it entered into an agreement with an engineering firm for the purpose of repairing its plant for a consideration of Rs. 180 lacs. The engineering firm started the repairing work in the month of April, 2006 and completed it in the same month. X Ltd. made the provision for said expenditure on repairs in its books of account for the financial year 2005-06 on the plea that the event of break down leading to repair expenditure had taken place in the financial year 2005-06, binding contract for repairs was entered into during the financial year 2005-06 and repair work was also completed before the financial statements were approved by the Board of Directors of the company.

(5 Marks)

(c) The management tells you that WIP is not valued since it is difficult to know the same in view of multiple processes involved and in any case opening and closing WIP would be more or less the same. (4 Marks)

(d) JKT Ltd. having Rs. 40 lacs paid up capital, Rs. 9.50 lacs reserves and turnover of last three consecutive financial years, immediately preceding the financial year under audit, being Rs. 4.90 crores, Rs. 4.50 crores and Rs. 6 crores, but does not have any internal audit system. In view of the management, internal audit system is not mandatory.

(4 Marks)

Answer

(a) Revenue Recognition (AS-9): Revenue from sales can be recognised only if the following conditions are fulfilled:

(i) The seller of goods has transferred to the buyer, the property in the goods for a price and all significant risks and rewards of ownership have been transferred to a degree usually associated with ownership and

(ii) There is no significant uncertainty exists regarding the amount of consideration that will be derived from the sale of the goods.

In the light of above two conditions in the given case SMT Enterprise had transferred the property in the goods at an agreed price and all significant risks and rewards. Thus sale is fully completed. Mere postponement of delivery until further notice as requested by ST LTD., does not alter the status of sale.

As the sale is completed, entire amount of Rs. 24 lakhs should be recognized lacs in the F.Y. 2005-2006 only. SMT Enterprise recognising only 12 lacs sales in F. Y. 2005-2006 is not correct.

(b) Provision for Expenditure on Repairs (AS 29): As per AS-29 on provisions, contingent liabilities and contingent assets, a liability is defined as a present obligation of the enterprise, arising from past events the settlement of which is expected to result in an outflow of resources embodying economic benefits. A provision is a liability which can be measured only by using a substantial degree of estimation. Provision for liability can be made which is existing as on the date of balance sheet.

In the instant case, though the event of break down and binding contract for repairs was entered into F. Y. 2005-06, but as the Engineering firm has not started performing the work of repair until the date of balance sheet, liability can not be said to have been arisen as on the date of balance sheet.

In view of the above, provision made by X Ltd. for expenditure on repairs in its books of account of F.Y. 2005-06, for repair work to be done in the next F.Y. 2006-07 is absolutely wrong, as there was no obligation. The auditor should bring this wrong provision to the notice of the authorities of X Ltd. and report accordingly.

(c) Valuation Of WIP : AS-2, prescribes the valuation of inventories. The word inventories includes any item held in the process of production. Production process is going on but final product has not came out before the end of accounting year. This is known as WIP, and company will have to find out the stage of completion of products. It has to decide and find out the process at which the said stock is lying at the end of the year and value the same. In certain cases, due to nature of the product and the manufacturing process involved, physical verification of WIP may be impracticable. But in such cases, if necessary, the advice of an expert can be taken in the matter. The value of such WIP is normally done by taking the basic raw material cost and adding thereto the proportionate factory overhead cost incurred up to the stage of completion.

WIP is an item of Manufacturing, Trading & Profit & Loss A/c and also forming part of current assets, is relevant and can not be ignored. Omitting WIP will result in under or over statement of profit and current assets.

Part II of Schedule VI to the Companies Act also prescribes that the figures of opening and closing balances of stock and WIP be disclosed in the profit & loss account. Part I of the same schedule requires that the mode of valuation of stock be shown in the Balance Sheet.

The argument of the management that the opening and closing WIP would be more or less the same is not justified because the cost incurred for raw materials and overheads would be different and would give different value of opening and closing WIP.

Taking into consideration all the above aspects, management is wrong and if WIP is not valued or taken into consideration, he should qualify his report.

(d) Internal Audit System in Case of Company : As per CARO-2003, para 4(vii), statutory auditor is required to comment whether the auditee company has an internal audit system commensurate with the size and nature of company's business.

Internal audit system is mandatory where:-

(i) The company has a paid up capital and reserve exceeds 50 lakhs as at the commencement of the financial year or

(ii) The company has an average annual turnover of rupees 5 crores or more for a period of 3 consecutive financial year preceding the current financial year.

Applying the above conditions in the given case, the second condition is fulfilled and the company is required to maintain and internal audit system commensurate with its size and the nature of its business.

Hence the management view that internal audit system in their case is not mandatory is wrong.

The auditor will have to mention the fact of not having such internal audit system in his report.

Question 2

(a) Managing Director of PQR Ltd. himself wants to appoint Shri Ganpati, a practicing Chartered Accountant, as first auditor of the company. Comment on the proposed action of the Managing Director. (4 Marks)

(b) PBS & Associates, a firm of Chartered Accountants, has three partners P, B and S. The firm is already having audit of 60 companies, which includes 2 branch audits of a company. The firm is offered 3 company audits, out of which one is a private company, other is a foreign company and the third one is a public company. Decide and advise whether PBS & Associates will exceed the ceiling prescribed under Section 224(1B) by accepting the above audit assignments? (4 Marks)

(c) RT Ltd. Received Rs. 50 lacs as grant from the State Government towards the part cost of a specific machinery. The company credited the above sum of Rs. 50 lacs as income in its Profit and Loss Account for the year. What are your views on the accounting treatment of the above receipt of Rs. 50 lacs? (4 Marks)

(d) Audit of expenditure is one of the major components of Government Audit. In this context, write in brief what do you understand by:

(i) Audit against Rules and Orders

(ii) Audit of Sanctions

(iii) Propriety Audit (6 Marks)

Answer

(a) Appointment of First Auditor of Company : As per Section 224(5) of the Companies Act, 1956 the first auditor of a company can be appointed by the Board of Directors within one month of the date of registration of the company. If the Board fails to appoint the first auditor or auditors, the company, in general meeting, is empowered to make such appointment. This authority is not available to the Managing Director of the company himself. Such appointment should be made through Board of Directors or by shareholders in the general meeting.

In view of the above provision, Managing Director is advised not to appoint first auditors himself and let the Board to take decision in this regard. It will be considered as violation of section 224(5) of the Companies Act, 1956.

(b) Ceiling Limit for accepting Audit of Companies : As per Section 224(1B) of Companies Act, 1956, a Chartered Accountant cannot hold more than the specified number of company audit. It further says that in case of Chartered Accountant firms, the specified number is 20 companies per such partner who is not in whole time employment elsewhere. While counting 20 companies, not more than 10 companies may have a paid up share capital of Rs.25 lacs or more. Besides, while counting 20 companies ceiling limit, the following companies should not be considered as these companies are outside the scope of section 224.

(i) Branch audit

(ii) Special audit

(iii) Audit of foreign companies and

(iv) Audit of private companies.

In the given case if Mr. P, B and S do not hold any audits in their personal capacity or as partners of other firms, the total number of companies audit that can be accepted by M/s. PBS & Associates is 60.

Total Audit at present	60
Less: Branch Audit	2
Balance	58
Add: New Audit offered	01
(private co. audit and audit of foreign co. excluded)	
Total Audit of companies	59

Thus PBS Associates can accept additional audit of all above three companies as given in the question which will be considered well within the limit specified by section 224(1B) of the Companies Act, 1956.

(c) Accounting for Government Grants (AS-12): Grants or subsidy related to specific fixed assets are Govt. grants whose primary condition is that an organisation qualifying for such grant, should either purchase, construct or otherwise acquire such assets.

Besides Govt. may specify the type or location of the assets or the periods during which they are to be acquired or held.

For accounting treatment, following basis should be taken into consideration:

(i) Grant to be shown as a deduction from gross value of assets concerned in arriving at its book value. Depreciation is charged on reduced value of fixed assets

Or

(ii) Grant related to depreciable asset is treated as deferred income which is recognised as revenue in the Profit & Loss account on a systematic and rational basis over the useful life of asset and

(iii) In case of grants related to non-depreciable assets, the same shall be credited to Capital Reserve Account.

Taking into consideration the above view, accounting treatment given of the grants received by the organisation is not correct.

As an auditor, it will be advised to correct the wrong treatment given (the whole amount of grants Rs.50 lacs credited to Profit & Loss Account), otherwise, it is the duty of the auditor to qualify his report.

(d) (i) Audit against Rules and Orders: Audit against rules and orders aims to ensure that expenditure conforms the relevant provisions of the constitution and of the laws and rules made there under. It also seeks to satisfy the expenditure is in accordance with the financial rules, regulations and orders issued by a competent authority. It includes :

(1) Rules and orders regulating the powers to incur and sanction expenditure

(2) Rules and orders dealing with the mode of presentation of claims against Government and in general the financial rules prescribing the detailed procedure to be followed by Govt. servants in dealing with Government transactions and

(3) Rules and orders regulating the conditions of services, pay and allowances, and pensions of Govt. servants.

(ii) Audit of Sanctions: The auditor has to ensure that each item of expenditure is covered by sanction, either general or special from the competent authority. The audit of sanction is directed both in respect of ensuring that:

(1) The expenditure is properly covered by a sanction and

(2) to satisfy that the authority sanctioning it, is competent for the purpose by virtue of powers vested by constitution.

(iii) Propriety Audit: It means to bring out cases of improper, avoidable or infractious expenditure, even though the expenditure has been incurred in conformity with the existing rules and regulations. A transaction may satisfy all the requirements of regularity audit in so far as the various formalities regarding rules and regulations are concerned, but may still be highly wasteful. Audit against propriety which are as under:

(1) The expenditure should not be prima-facie more than the occasion demands.

(2) No authority should exercise its powers of sanctioning expenditure to pass an order which will directly or indirectly to its own advantage.

(3) Public money should not be utilised for the benefit of particular person or section of the community.

Question 3

(a) What are the basic principles governing an audit as laid down in AAS 1 ? Explain in brief. (10 Marks)

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

Answer

(a) Basic Principles Governing an Audit: Auditing and Assurance Standard-1 on "Basic Principles Governing an Audit" issued by the ICAI describes the basic principles which govern the auditor's professional responsibilities and which should be complied with whenever an audit of financial information of any entity is carried out. The basic principles as stated are as under:

(i) Integrity, Objectivity and Independence: The auditor should be honest, straightforward and sincere in his approach to his professional work. He must be fair and must not allow prejudice or bias to override his objectivity. He should maintain an impartial attitude and both be and appear to be free of any interest which might be regarded, whatever its actual effect, as being incompatible with integrity and objectivity .

(ii) Confidentiality: The auditor should respect the confidentiality of information acquired in the course of his work and should not disclose any such information to a third party without specific authority or unless there is a legal or professional duty to disclose.

(iii) Skills and Competence: The audit should be performed and the report should be prepared with due professional care by persons who have adequate training, experience and competence in auditing.

(iv) Work Performed by Others : When the auditor delegates work to assistants or uses work performed by other auditors and experts, he will be entitled to rely on work performed by others provided he exercise adequate skill and care and is not aware of any reasons to believe that he should not have so relied. The auditor should carefully direct supervise and review work delegated to assistants and obtain reasonable assurance that work performed by other auditors or experts is adequate for his purpose since he will continue to be responsible for forming and expressing his opinion on the financial information.

(v) Documentation : The auditor should document matters which are important in providing evidence that the audit was carried in accordance with the basic principles.

(vi) Planning: Planning enables the auditor to conduct an effective audit in an efficient and timely manner. Primarily, planning should be based on the knowledge of the client's business. Plans should be further developed and revised as necessary during the course of the audit.

(vii) Audit Evidence: The auditor should obtain sufficient appropriate audit evidence through the performance of compliance and substantive procedures to enable him to draw reasonable conclusions therefrom on which to base his opinion on the financial information.

(viii) Accounting System and Internal Control: The auditor should reasonably assure himself that the accounting system is adequate and that all the accounting information which should be recorded has in fact been recorded and internal controls normally contribute to such assurance.

(ix) Audit Conclusion and Reporting : The auditor should review and assess the conclusions drawn from the audit evidence obtained and from his knowledge of business of the entity as the basis for the expression of his opinion on the financial information. This review and assessment involves forming an overall conclusion as to whether:

(1) the financial information has been prepared using acceptable accounting policies which have been consistently applied,

(2) the financial information complies with relevant regulations and statutory requirements,

(3) there is an adequate disclosure of all material matter relevance to the proper presentation of the financial information, subject to statutory requirements, where applicable.

(b) External Confirmation: The purpose of Auditing and Assurance Standard 30 is to establish standards on the auditor's use of external confirmations as a means of obtaining audit evidence.

External confirmation is the process of obtaining and evaluating audit evidence through a direct communication from a third party in response to a request for information about a particular item affecting assertions made by management in the financial statements. The auditor should employ external confirmation procedure in consultation with management.

AAS 5 “Audit Evidence” states that in general, audit evidence from external sources is more reliable than audit evidence generated internally. Audit evidence in the form of written responses to confirmation requests received directly by the auditor from third parties who are not related to the entity being audited, when considered individually or cumulatively with audit evidence from other procedures, may assist in reducing audit risk for the related financial statement assertions to an acceptably low level.

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

(i) Bank balance & other information from bankers

(ii) Account receivable balances

(iii) Stock held by third parties

(iv) Property Title Deed held by third parties

(v) Investments purchased but delivery not taken

(vi) Loan from lenders

(vii) Account payable balances

(viii) Long outstanding share application money

Question 4

How will you vouch and/or verify the following ?

(a) Goods sent on Consignment (4 Marks)

(b) Expenditure on Foreign Travelling. (4 Marks)

(c) Re-issue of Forfeited Shares (4 Marks)

(d) Premium paid for insurance of a Motor car. (4 Marks)

Answer

(a) Goods sent on consignment: Such transaction should be vouched and verified as under-

(i) Proforma invoice sent with goods.

(ii) Freight evidences given by the transporter like Challan, Bill, Receipt for freight charged.

(iii) Insurance charge to be verified from cover note and premium paid receipt issued by Insurance Company.

(iv) Account sale sent by consignee, referring to sale price of the goods sold, expenses incurred by him and stock remained unsold.

(v) Unsold goods should have been taken in the closing stock valued properly inclusive of expenses (Proportionate) incurred by consignee.

(vi) Journal entries relating to such transaction be verified from the books of the Company.

(b) Expenditure on foreign traveling: Such expenditure should be vouched on the basis of actual expenditure incurred for which the following matters should be taken into consideration.

(i) The counterfoil of the air ticket to inspect.

(ii) Visa entry on passport to be verified.

(iii) Foreign currency drawn from authorised dealers for expenses abroad to verify.

(iv) Sanctions by the Board of Directors be verified.

(v) If any advances taken against such traveling, adjustments thereof by verifying entries in the books.

(vi) To see that all vouchers for traveling expenses should be authorised by some responsible official.

(vii) Such expenditures are incurred in the interest of the business.

(c) Re- issue of forfeited shares:

(i) The auditor should ascertain that Board of Directors has the authority under the Articles to Re-issue forfeited shares. Check relevant resolution of the Board of Directors.

(ii) The auditor should vouch the amounts collected from person to whom the shares have been allotted and verify the entries recorded from re-allotment and see that the total amount received on the shares including that received prior to forfeiture, is not less than the par value.

(iii) The auditor should verify the amount of surplus resulting on the re-issue of shares rightly credited to Capital Reserve Account.

(iv) Where partly paid shares are forfeited for non-payment of calls, and are re-issued as fully paid, the re-issue is treated as an allotment at a discount. In such case, the provisions of Sec. 79 of the Companies Act would require compliance.

(d) Premium paid on Insurance of a Motor Car:

(i) Check insurance cover note issued by Insurance Company. Verify car no., period of Insurance etc.

(ii) See 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 5

(a) What special steps are involved in audit of a Cinema Hall? (10 Marks)

(b) What do you understand by Internal checks? (6 Marks)

Answer

(a) Special steps involved in audit of a Cinema Hall:

(i) Verify

(a) that entrance to the cinema hall is only through printed tickets;

(b) tickets are serially numbered and bound into books;

(c) that the number of tickets issues for each show and class are different;

(d) that for advance booking a separate series of tickets is issued and

(e) stock of tickets is kept in proper custody.

(ii) If tickets are issued through computer- audit the system to ensure its reliability and authenticity of data generated by it.

(iii) System should provide that at the end of each show a proper statement should be prepared and cash collected be tallied.

(iv) Cash collected is deposited in banks partly on the same day and rest on the next day – depending upon the banking facility available.

(v) Verify that proper record is kept for free passes issued and the same are issued under proper authority.

(vi) Cross check the entertainment tax deposited.

(vii) Verify the income from advertisements and slides showed before the show.

(viii) Vouch the expenditure incurred on publicity of picture, maintenance of hall, electricity expenses etc.

(ix) Vouch recoveries of advertisement expenses etc from film distributors.

(x) Vouch payment of film hire with reference to agreement with distributor or producer.

(xi) Verify the basis of other incomes earned like restaurant, car and scooter parking and display windows etc.

(xii) Confirm that depreciation on machinery and furniture has been charged at an appropriate rate which are higher, as compared to those admissible in the case of other businesses, in respect of similar assets.

(b) Internal Check: It means checks on day to day transaction which operate continuously as part of the routine system whereby the work of one person is proved independently or is complimentary to the work of another. The object of internal check is mainly prevention or early detection of fraud or error-intentional or unintentional. By employing a good system, the chances of occurrence of errors or fraud or their remaining undetected are greatly reduced. Internal check is a part of the overall internal control system and operates as a built-in-devices as far as the staff organisation and job allocation aspects of the control system are concerned. The system in accounting implies organization of system of bookkeeping and arrangement of staff in such a manner that no one person can completely carry through a transaction and record every aspect thereof.

Therefore it is increasingly being recognised that for an audit to be effective, especially when the size of a concern is large, the existence of a system of internal check is essential. The auditor can rely on sound system of internal check and on that consideration, reduce the extent of detailed checking to be carried out by him. Scope of audit can be reduced by both the time and cost factors.

Question 6

(a) Explain the scope paragraph of auditors Report. (8 Marks)

(b) How the work of an expert should be evaluated before accepting the same as an Audit evidence? (8 Marks)

Answer

(a) Scope Paragraph Of Auditors Report (AAS 2): The auditor's report should prescribe the scope of the audit by stating that the audit was conducted in accordance with auditing standards generally accepted in India. The Auditing and Assurance Standards issued by ICAI establish the auditing standards generally accepted in India. The reader needs this is as an assurance that the audit has been carried out in accordance with such established standards. Scope means auditor's ability to perform audit procedures deemed necessary in the circumstances.

As per AAS 2 the scope of an audit of financial statement will be determined by the auditor having regard to the terms of the engagement, the requirement of relevant legislation and the pronouncements of the Institute. The terms of engagement cannot however restrict the scope of an audit in relation to matters which are prescribed by legislation or by pronouncements of the Institute.

(b) Evaluation of work of an expert: AAS-9 discusses the auditors responsibility in relation to and the procedure the auditor should consider in using the work of an expert as audit evidence. When the auditor delegates work or uses work performed by experts, he will continue to be responsible for forming and expressing his opinion on the financial information. In such cases, the auditor should obtain reasonable assurance that work performed by experts is adequate for his purpose. When the auditor intends to use the work of an expert, he should examine:-

(i) Evidence to gain knowledge regarding the terms of the expert's engagement. There should not have been placed any restriction affecting his work (under influence).

(ii) Expert's relationship with the client.

(iii) The sources of data used by him are sufficient and appropriate in the circumstances.

(iv) The assumptions and methods used and, if appropriate, their consistency with the prior period.

(v) The result of the expert's work in the light of the auditor's overall knowledge of the business and of the results of his audit procedures.

(vi) The auditor should also satisfy himself that the substance of the expert's findings is properly reflected in the financial information.

Question 7

(a) 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)

(b) Why Central Government permission is required, when the auditors are to be removed before expiry of their term, but the same is not needed when the auditors are changed after expiry of their term? (4 Marks)

Answer

(a) 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 stock or overvaluation of opening stock either due to wrong valuation of stock or mistake in stock taking .

(ii) Change in the basis of stock valuation. For example, opening stock was valued at market price above cost when closing stock 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 stock.

(viii) Value of unusual stock of consumable stores (fuel and packing materials) are not shown as stock or not adjusted from corresponding expenses .

(ix) Expenses which should be charged in the in 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.

(b) Removal of an auditor: Removal of an auditor before the expiry of his term requires prior approval of the Central Govt. [Section 224(7)]. This is a very stringent provision to ensure that any auditor who is inconvenient to the management cannot be removed so easily. Such a provision goes a long way to ensure independence of auditor.

Therefore law has provided this safeguard so that Central Govt. can know the real reason of auditor's removal before expiry of his term and if not satisfied with the reason, may not accord approval.

On the other hand, if the auditor has completed his term, i.e. has submitted his report and thereafter he is not re-appointed, then the matter is not serious enough for Central Govt. to call for its intervention.

In view of the above, Central Govt. permission is required when auditors are removed before expiry of their term and the same is not required when they are not re-appointed after the expiry of their term.

Question 8

Write short notes on the following :

(a) Audit Programme (4 Marks)

(b) Current Investments (4 Marks)

(c) First in First out (FIFO) method (4 Marks)

(d) Accounting Estimates. (4 Marks)

Answer

(a) Audit Programme : Audit programme is a written documents setting forth, in details, the various aspects of the proposed audit. Such programme is prepared before commencing the audit and it is updated with the progress of the audit.

Without a written and pre-determined programme, work is necessarily, to be carried out on the basis of some, 'mental' plan. In such a situation, there is always a danger of ignoring or overlooking certain books and records. Under a properly framed programme, the danger insignificantly less and the audit can proceed systematically.

It serves as a guide to be carried out in the succeeding year. A properly drawn up audit programme serve as evidence in the event of any charge of negligence being brought against auditor.

Audit programme normally provide for the following:

(i) Audit procedure to be applied

(ii) Extent of check

(iii) Timing of check

(iv) Allocation of work amongst the audit team members.

(v) Special instructions based on past experience of the auditee.

Audit programme provides sufficient details to serves as a set of instruction to the team and also help to control the proper execution of work.

(b) Current Investment : It means an Investment that is by nature readily saleable & realisable and is intended to be held for not more than one year, from the date on which such investment is made.

As per AS 13, the valuation of current investment at lower of cost and fair value provides a prudent method of determining the carrying amount to be stated in the balance sheet.

Any reduction to fair value and any reversal of such reduction are to be included in the Profit & Loss Account. It is essential to disclose in financial statement the accounting policies for determination of carrying amount of investment and income therefrom. Disclosure of profit/loss on disposal of current investment and changes in carrying amount of investment is also necessary.

(c) First-In-First-Out (FIFO) Method: It is a cost formula used in assigning the cost to inventories which are ordinarily interchangeable. The FIFO formula assumes that the items of inventories which were purchased or produced first are consumed or sold first, and consequently the items remaining in inventory at the end of the period are those which have been most recently purchased or produced. This method of valuation of inventory is not applied where items of inventory are not ordinarily interchangeable.

(d) Accounting Estimates : It means an approximation of the amount of an item in absence of a precise means of measurement.

Management is responsible for making accounting estimates included in financial statements. These estimate are often made in conditions of uncertainty regarding the outcome of events that have occurred or likely to occur and involved the use of judgement. As a result, the risk of material misstatement is greater when accounting estimates are involved.

Examples:

(I) accrued revenue

(ii) provision for taxation

(iii) provision for a loss from a lawsuit

(iv) provision to allocate the cost of fixed assets over their estimated useful lives

(v) Insurer's liability for outstanding claims

(vi) provision for retirement benefits in the financial statements of employers

(vii) amortisation of certain items like goodwill and deferred revenue expenditure