

Vouching & Verification

Meaning of Voucher

Ans: A voucher is a piece of substantiating evidence, in the form of a written record of expenditure, disbursement, or completed transaction.

Examples of types of vouchers: Cash Memo, Sale Invoice, Purchase Requisition Slip, Purchase Invoice, Gate Keeper's Note, Bank Paying Slip, Bank Statements, Minutes Book, etc.

Types of Vouchers

Ans:

1. Original and Collateral Vouchers:

Original vouchers are called primary vouchers, and their copies or supporting documents are called collateral vouchers.

2. Internal and External Vouchers:

Vouchers may generate inside the company (internal vouchers) or outside the company (external vouchers).

3. Missing Vouchers:

- a) A missing voucher can be any of the following: missing Cash Memo, missing page in a Cash Collection Statement, missing inward challan for goods received, missing Inspection Report for material, missing TDS Certificate for tax deductions at source, missing Resolution to authorize increase in borrowing power by the company, missing Bank Statement for a day or a month, etc.
- b) A voucher could become missing due to:
 - i. Wrong or careless filing of document. E.g., missing Bank Statement for a day or a month, missing TDS Certificate.
 - ii. Unintentional non-awareness of statutory requirements. E.g., missing Resolution to authorize increase in borrowing power by the company, or accidental fire, or lost otherwise.
 - iii. Intention to hide the misappropriation by a person. E.g., non-recording of Purchas Invoices received later for goods received and taken in stocks, missing Cash Memo, etc.
- c) The auditor should be careful and should carry out cross verification processes from other sources and documents to be able to form a firm opinion in the case of missing vouchers.
- d) The auditor should qualify his report or give a Disclaimer of Opinion in this case, or may give an adverse report with reasoning on a particular issue depending upon the materiality of the missing voucher as necessary evidence on the issue.

Disqualification of a Voucher

Ans: The following stated defects would disqualify a voucher from being appropriate evidence:

- 1. If the date of voucher does not correspond with the date of payment entered in the Cash Book, the auditor may refuse to accept it as an old voucher may have been used to conceal misappropriation.
- 2. If the voucher is not passed by the authorized personnel in the organization.
- 3. The amount of the voucher differs in words and figures.
- 4. The nature of payment in the voucher does not relate to the business.
- 5. The amount of voucher does not tally with the amount entered in the Cash Book.
- 6. The voucher is in the name of an employee/director, and not in the name of the client's company.

Define Vouching

Ans: "Vouching is the examination by the auditor of all documentary evidences, which are available to support the authenticity of the transaction entered in the client's record."

The act of examining all documentary evidences (vouchers) is referred to as vouching. Its basic objective is to establish the authenticity of the transactions recorded in the primary books of account.

Vouching is said to be "the essence of auditing" or may be termed as the "backbone of auditing"

• Importance of Vouching

"Vouching is the foundation over which the structure of auditing is erected"

Vouching & Verification

1. **Serves as evidence:** Vouching being an important auditing procedure helps in obtaining evidence with respect to transactions recorded, which ultimately ensures the completeness, accuracy, genuineness and validity of the transactions.
2. **Assurance:** With the help of vouching, the auditor is ensured about recording of transaction, proper allocation to accounting period, occurrence of transaction, and further classification and disclosure of transactions as per the standard accounting principles and policies.
3. **Preliminary for Verification:** Vouching serves as a basis of verification of assets and liabilities. Examination of the source documents justifying the amount of assets and liabilities stated in the Balance Sheet can be done by vouching.
4. **Establishes Authenticity:** It facilitates authenticity of the transactions recorded in the primary books of accounts.

- **Special Considerations During Vouching**

- A) It is important to note that in vouching of payments, the auditor does not merely seek proof that money has been paid away, but keeps into consideration the following relevant points:

1. **Checking the relevant documentary evidence:** It helps in assuring the genuineness of the transaction and accuracy in its recording.
2. **Checking the authority on the basis of which the entry has been made:** It helps in assuring that the transaction has actually occurred.
3. **Confirming that the amount mentioned in the voucher has been posted to the appropriate account:** It helps in assuring the proper classification according to accounting policies and practices.
4. **Checking that complete disclosure regarding the nature of the transaction is made.**

- B) Thus, the general principles of vouching as well as auditing can be listed as under:

- i. Genuineness
- ii. Accuracy
- iii. Authenticity
- iv. Authorization
- v. Classification
- vi. Disclosure

- **Vouching Of Cash Transactions**

1. Weaknesses in the internal control system cause a number of risks to arise relating to cash transactions. The auditor should be careful in evaluating the internal checks and controls to detect the possible cash misappropriations such as:
 - a) Excessive cash balances in the cash book could be fictitious.
 - b) Understatement of receipts by preparing duplicate receipts for sums less than original.
 - c) Duplicate copy of sales invoice may be altered so that the party's account is debited with an amount that is lower than the actual sale and the amount of difference may be misappropriated.
 - d) Incorrect totaling or balancing of the Cash Statements/Day Book/Cash Book.
 - e) **Suspense A/c:** Cheques from customers may be credited to suspense account and cash may be withdrawn later to square up the account.
 - f) **Dummy workers:** Salary payments to non-existing workers.
 - g) False bank confirmations may be prepared.
 - h) False bank statements and duplicate FDRs get issued by the top management at the banks (as in the case of Satyam Computers).
 - i) Receipts not entered in the cash book, particularly casual or non-recurring transactions such as:
 - Bad debts recovered
 - Overpayment to suppliers
 - Sale of assets
 - j) Bad debt written off in earlier years but cash recovered later may be misappropriated.
 - k) Discounts allowed may be overstated and the excess amount may be misappropriated from cash received.
 - l) Cheques deposited in the bank may not be recorded in the Cash Book/Bank ledger and an equivalent amount of cash may be withdrawn later on.

Vouching & Verification

- m) Bank balance “kited”, i.e. in the case of money transfer from one bank account to another, the receipt in a Bank A is shown prior to the balance date and the payment after it.
- n) Teeming and leading: Part cash received may be held up and lapped up against subsequent receipts.
- o) Cash sales treated as credit sales.
- p) Bank pay-in-slips with false particulars.

2. The auditor should take the following steps of action in case of occurrence of such risks:

<u>S. No.</u>	<u>Risky Elements</u>	<u>Auditor's Action</u>
i.	Opening Balance	It should be compared with the closing balance of the last year's Cash Book and as per audited Balance Sheet of the previous year.
ii.	Accounting Manual	To ensure written guidelines and set procedures to be followed in the company and its effective adherence.
iii.	Review of compliance Procedure	He should select a few representative transactions and entries, and follow them from the beginning to the end, to ensure that they are properly authorized, processed and substantiated.
iv.	Sample Transactions checked in depth	He may select a few representative transactions and entries, and follow them from the beginning to the end, to ensure that they are properly authorized, processed and substantiated.
v.	Numbering	There should be pre-numbered Cash Memos, Invoices, money receipts, Credit Notes, etc. and their copies should be properly maintained.
vi.	Cashier's Control	The cashier should not have full control on Sales Ledger, Creditor's Ledger, Invoices, Bank Reconciliation, Credit Notes, etc.
vii.	Incoming Mail	It should not be opened by the cashier or the clerk maintaining the Debtors' Ledger.
viii.	Cheques/ Postal Orders	It should be crossed 'Account payee only', and should be promptly dispatched to the parties concerned.
ix.	Daily Reconciliation	Of cash credited to debtors and the collection/receipts issued.
x.	Daily deposit of Collection	Cash collections should be deposited in the bank on the same day (net of payments authorized, if any, out of that).
xi.	Bank Reconciliation Statement	it should be prepared regularly by the cashier and also by some other person not involved with cash receipts or records

Vouching & Verification

xii.	Petty Cash Imprest System	Petty cash should be maintained as per the impress system.
xiii.	Petty Cash Register	It should be under proper supervision and all payments through the register should be authorized with a maximum amount fixed for individual payments.
xiv.	Authorized Payments	All payments other than petty cash should be made by cheques which are prepared only against authorization of a senior executive.
xv.	Mark as “Paid” vouchers	Vouchers, against which cheques have been issued, should be marked as “Paid” so as to prevent their production in support of further cheques.
xvi.	Wrong Payee Name	E.g. A cheque received in the name of MCD could be fraudulently deposited by the cashier in the name of “M. C. Dey” by fradulantly adding the two dots and “ey”. E.g. A cheque issued similarly in the name of “D. R. Khanna” could be encashed by “Des Raj Khanna” or his tenant/ brother on the other floor “dev Ram Khanna”.
xvii.	Issue of Cheques	A double sided carbon paper may be used while issuing a cheque so that the cheque’s details are noted not only on the sheet placed under the cheque (for the issuer’s record), but also behind the cheque, to prevent unauthorized changes being made on the face of the cheque, that may go undetected. A transparent tape may be stuck on the name of the payee and the amount of the cheque to prevent manipulations.
xviii.	Bank Dealings	Insistence on payments and receipts by Payees A/c Cheques or Drafts as far as possible. The nature of imprest payments should be such that they could ordinarily be made by cheques.

Cash Vouching Procedure

Ans: Cash sales are generally open to a wide scope for commission of frauds and these may be prevented only by an effective system of internal checks and controls.

After ascertaining the efficiency of the internal check system of cash controls as detailed above, the auditor should vouch cash sales as follows:

<u>S. No.</u>	<u>Evidences Relevant</u>	<u>Audit Procedures</u>
i.	Compliance of Accounting Manual or laid down Control Systems	To evaluate that the system laid down is proper and the same is being adhered to.
ii.	Separate authority to deliver goods and collect cash	To ensure that the salesmen have no authority to deliver the goods to, or receive cash from, the customers.
iii.	Three copies of Cash Memo	To verify that there should be at least three copies, preferably in different colors and clearly marked on it the purpose “Original for Customer” and the second copy for the Delivery Counter” are to be delivered to the customer. The third (book copy) remains with the respective salesman.

Vouching & Verification

iv.	Stamp – marking by cashier as “paid”	To ensure that the customers present both the copies to the cashier who, upon receiving the payment and stamp-marking the copies as 'Paid'; returns the same to the customer.
v.	One copy retained by Delivery Counter	To verify that the second copy with “Paid” stamp is handed over to, and retained by the delivery clerk for his own record of outgo.
vi.	Daily Cash Sales Summary for Reconciliation	To verify that the pre-numbered Cash Memos are reconciled with the Daily Cash Summary and that any missing number is vouched for to be recorded in it.
vii.	• Bank pay-in-slips • Cash Book Bank Book Bank Statement	To check daily deposit of cash as per Cash Sales Summary.
viii.	Till Rolls, in case of Automatic Cash Registers	To verify that the daily totals entered in the Cash Book are checked with the Till Rolls.
ix.	Stocks Register	The entries in the Stock Register should be reconciled with Daily Cash Sales Summary.
x.	Originals of cancelled Cash Memos	These must be available in original, duly cancelled.
xi.	Reconciliations of Cash Sales with: • VAT/Sales Tax returns • Excise Returns • General ledger Sales Ledger Accounts	The cross verifications may be checked to ensure accuracy

Audit of Payments

Ans: Teeming & Leading is a commonly followed method of misappropriation of cash by concealing cash shortages and covering them through recoveries from another customer. It is not uncommon in case of cash collections if the internal check and internal control on cash transactions are not proper. Teeming and leading may not amount to fraud, but negligence on the part of the management and weaknesses in internal checks or controls may lead to substantial amounts being misappropriated by the cashier. This may result in a huge loss if he is not in a position to clear the debts when caught.

- The auditor has to follow the following procedure for timely detection of teeming and leading:
 1. Ascertain if the Cash Memos are consecutively numbered, and the dates, name and amount as per the Daily Summary reconcile with relevant cash receipt records.
 2. Reconcile individual cash amounts as per receipts with records in the Rough Cash Book.
 3. Reconcile the receipts as recorded in the Rough Cash Book, main Cash Book, pre-numbered Cash Memos, with counterfoils of the pay-in-slips.
 4. Ensure whether cash receipts are deposited in the bank on a timely basis.
 5. Examine the Debtors Ledger, especially entries showing part payments, to satisfy that the debtors concerned have indeed made part payments.
 6. Confirmations may be obtained from the debtors from time to time.

Vouching & Verification

Teeming & Leading

Ans:

1. Transactions with Directors

- ➔ Check that any contract entered into by the director or his relatives etc. with the company is in accordance with the provisions of section 188 of the Companies Act, 2013.
- ➔ Every director of a company who is directly or indirectly, concerned or interested in a contract or agreement entered or proposed to be entered into with the company, must disclose his interest to the company at the Board meeting (Section 184).
- ➔ Further, for making purchase of goods and materials and sale of goods, materials and services to certain parties in which directors are interested, it is necessary to ensure that the prices are reasonable.
- ➔ The remuneration paid to the directors of public companies or the private companies which are the subsidiaries of public companies should be in accordance with the provisions of section 197 of the Companies Act, 2013.

2. Payment for Acquisition of Assets

- (a) The payment for acquisition of assets should be made under proper authorization and be duly supported by receipt for amount paid.
- (b) Check the title deeds in case of purchase of immovable properties. Also ensure that the ownership in case of the moveable asset has been registered in the name the purchaser.
- (c) The auditor should also verify the existence, value and the title of the assets acquired.
- (d) In case of a company, ensure that the provisions of section 179 of the Companies Act, 2013 have been complied with.
- (e) Check that the cost of the asset purchased has been properly capitalized in the books of account. Thus, the amounts paid to bring the asset to their present condition or location and incurred upto the asset being put into use should be capitalized. Further such taxes (e.g. CENVAT) which are recoverable from the authorities shall not form the part of cost of the asset.

3. Payments controlled by the Companies Act, 2013- As per section 179 & 180, the Board of Directors of a public company or of a private company which is a subsidiary of a public company, shall not, except with the consent of such public company or subsidiary in general meeting, exercise the following powers:

- ➔ Sell, lease or otherwise dispose of the whole or substantially the whole of the undertaking or undertakings of the company.
- ➔ Remit or give time for repayment of any debt due by director(s), except in case of renewal or continuance of an advance made b' a banking company in the ordinary course of its business.
- ➔ Invest, otherwise than in trust securities, the amount of compensation received by the company in respect of the compulsory acquisition, after the commencement of this Act, of any such undertaking referred in (i) above, or of any premises or properties used for any such undertaking and without which it cannot be carried on or an be carried on only with difficulty or only after a considerable time.
- ➔ Borrow monies where the amount borrowed together with monies already borrowed by the company apart from the temporary loans obtained from the company's bankers in the ordinary course of business, exceeds the aggregate of the paid up capital of the company and its free reserves; and
- ➔ Contribute amounts to charitable and other funds, not related to the business of the company or the welfare of the employees, the aggregate whereof exceeds in a financial year ` 50,000 or 5% of the average net profit, during the three financial years immediately preceding, whichever is greater.

4. Assets acquired on Hire Purchase Basis

- ➔ A movable asset, acquired on a hire purchase basis, should preferably be adjusted in accounts at its cash value by raising a liability for the amount payable to the financing company.
- ➔ The amount of interest payable along with each installment, whether separately or included therein should be debited to the interest account.
- ➔ Payments under a hire purchase agreement should be vouched having regard to the conditions contained therein.
- ➔ The amount, if any, paid as a penalty for late payment of installments should be debited as an expense instead of being added to the cost of the assets.

Vouching & Verification

5. Payment of Expenses

- ➔ Every item of expenditure should be written off in the year in which it is incurred, except where its benefit is likely to extend over a number of years. In such case, only a part of it may be written off in the year in which it is incurred and the balance carried forward as deferred revenue expenditure, to be written off in subsequent years.
- ➔ The amount of expenses should be written off as soon as practicable, on taking into account the nature of the expenditure and the period over which the benefit is expected to extend.
- ➔ Further, the auditor should be careful to see that Deferred Revenue Expenditure be distinguished from losses of an extraordinary character which sometimes also are carried forward, when it is not possible to write them off, in the year in which these are suffered either on account of inadequacy of profits or on account of the desire of the directors not to burden unduly the profits of a year.
- ➔ If the provision for outstanding expenses made in a past year turns out to be insufficient and the amount is material, proper disclosure of such a fact should be made in the accounts of the year in which any further amount is charged on that account.
- ➔ Only expenses incurred for the purpose or for the benefit of business are chargeable to it. The auditor therefore, should make certain, as far as practicable, that no personal expenses are charged to the business. In the case of a company, as per section 143, personal expenses, if charged to revenue, have to be reported, particularly those which are not covered by commercial practices or contractual obligation.
- ➔ It should be verified that all expenses incurred, whether paid or payable, have been included in the accounts and that where any part of an item of expenses relates to the period that extends beyond the close of the year, a proportionate amount thereof has been adjusted as prepaid expense.
- ➔ Where some of the expenses are found to have been adjusted in a lump-sum specially at the close of the year, these might be fictitious items introduced merely to reduce profits. These, therefore, should receive special attention of the auditor.

6. Payment of Taxes

- ➔ Payment on account of income-tax and other taxes consequent upon a regular assessment should be verified by reference to the copy of the assessment order, assessment form, notice of demand and the receipted challan.
- ➔ Payments or advance payments of income-tax should also be verified with the notice of demand and the receipted challan acknowledging the amount paid.
- ➔ The interest allowed on advance payments of income tax should be included as income and penal interest charged for non-payment should be debited to the interest account.

7. Customs and Excise Duties

➔ Custom Duty

- a) Check the bills of clearing agents duly supported by receipted Bills of Entry, where the custom duty has been paid by the Custom Agents. If a payment has been made directly, the Bill of Entry relevant thereto together with the receipt should be inspected.
- b) In the event of dispute where a provisional payment has been made, the amount determined as payable finally should be ascertained and any additional duty payable or refund of the amount paid in excess which is recoverable should be brought into account.
- c) In certain cases, drawback of customs duty is allowed if goods (imported or containing imported materials) are exported. The auditor should see that on export the refund of duty has been claimed.
- ➔ **Excise Duty** Excise duty is a levy on manufacture. The liability for the duty arises at the point of time at which manufacture is completed. The point of time at which duty is collected may be determined by consideration of administrative convenience. Normally, excise duty is paid before the issue of excisable goods from the factory. The amount thereof is deposited with the State Bank or any other bank notified by the excise authorities, to the credit of the Controller of Excise and the duplicate copy of the challan is forwarded to him for obtaining the permit.

The following points should be considered to verify such payments:

- a) The amount of duty paid must be checked with quantity of goods in respect of which the issue permits for the goods have been received.
- b) Check the triplicate copy of the TR-61GAR-7 challan, if available in the file in respect of such payments_ It will serve as an additional evidence of the duty having been paid.
- c) Certain entities maintain a current account with the excise authorities. In such a case, permits are issued in advance and duty is paid according to the quantity of excisable goods issued during each month or a shorter period.

Vouching & Verification

8. **Travelling Expenses-** Travelling expenses are normally payable to staff according to rules approved by directors or partners. Where no rules exist, the auditor should recommend that these be framed for controlling the expenditure. In the absence of T.A. Rules, the expenditure should be vouched on the basis of actual expenditure incurred. A voucher should be demanded for all items of expenses incurred, except those which are capable of independent verification.

As regards travelling expenses claimed by directors the auditor should satisfy himself that these were incurred by them in the interest of the business and that the directors were entitled to receive the amount from the business.

The voucher for travelling expenses should normally contain the undermentioned information:

- ➔ Name and designation of the person claiming the amount.
- ➔ Particulars of the journey.
- ➔ Amount of railway or air fare.
- ➔ Amount of boarding or lodging expenses or daily allowance along with the dates and times of arrival and departure from each station.
- ➔ Other expenses claimed, e.g., portorage, tips, conveyance, etc.

If the journey was undertaken by air, the counterfoil of the air ticket should be attached to the voucher, this should be inspected. For travel by rail or road, the amount of the fare claimed should be checked from some independent source. Particulars of boarding and lodging expenses and in the case of halting allowance the rates thereof should be verified. The evidence in regard to sundry expenses claimed is generally not attached to T.A. bills. So long as the amount appears to be reasonable it is usually not questioned. All vouchers for travelling expenses should be authorised by some responsible official. In the case of foreign travel or any extraordinary travel, the expenses, before being paid, should be sanctioned by the Board.

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

9. **Repairs to Assets-** Since the line demarcating repairs from renewals is slender. usually it is not a simple matter to determine the amount of the expenditure, if any, included as charges for repairs, which should be considered as that incurred for renewal of an asset and added to its cost. It may sometimes be possible to determine this on a consideration of the nature of repairs carried out.
- ➔ The proportion of the charges which had the effect of increasing the value of an asset or enhancing its capacity or life, should be treated as capital expenditure.
 - ➔ If it is not possible to form an opinion accurately on the basis of evidence as regards the nature of repairs, a certificate from the engineer under whose supervision the repairs were carried out, confirming the classification of expenditure should be obtained.
10. **Preliminary Expenses-** The expenditure incidental to the creation and floating of a company includes stamp duties, registration fees, legal costs, accountant's fees, cost of printing, etc.
- ➔ Check the contracts relating to preliminary expenses.
 - ➔ If preliminary expenses incurred by promoters have been reimbursed to them by the company, the resolution of the Board of Directors and the power *in* the Articles to make such reimbursement should be seen.
 - ➔ Examine the bills and statements supporting each item of preliminary expenses.
 - ➔ It should be seen that no expenses other than those which constitutes preliminary expenses are booked under this head. The auditor can cross check the amount of preliminary expenses with that disclosed in the prospectus, statutory report and the balance sheet.
 - ➔ Check that any amount which is paid in excess of the amount disclosed in the prospectus should have been approved by the shareholders.
 - ➔ Expenditure in connection with the preliminary expenses so far it has not been written-off should be separately disclosed under the head miscellaneous expenditure.
 - ➔ Further, see that Underwriting commission and brokerage paid for shares and debentures should not be included under the head preliminary expenses.
11. **Salaries and Wages-** The auditor should take into consideration the following points:
- (a) **Internal Control:** See that an adequate system of internal control exist as to the appointment, promotion, transfer and discharge of employees, recording attendance of workers engaged on the time basis, as well as particulars of jobs performed by piece workers, arrangement for the preparation of wages and salaries bills and their analysis, and sanctioning the disbursement of wages and salaries. The system of internal check should be operational one and that too in an effective manner.

Vouching & Verification

(b) Other matters:

- ➔ **Salary and Wage Bill:** Check the salary and wage bill in detail by reference to the record of attendance, schedule of rates, sanctioned by the management for different classes of workers and employees and the sanction for their payment.
- ➔ **Dummy Workers:** Examine that the salary and wage sheet contains no names of dummy workers. Also see that the employee or worker who has received the salary or wage has put his initials for the amount received against his name in the sheet.
- ➔ **Statutory Deductions:** Check the computation of wages and salaries payable to different workers and employees on taking into account the deduction and other factors such as leave pay, PF, ESI, TDS etc.. into consideration.
- ➔ **Mode of Payment:** Check whether the amount has been paid in cash or through cheque or through bank arrangements. Now a days, the companies are also giving the salary in the form of ESOPs etc.
- ➔ **Undisbursed Payments:** Ensure that all payments to workers and other employees have been acknowledged and amounts which have remained undisbursed have been deposited back in the bank and credited to the Unpaid Wages and Salaries Accounts.
- ➔ **Computation:** Test the correctness of the amount paid by reference to the Annual Return of Salaries, etc., submitted to the Income-tax Authorities and that of wages with Employee's State Insurance Cards.
- ➔ **Loans and Advances to employees or workers:** Where loans have been granted to employees or workers, the auditor should trace recoveries out of loans and advances, outstanding against employees into the Employees Loans and Advances Register.
- ➔ **Arrangement with Banks:** Where the enterprise has made arrangements with bank as to the deposit of salary and wages in say, 'Salary and Wage Account - XYZ Limited' with the bank, the auditor should prepare a reconciliation statement as to the amount withdrawn and not withdrawn by the employees or workers.

12. Petty Cash

- ➔ Trace the amounts advanced to the petty cashier for meeting petty office expenses from the Cash Book in the Petty Book.
- ➔ Vouch payments with docket vouchers which must be supported, wherever possible, by external evidence e.g., payee's receipted bill or invoices, cash memo, etc.
- ➔ Trace payments made for the purchase of postage stamps recorded in the Postage Book. The totals of the Postage Book should be test checked.
- ➔ Confirm that the postage expenses for the year are reasonable as compared with that in the postage expenses from month to month.
- ➔ Where a columnar Petty Cash Book is maintained, check that the extension have been carried forward into appropriate amount columns.
- ➔ Check the column totals and cross totals. Trace posting of the various columns in which payments are classified to the respective ledger accounts.
- ➔ Verify the cash balance in hand.

13. Research and Development Expenditure

- ➔ Ascertain the nature of research and development work to be carried out or that have already been carried out.
- ➔ If the expenses are routine development expenses, it should be seen that they are written off to the profit and loss account.
- ➔ Check whether the concerned research activity is authorised by the Board and has relevance to the objectives of the company.
- ➔ If any machinery and equipment have been bought specially for the purpose of research activity, the cost thereof, less the residual value should be appropriately debited to the Research and Development Account over the year of research.
- ➔ Ensure that the stipulations of AS-26 on Intangible Assets have been adhered to.
- ➔ Tax benefit arising on the research and development expenses should be taken into account in creating tax provision.
- ➔ No expense unrelated to the research and development programme should be allowed to be debited to Research & Development Account.

14. Advertisement Expenses

- ➔ Ascertain the nature of advertisement expenses to ensure that the same have been allocated properly, i.e. capital, deferred revenue or revenue.

Vouching & Verification

- ➔ Obtain the complete list of media of advertisement i.e., newspapers, hoardings, magazines, television, radio etc. showing the dates, exact location, timings, etc., along with the amounts paid in respect of each category.
- ➔ See that advertisement expenses relate to the clients business.
- ➔ Ascertain whether there is a regular contract with an advertising agency.
- ➔ Discounts, if any, should be properly adjusted and disclosed in the bills.
- ➔ Checks the receipts for amounts paid for the advertising expenses incurred.
- ➔ See that outstanding advertising expenses have been properly disclosed on the liabilities side of the balance sheet.

15. Retirement Gratuity to Employees

- ➔ Check the basis on which the gratuity payable to employees is worked out. The liability for gratuity may either be worked out on actuarial rules or agreement or on the presumption that all employees retire on the balance sheet date.
- ➔ Ensure that the basis of computing gratuity is valid.
- ➔ Verify computation of liability of gratuity on the aggregate basis.
- ➔ Check the amount of gratuity paid to employees who retired during the year with reference to number of years of service rendered by them.
- ➔ See that the annual premium has been charged to Profit and Loss Account in case the concern has taken a policy from LIC.
- ➔ Ensure that the accounting treatment is in accordance with AS-15.

Verification of Assets and Liabilities

Ans: “An enquiry into the Value, Ownership, Title, Existence, possession and presence of any charge on the assets”, while according to Lan Caster, “The verification of assets is a process by which the auditor substantiates the accuracy of the right hand side of the balance sheet, and must be considered as having three distinct objects –

- ➔ the verification of the existence of assets
- ➔ the valuation of assets and
- ➔ the authority of their acquisition.

• Meaning

Verification means “**Proving the truth**”. An auditor has not only to see the arithmetical accuracy and bonafides of the transactions in the books of accounts by vouching only, but has also to see that the assets as recorded in the balance sheet actually exist. The fact that there is an entry regarding purchases of an asset and has been found to be currently recorded, is not a proof that the asset is in the possession of the concern at the date of balance sheet. It is possible that after the asset had been acquired and the necessary entries made in the books of accounts, the asset might have been disposed of or pledged or mortgaged and no entry had been made regarding these facts in the books of accounts before the closing of the financial year. He has also to see whether a particular asset as appearing in the balance sheet exists or not. Verification of liabilities is also as important as the verification and assets. If the liabilities are overstated or understated, the balance sheet will not represent a true and fair view of the state of affairs of the Company.

verification is a function of examining assets & liabilities to check

- (a) Value
- (b) Ownership
- (c) Title
- (d) Existence
- (e) Possession and
- (f) to see whether the assets are free from any charge or encumbrance etc.

Vouching & Verification

- **Importance of Verification** – Verification is very important function from view point of both, the auditor and the client as it gives clear idea as to true and fair view of balance sheet. The importance of verification may be described as under –
 - (a) True and fair view of Balance Sheet – verification of assets and liabilities enables the auditor to comment on true and fair state of affairs of the business.
 - (b) Valuation – verification enables the auditor to determine whether the assets or liabilities are overstated or under stated.
 - (c) Omissions – verification facilitates the act of confirming the omission of any asset or liability in the balance sheet.
- **Scope of Verification** – verification includes confirming of whether the assets were in existence on the date of balance sheet, whether assets had been acquired for the purpose of business only, whether the assets had been acquired under a proper authority, whether the right of ownership of the assets vested in the enterprise, whether the assets were free from any charge and whether, the assets were properly valued and disclosed in the balance sheet.
- **Objects of Verification** – verification of assets and liabilities is done with the following objects
 - (a) To know whether the Balance-Sheet exhibits a true and fair view of the State of affairs of the business.
 - (b) To find out whether the assets were in existence
 - (c) To find out the ownership and title of the assets
 - (d) To show correct valuation of assets and liabilities
 - (e) To verify the arithmetical accuracy of the books of accounts
 - (f) To ensure that the assets have been recorded properly
 - (g) To detect frauds & errors, if any
 - (h) To find out whether there is an adequate internal control regarding acquisition, utilization and disposal of assets.
- **Advantages of Verification:** Careful verification of assets fetches the following advantages to the client -
 - (a) It avoids manipulation of accounts
 - (b) It guards against improper use of assets
 - (c) It ensures Proper recording and valuation of assets.
 - (d) It exhibits true and fair view of the state of affairs of the Company.
- **Technique of Verification** – Auditor may adopt the following techniques for verification of assets & liabilities.
 - (a) **Inspection** – This means physical inspection of the assets like counting cash in hand, measuring inventory, inspection of securities, share certificate etc.,
 - (b) **Observation** – The auditor may observe or witness the inspection of assets done by others.
 - (c) **Confirmation** – This means obtaining written evidence from outside parties regarding existence of assets like, confirmation from Debtors and Creditors about the balance outstanding etc.,
 - (d) How to conduct the verification work
 1. Examine the documentary evidence and see that the assets are properly recorded in the books of accounts.
 2. Verify the opening balance from the schedule of fixed assets, ledger or register.
 3. Verify acquisition on the basis of orders, invoices, title deeds etc.,
 4. Verify the self constructed assets on the basis of contractors bill, work order etc.,
 5. Ensure that the fully written off fixed assets are properly recorded.
 6. See the authority of disposal of fixed assets.
 7. Follow a proper procedure to ascertain the omissions, if any.
 8. Verify ownership of the fixed assets on the basis of title deeds.
 9. Verify existence of assets by physical verification. He should ensure that the physical verification of assets is carried out by the management.
 10. Test check the records of fixed assets with physical verification reports and see that discrepancies, if any, are properly dealt with.
 11. See whether the assets are charged. He should verify the Loan Agreements, Register of charge, Board Resolution, Share Holders Resolution
 12. He should keep in mind the following points while verifying the assets & liabilities –

Vouching & Verification

- (a) Whether the assets and liabilities are properly traced from ledger to Balance Sheet
- (b) Whether the assets are acquired for the business and liabilities got created for the purpose of business and are clearly stated in the Balance Sheet.
- (c) Whether the assets and liabilities are properly grouped under specified heads in the balance Sheet.
- (d) Whether the assets & liabilities are in actual existence on Balance Sheet date.
- (e) Whether along with ownership the possession of assets lies with the client.
- (f) Whether the assets are properly valued in the Balance Sheet
- (g) Whether the liabilities stated in the Balance Sheet tallies with the confirmation certificate.

Plant & Machinery :

Ans: As in case of industrial concern out of total assets 20% to 50% cost is that of Plant & Machinery and hence the auditor is required to take much more precaution while verifying the Plant and Machinery and for this he should give attention to following points-

- (a) He should get the detailed list of all Plant and Machineries and asset wise accumulated depreciation.
- (b) He should trace the opening balance in the Plant & Machinery register with the help of last year's audited balance sheet.
- (c) He should verify quotations, invoices, cost etc., in connection with Purchase of Plant & Machinery. If there are sales of Plant & Machinery in audit period he should verify the invoice to that effect. He should check the Board Resolution authorizing Purchases of Plant & Machinery.
- (d) If any machinery is disposed off and sold as scrap during the audit period, he should check the authorization and values report in that connection.
- (e) He should check the rates and calculation of depreciation and ensure these are according to the provision of Section 123 of the Companies Act, 2013.
- (f) He should check whether related expenses incurred on purchases of machinery are duly capitalized.
- (g) He should check whether proper accounting of profit earned or loss suffered on Sale of Machinery, during the audit period, is done.
- (h) If any machine is manufactured by the client it self, auditor should verify that capitalization of material, labor and other expenses is properly done.
- (i) He should obtain from the Company management certificate about the verification of all items as required under CARO. [Section 143]
- (j) He should scan the Plant register and physically inspect some of the major plants by visiting to the works.
- (k) He should, finally, ensure appropriate disclosure of all information on the balance sheet as required by the Companies Act.
- (l) He should obtain a certificate from the local auditor to that effect, if Plant and Machinery is kept abroad at a distant place.

Freehold Land and Building:

- (a) He should see that Freehold Land and Buildings are shown separately and not mixed with lease hold or other assets.
- (b) He should see that separate accounts for land and for buildings are mentioned because on land usually no depreciation is provided.
- (c) He should see that the balance shown on Balance Sheet is directly traceable from respective ledger account.
- (d) He should examine the title deeds of the property and see that the asset is in the name of the client and in the free and fair possession of the client.
- (e) He should examine that the title deed is genuine.
- (f) The Purchases during the year be examined with the related correspondence, broker's note, auctioneer's note.
- (g) In case of construction of the building auditor should examine the various certificates such as Builder's certificate, Contractor's certificates, Architect's certificate, Local authority certificate where needed.
- (h) He should verify the sale, if a part of property has been sold during the period under audit.
- (i) He should obtain a certificate from mortgagee if the property has been mortgaged and the deeds are with the mortgagee to verify the property.
- (j) Land is not subject to depreciation but see that proper depreciation is provided on building as per the provision of Section 123 of the Companies Act, 2013.

Vouching & Verification

- (k) See that the fluctuation in the value is not to be considered on Balance Sheet but if it has been considered then see that this is properly disclosed on Balance Sheet.
- (l) Auditor should physically verify the existence of asset.

Imported Plant & Machinery:

- (a) The Auditor should examine the directors Minute Book for the resolution passed authorizing the purchases.
- (b) The Auditor should check the RBI's permission and the import License.
- (c) The Auditor should examine the agreement with the foreign supplier, particularly check the terms of payment, interest rates and the basis of deferred Payment.
- (d) The Auditor should vouch the bills & receipts relating to purchases, customs duty payment, clearing & shipping charge, insurance premium
- (e) The Auditor should check the entries made in the books of account.

Revaluation of Fixed Assets

Ans: A revaluation means a revision of the book value of capital assets in accordance with a proper appraisal of such assets. Such appraisal includes establishment of proper values by a systematic procedure that encompasses:

- ➔ Physical examination of each unit of the plant.
- ➔ Engineering estimates of future working.
- ➔ Possibility of obsolescence

If a company revalues its assets and shows the same in the Balance Sheet at their replacement cost, depreciation in respect of such assets is to be provided on the basis of the revalued costs.

Any reserve created out of revaluation should not be used for distribution as dividend because revaluation by itself does not create any funds. Only provision of increased depreciation on the revalued cost will result in creation of funds to be utilized for replacement of the assets concerned.

Furniture & Fixtures :

- (a) Generally, furniture, fixtures and fittings are shown as one asset in the Balance Sheet, but auditor should remember that there is a distinction between them. Furniture, is movable e.g. chairs, fixture is tightly fixed to the ground e.g. science laboratory, while fittings are fitted on the walls e.g. electric wiring.
- (b) See that furniture, fixture & fittings register is properly maintained.
- (c) Verify that the balance from the register is correctly posted on the Balance Sheet.
- (d) See that proper depreciation is charged in each class as per the provision of section 123 of the Companies Act, 2013.
- (e) Check the invoices, quotations, orders and authorizations in regard to new purchases of furniture during the years.
- (f) Verify the sale of furniture and authorization for sale.
- (g) Check whether proper accounting is done for any profit earned or loss suffered on sale. Physically verify the existence of the furniture, fixture & fittings.
- (h) If acquired on lease, examine the conditions of lease and see whether these are followed duly or otherwise the lease will be forfeited.

Motor Vehicles :

- (a) Ensure whether the concern is maintaining proper and separate register giving full particulars of vehicles.
- (b) Check up whether opening balances have been properly traced in the register or not.
- (c) Check up whether the entries regarding new purchases and sales of old vehicles have been properly recorded or not.
- (d) Check up various documents such as agreement, invoices, bills, orders, authorizations etc., relevant to purchases & sales.
- (e) Check the auctioneer's statement, valuer's report etc., in case of sale of vehicle as scrap.

Vouching & Verification

- (f) See profit earned or loss suffered on sale is properly accounted.
- (g) Verify whether fair depreciation on vehicles is provided or not.
- (h) Verify registration & license to see all the vehicles are in the name of the auditee or not.
- (i) Verify physically all the vehicles by inspecting their registration numbers.
- (j) Check the certificate from lender in case R/C book of any vehicle is lying with the lender.
- (k) See whether proper insurance on vehicles are paid or not.

Goodwill :

Ans: Goodwill is intangible but not a fictitious asset and as such has value so long it remains with the business. Therefore its value depends upon the earning capacity of the business and fluctuates accordingly. Auditor, while verifying the goodwill, will take into consideration the following points –

- (a) Auditor should see how the goodwill gets created, if there was no opening balance, verify the value from the agreement of purchasers of business, minute books etc.,
- (b) Opening balance be verified from last year's audited Balance Sheet.
- (c) He should check the accounts and compare goodwill account with the Balance Sheet to ensure that goodwill account is clearly stated in the Balance Sheet and no other asset is mixed with it.
- (d) Satisfy himself by making a reference to the Articles of Association or Partnership Deed, as the case may be, if value of goodwill is enhanced or reduced during the year under audit.
- (e) Since goodwill is an intangible asset, verification of charge on it doesn't arise.
- (f) As goodwill is always valued at cost, a question of providing depreciation on it doesn't arise.

Investments:

- (a) Insist on a schedule of investments, when number of investments held by the auditee is very large.
- (b) Examine the investment schedule with reference to the relevant ledger accounts.
- (c) See that the investments have been shown properly in the Balance Sheet
- (d) He should verify the existence of investments by inspecting the certificate, deposit receipts etc.,
- (e) Obtain a certificate from bank of certain securities given to the bank for safe custody.
- (f) Examine the transfer deed, broker's contract note if certificate of investments is not received upto the date of audit of the securities purchased during the year under audit.
- (g) Examine the trust deed if securities are held by a trust on behalf of the client.
- (h) Verify the Sales proceeds from pass book of the sale of any securities made after the date of Balance Sheet but before the audit.
- (i) Verify relevant vouchers and certificates whether securities are free from any charge or not
- (j) See whether investments are properly valued or not giving consideration to the provisions of the Articles of Association in case of trust companies as they are valued at cost but in case of finance companies they are valued, being traded as current assets, at cost price or market price, whichever is less.
- (k) See that regarding the investments in subsidiaries, disclosure requirements of section 133 are complied with.
- (l) Check the balance in the schedule of investments in the name of the client and compare it with the general ledger and Balance Sheet. See that the investments are in the name of the client.
- (m) See that investments made by the company are not contrary to the provisions of section 186 of the Indian Companies Act, 2013.
- (n) In case of application money paid for shares which are still to be allotted, the fact is to be specifically disclosed in Balance Sheet.
- (o) Confirm that uncalled amount on partly paid shares held as investment is shown as contingent liability in Balance sheet.
- (p) The auditor has to report, as per section 143 of the Companies Act, whether any shares, debenture sold at price lower than their cost, in the case of finance company, whether proper records of investments are kept.
- (q) While auditing the investments the auditor should keep in mind the provisions of AS 13.

Vouching & Verification

Patents :

- (a) Examine the patents and verify them with the help of the certificate from the party granting the patents.
- (b) Ensure that the patents are duly registered in the name of the auditor.
- (c) Verify the voucher, pass book, agreement, authorization etc., in case of outright purchases of patents and see that the cost is fully capitalized.
- (d) Check the renewal fees, if any, paid is debited to Profit and Loss Account.
- (e) In case of patents developed by the client, expenditure incurred on its development, should be capitalized.
- (f) Call for schedule in case the number of patents is large and examine the dates and acquisition, description and expiry date etc.,
- (g) Question of charge on patents does not arise as it itself is a right in use.
- (h) See that proper depreciation is provided on patents as per the provision of the Companies Act.

Trade Marks

- (a) See that the trade Marks are registered in the name of the auditee.
- (b) See whether it is shown distinctively in the Balance Sheet.
- (c) Check the Assignment Deed to ascertain the Terms and Conditions of the acquisition of Trade Marks to see whether the terms are followed properly.
- (d) Obtain a schedule of Trade Marks if those are in large numbers.
- (e) See that the renewal fee is regularly paid.
- (f) Verify the valuation of Trade Marks to see whether it is properly done or not.

Copy Rights

- (a) Verify copyrights with agreements.
- (b) See whether revaluation of copyrights is made properly and profit or loss is properly accounted.
- (c) Obtain the certificate of approved valuer to that effect.
- (d) See that the balance exhibited on balance sheet can be traced from ledger account.
- (e) Verify the opening balance from last year's audited balance sheet.

Sundry Debtors

- (a) Trace the opening balance from last year's audited Balance Sheet.
- (b) Obtain Sundry Debtors' schedule from the management and compare it with ledger accounts.
- (c) See the debtors are shown properly on Balance Sheet.
- (d) See that the provision for bad debts, discounts etc., is properly made.
- (e) Examine the relevant vouchers, minute book for verifying whether bad debts written off are correct or not.
- (f) See that the legal requirements of schedule of the Companies Act, 2013 are duly complied with. For this purpose the debtors are to be classified as –
 - ➔ Debtors outstanding for a period exceeding six months and
 - ➔ Other Debtors also, particulars to be given separately of –
 - ➔ Debts considered good and in respect of which the Company is fully secured.
 - ➔ Debts considered good for which the Company holds no security other than the debtors' personal security.
 - ➔ Debts considered doubtful or bad. Over and above these requirements, 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 to be disclosed separately. Debts due from other Companies under the same management to be disclosed with the name of the Companies. The maximum amount due by directors or other officers of the Company at any time during the year to be shown by way of a note.

Vouching & Verification

- (g) If the customers have purchased the goods on hire purchase basis and some of the installments are not due, the same is not to be shown as debtors, instead they are to be shown on "Stock out on "hire purchase" at cost.
- (h) If the goods are sold on Sale or approval basis, such customers cannot be shown as debtors unless they have agreed to purchase the same before the date of the Balance Sheet.
- (i) Whenever there are credit balance in debtors accounts, the same should not be deducted from other debtors' debit balance. Such credit balance is to be shown on the liability side separately.
- (j) Enquire whether there is any dispute regarding any balance included in debtors. The auditor should verify the document regarding any dispute.
- (k) The auditor should ascertain that there are no unrecorded debtors and for he has to examine the cut off transactions. He should examine the cut off procedures to ensure separation of transactions of the current year from the next year. Sale of the current year should be separated from the sale of next year. He shall ensure that sales bills are prepared for goods dispatched. No sales bills are raised unless the goods are actually dispatched and sold during the accounting year.
- (l) The auditor shall check collection from debtors in the next year to decide whether the year end balances are good or not. If debtor has become insolvent, after the date of Balance Sheet, such debtors should be provided for.
- (m) The auditor should arrange to send the letters of confirmation balance by the client as per clients record and see that the reply of confirmation is forwarded to his office directly, usually this should be sent within 15 or 20 days of year ending date under the supervision of audit staff. After the reply is received, the same should be tallied with the balance shown in the debtors ledger and differences, if any, be reconciled.

Stock in Trade

Ans: This is an important asset and may be used to fabricate profit and give misleading Balance Sheet and hence an auditor is required to take lot of care and caution while verifying stock in trade and for following points be considered –

- (a) Verify whether an efficient internal check system regarding stock is in operation or not.
- (b) Compare the stock register with purchases and sales book, in regard to question
- (c) Check the gate keepers' outward register to find out whether any fictitious sale has been entered in Sales Book.
- (d) Check the Stock sheets and Calculations, additions, costing etc., there in.
- (e) See that goods sold but not delivered are not included in Closing Stock.
- (f) See that goods purchased, invoices received but delivery yet to be received are included in the Closing Stock.
- (g) See that goods received from others to be sold on their behalf are not included in Closing Stock.
- (h) See that furniture, tools etc., are not included in Closing Stock.
- (i) Compare the balances of Stock Register with the Stock sheets.
- (j) Method of stock taking may be enquired into, to find out possibilities of frauds and errors.
- (k) Examine the principle followed in the valuation of stock to ensure that those were followed in previous years.
- (l) Check whether stocks are valued on the basis of "Cost price" or "Market price" whichever is less or not.
- (m) Compare the Gross Profit rate of current year with that of previous years, if considerable variation is found, that should be enquired into in detail.
- (n) Determine the obsolete, slow moving, non-moving and damaged item and ascertain their treatment in accounts.
- (o) Obtain a certificate from the management to the effect that the stock sheets are accurate and confirming that they have been signed by responsible person.
- (p) In case of the manufacturing concern the goods may be of following categories and should be valued and verified after taking above points into considerations and checking the relevant cost recorded like purchases requisitions, material requisitions, goods received notes, bin card and stores ledger etc.,
 - ➔ Raw materials
 - ➔ Work in Progress
 - ➔ Finished goods
 - ➔ Stores & Spare parts.
- (q) Ensure that the various components of Stock have been separately disclosed in the Balance Sheet with their mode of valuation.

Vouching & Verification

Loose Tools:

Ans: Loose tools at the end of the year should be checked by the auditor as follows:

- (a) The auditor should see that the cost of loose tools is properly determined and certified by the Chief Engineer.
- (b) If the loose tools are manufactured by the organization, the authorized officer shall certify the value of such tools.
- (c) He should physically verify these tools or obtain a list of tools duly certified by the responsible officer. Any discrepancies shall be investigated.
- (d) Ensure that the closing stock of tools is valued at cost. See that the valuation is done on the basis, which is consistent taking in to consideration obsolescence, damage, brokerage etc.,
- (e) See that the loose tools are disclosed in the Balance Sheet on asset side under the head "Current Assets".

Live Stock :

- (a) See the live Stock Register and note down carefully the particulars like breed, year of purchases, purchase price, depreciation etc., for various categories of animals.
- (b) See that some identification number is given to identify the animals.
- (c) Examine the basic of valuation of animals. In case the animals are purchased at the age of maturity the cost will include Purchase Price plus freight. If the animal is reared from its conception and then brought to Maturity the cost includes cost of calving, cost of fodder etc., consumed till maturity and the suitable share of overheads.
- (d) See that the cost up to the maturity stage of animal has been written off once the earning capacity of the animals starts declining over the remaining life.
- (e) Ensure that disposal value at the end of the life of the assets has been adjusted properly.

Bills Receivables :

- (a) Get the schedule of bills receivables from the management.
- (b) Check the total of the Schedule with the ledger.
- (c) Check each bill to ascertain whether it is properly drawn, signed by the drawee and properly stamped or not.
- (d) Verify the Cash received on the matured bills after Balance Sheet date.
- (e) Check the bills discounted with the B.R. Book and Cash Book.
- (f) See that relevant foot note by way of contingent liabilities regarding bills discounted but yet not matured, properly appears on Balance Sheet.
- (g) Verify the bills deposited with bank for safe custody or for collection or for securities of loans, with the bank certificate to that effect.
- (h) Check the cash book and rebate / discount in connection with the proceeds received from retired bills before maturity.
- (i) Trace the balance shown in Balance Sheet from the ledger account. Check the opening balance from last year's audited Balance Sheet.

Cash in Hand :

- (a) Visit the auditee's premises and physically count, whole of the cash at a time and compare it with the balance shown on Cash Book.
- (b) He should not accept IOU's as cash.
- (c) If cash could not be counted on last day of the year he may visit as per his convenience and count the cash and check the cash book from the end of the last year to the date as and when cash is counted to verify the correctness of each balance at the end of last year.
- (d) If actual cash counting is not possible ask the auditee to deposit whole of the cash in hand at the close of the year into bank, then the Closing Cash Balance gets automatically checked.
- (e) Whatever it may be, auditor should pay surprise visit to auditee and count the cash to prevent the cashier to borrow money and make up the deficiency which was due to embezzlement in the past.
- (f) Get certificates from the auditors of the branches about the cash balance in hand and their correctness.
- (g) Check the documentary evidences in reference to the cash in transit.

Vouching & Verification

- (h) See that the cash in hand is properly shown on the Balance Sheet.
- (i) See if the large number of post dated cheques is found in hand on the date of balance sheet, the same are not treated as realised/collected during the audit period.
- (j) see the form and quantum of mutilated notes/coins is not large enough considering the size and nature of the business. Also see that such mutilated coins/notes are exchanged at the earliest.

Cash at Bank

- (a) Compare the balance as shown in the Pass Book with balance of Cash shown in the bank column of Cash Book.
- (b) Prepare Bank Reconciliation Statement to ascertain the reasons behind the difference between Pass book balance and Cash book balance.
- (c) Obtain a balance certificate from the bank in case of suspicion of presentation of fictitious pass book and compare the balance with Cash book.
- (d) Obtain separate certificates for different accounts or deposits with the bank for proper verification of different balances.
- (e) See that “The charges not yet collected” are genuine and not made up in order to conceal the deficiency.

Loans and Advances

Ans: Loans and advances may be of different types like –

- (a) Loans against the security of Land & Building.
- (b) Loans against the security of goods.
- (c) Loans against the security of stocks & shares
- (d) Loans against the security of Insurance Policies
- (e) Loans against the personal Security of the borrower.

- Therefore, in each case the duty of auditor in general is as under:
 - (a) Examine whether a proper loan ledger has been maintained upto date or not.
 - (b) Examination of the Security ledger against each loan.
 - (c) Examine the loan agreement and find out the rate of interest, due dates of installments, penalty, interest etc.,
 - (d) Ascertain whether any loan is doubtful of recovery. In case it is doubtful, a provision for the expected loss is to be made.
 - (e) Verify that loans have got proper sanction from the authority.
 - (f) Obtain a letter of confirmation from the parties to whom loans are advanced.

In case of loans to directors, prior approval of the Central Government is obtained.

➔ Loans Against The Security of Land & Buildings

- (a) Examine the mortgage deed in depth and to confirm that the mortgage has been properly executed in favour of the lender.
- (b) Examine the title deeds deposited.
- (c) Examine the Valuer's certificate, in order to verify the value and see that the value is adequate.
- (d) Confirm that the property is properly insured and insurance premium has been paid in time.
- (e) Examine the title of the borrower in connection with property etc.,
- (f) Take the acknowledgement of title deeds from the first mortgage in the case of second mortgage.
- (g) Confirm that the mortgage is properly registered.
- (h) The amount of loan should not be more than two thirds of the value of property.
- (i) The auditor should enquire the rated interest and the date on which it is payable; if the loan has been outstanding for a long time, he should make an enquiry when the interest has not been paid.
- (j) In the case of loan on mortgage of lease hold land, the auditor should see that the ground rent has been paid regularly by the borrower on the due date.
- (k) In the case of part repayment of loan, the auditor should get the loan confirmed.

Vouching & Verification

➔ Loans Against The Security of Goods.

- (a) Examine the nature of the goods and confirm that the goods are belonging to the borrower.
- (b) Verify whether loan is granted against railway receipts, lorry receipt, dock warrant, godown keeper's receipt etc.,
- (c) See that the rent of godown is paid in full and the goods are fully insured if the goods are stored in godown.
- (d) Examine the value of goods by comparing them to the present market value. He may rely on the inspector's report regarding quantity and quality.
- (e) Examine the turnover of the client if the goods are perishable.

➔ Loans Against Security of Stocks & Shares.

- (a) Call for a statement of stocks and shares given as security.
- (b) Confirm that all shares are fully paid up
- (c) See that an instrument of transfer, properly stamped is available for his checking.
- (d) See that the value is properly disclosed as per the market rates.
- (e) Ensure that there is a sufficient margin for the loans advanced.
- (f) Ensure that the charge is properly registered.

➔ Loans Against The Security of Insurance Policies.

- (a) See that the policy has completed at least two years from the date of the first premium.
- (b) Confirm that all the premiums have been properly paid and policy is in force.
- (c) Ascertain that the due notice has been given to the insurance company.
- (d) See that loan has been advanced on the basis of surrender value of the policy as certified by the insurance company.
- (e) Confirm that the premium, if any, paid by the lender to keep the policy in force is debited to loan account of the borrower.

• **Trade Creditors**

- (a) Ask for a schedule of creditors and check the same with purchase ledger already examined by him.
- (b) Verify posting in the purchase ledger
- (c) Ensure that all purchases made during the year especially at the end of the year are included in the accounts of the creditors.
- (d) In case of suspicion, ask for the statement of account to be sent and verify the same along with scrutiny of ledger account and reconcile the differences, if any,
- (e) See the various debits given for discount, goods return etc., are genuine
- (f) Enquire into the reason for non payment of overdue creditors. It is possible that amount might have been misappropriated.
- (g) Examine some purchase invoices and confirm that they are relating to the year under audit.
- (h) Test check returns and see that they are supported by credit notes of the suppliers.
- (i) Obtain confirmation from the parties.
- (j) Also, the auditor should keep in mind the following guidelines about audit of creditors.

• **Internal control** – The auditor should review the following aspects of internal control relating to creditors -

- (a) Proper recording of transactions and linking of payment with outstanding.
- (b) Periodical schedule of creditors.
- (c) Follow up action on overdue accounts
- (d) Payment to creditors as per the approved policies.
- (e) Statement of accounts obtained from creditors.
- (f) Proper adjustments in creditors accounts regarding purchase returns, cash discount, trade discount etc.,
- (g) Cut off Procedure regarding creditors.

Vouching & Verification

- **Verification** – The auditor should employ the following procedures **Examination of Records** –

- (a) Carryout appropriate procedure to judge the adequacy of cut off procedure. Ensure that documents relating to receipt of goods before the year end are recorded.
- (b) Look into the difference between total of creditors balance and the control account balance
- (c) Examine relevant correspondence for verification of validity, accuracy and completeness of creditors.
- (d) Pay attention to outstanding items claims for short supply, poor quality, discount etc., Examine correctness of transfer from one account to another.
- (e) Examine any unusual payments at the end of the year.
- (f) Confirm material liabilities at the end of the year.

- **Confirmation**

The direct confirmation for creditors is similar to that adopted for debtors.

- **Disclosure**

The auditor should examine whether creditors are disclosed properly in the financial statements.

- **Certificate from the Management**

Obtain a certificate from the management that all the known liabilities have been recorded in the books of accounts.

- **Working Papers**

The auditor should verify all the working papers relating to creditor.

- **Provision for Taxation**

- i. See that the provision for taxation made in the current year is adequate taking into account the profit made, deductions and any other allowances as per Income Tax Act. The auditor should see that suitable adjustment is made in respect of additional demand or refund as the case may be. Material Tax liability for which no provision is made should be disclosed in the report.
- ii. Get a Statement of Income.
- iii. Vouch advance payment of Income tax referring to the challans and bank statements.
- iv. Ensure that Provision for taxation for the current year is shown separately in the Profit and Loss account and in the Balance Sheet.
- v. In case the tax liability determined is more than that provided for against which the company might prefer an appeal before the high authority, a reference to this effect should be made in the accounts. Where an application for rectification of mistakes u/s 154 of the Income Tax Act, has been made the amount of tax decided is considered or disputed. As per AS4, the disputed tax liability may require a provision and suitable disclosure. The auditor should enquire from the management, review minute of the meeting of the BOD and correspondence with the lawyers for determination of the Provisions.
- vi. Examine the assessment completed, revised or rectified during the year.

- **Provision for Proposed Dividend**

- i. See that there is an adequate Profit for declaration of dividend.
- ii. Check the minute books recommending dividend to ascertain the rate of dividend recommended.
- iii. Verify the calculation of proposed dividend and see whether it is provided on the paid up share capital only, excluding the calls in arrears and forfeited shares.
- iv. See that it is properly exhibited in the final accounts.

- **Provision for Expenses Not Allowable Under Income Tax Act**

- i. The expenses not deductible in the calculation of tax liability can be debited to profit and Loss account, hence auditor should verify if any of such expenses appear in Profit and Loss accounts.
- ii. Verify the correctness of the amount.
- iii. See whether those 'not allowable expenses' are re-added in the profit of the year to calculate the expected tax liability and the provision for taxation is made accordingly or not.

- **Secret Reserve:**

Any reserve not appearing on the Balance Sheet is called as a Secret Reserve. The existence of the reserve may be inferred from an intelligent verification of the accounts by the auditor even though the amount cannot be ascertained. Generally such type of reserve appears in financial institutions and insurance companies. Secret reserve may be created by –

Vouching & Verification

- i. Writing down the assets much below their cost
- ii. Providing excessive depreciation
- iii. Providing more reserve for doubtful debts etc.,
- iv. Writing down the goodwill considerably
- v. Omitting certain assets from Balance Sheet
- vi. Charging capital expenditure to revenue account
- vii. Over valuing the liability.
- viii. Showing contingent liabilities as real liabilities etc., According to the Provisions of Companies Act, 2013, creation of Secret Reserve is prohibited except in the case of banking, financial, insurance and electricity companies.

• **To verify the secret reserve, if any, the auditor should keep in mind the following points :**

- i. Carefully enquire into the necessity of creating such reserve.
- ii. Don't qualify audit report if it is found that the intention of the company is honest and the amount is reasonable.
- iii. May pass a remark in audit report that the assets are understated,
- iv. Discuss the fact, if found, that the director's intention behind creating secret reserve was not honest and only to facilitate improper dealing in shares.

• **Contingent Liabilities :**

The liability which depends on happening or not happening something is called as contingent liability. This liability may involve payment of revenue nature incurring losses or involves the acquisition of asset.

Examples

- i. Disputed claims by workers for compensation
- ii. Bills Discounted
- iii. Guarantees given in favour of others
- iv. Amount on incomplete contracts
- v. Calls unpaid on partly paid shares
- vi. Payment of gratuity under Industrial Dispute Act,
- vii. Preference dividend in arrears.

• **Verification –**

Auditor should carefully verify contingent liabilities as it may become actual liability on happening or not happening certain events and while verifying keep in mind following points.

- i. Obtain certificate about the contingent liabilities disclosed in the Balance Sheet, from a responsible officer.
- ii. Carefully examine whether such liabilities are in existence or not.
- iii. Check relevant documents to confirm the existence of contingent liability.
- iv. Verify the certified list given by responsible officer to ascertain whether there exists any contingent liability which may turn to be an actual liability.
- v. Verify whether proper provision is made or not for the contingent liability turned out to be an actual liability.
- vi. Verify bill discounting register, investment register, minute book and other relevant records to establish the amount of contingent liability.
- vii. See whether contingent liability is properly disclosed in the Balance Sheet.

Vouching & Verification

- **Capital Reserve:**

It is not defined by the Companies Act, 2013. It may be defined as any profit or reserve earned on sale or purchase of capital asset and / or business and which cannot legally be distributed among share holders. It is created out of abnormal and non-trading profits like premium received on issue of shares, balance remaining after reissues of forfeited shares on share forfeited account, profit earned on amalgamation, absorption or reconstruction of companies, Capital Redemption reserve, Profit prior to incorporation etc. While verifying this reserve an auditor should keep in mind, following points –

- i. See whether the capital profits transferred to this reserve are really surpluses of capital nature or not.
- ii. See whether the Capital Reserve is utilized according to the provisions of Articles of Association or not.
- iii. See whether it is properly exhibited on Balance Sheet or not.

- **Gratuity:**

- i. Auditor should see that proper provision is made for the gratuity and if not whether the auditee has disclosed the amount not provided for
- ii. As provided in the Companies Act, amended in 1988, the auditor should qualify his report if the company has not provided for gratuity either wholly or partly.
- iii. He should check the calculation made for provision of gratuity and confirm whether it is based on the periodical actuarial valuation or not.
- iv. See whether gratuity is provided for on a net of tax basis then the gross amount is properly disclosed.
- v. See that the method used for calculating the provision for gratuity is disclosed and see the significance of such cost to the company.
- vi. Auditor should keep in mind the provisions of AS 15 while verifying the provision made for gratuity.