

MTP 4 (Ch. 5 – Audit of Items of Financial Statements)**Instructions: Part A comprises of MCQ.****Part B Comprises of descriptive questions.****Part – A (Multiple Choice Questions)**

- Q.1 (c) Statement I is false. However, statement II is true. (2 Marks)
- Q.2 (a) Name of body corporate in which investment is made, Basis of valuation of individual investment, aggregate amount of quoted investments and their market value. (2 Marks)
- Q.3 (d) Statement I is false. Statement II is true. (2 Marks)
- Q.4 (d) Existence. (2 Marks)

Part B (Descriptive Questions)

- Q.1 (i) Assertions:**
- (a) The auditor will check the Existence Assertion to ensure Assets, liabilities and equity balances exist as at the period end.
- (b) The auditor will check the Cut-off assertion to ensure that all assets and liabilities are reported in the appropriate period. www.altclasses.in
- (c) The auditor will check Completeness Assertion to ensure all Trade receivable balances that were supposed to be recorded have been recognized in the financial statements.
- (d) The auditor will check Rights & Obligations assertion to ensure that the entity has valid legal ownership rights over the inventories claimed to be held by the entity and recorded in the financial statements.
- (e) The auditor will check Valuation assertion to ensure PPE have been valued appropriately and as per generally accepted accounting policies and practices.

1 Mark for each Correct Point (5 Marks)**(ii) Attributes to be examined while vouching expenses:**

An entity in addition to making purchases and incurring employee benefit expenses, also incurs other expenditures like rent, power and fuel, repairs and maintenance, insurance, travelling, miscellaneous expenses etc., that are essential and incidental to running of business operations.

While the auditor may choose to analyse the monthly trends for expenses like rent, power and fuel, an auditor generally prefers to vouch for other expenses to verify following attributes:

- (i) Whether the expenditure pertained to current period under audit;
- (ii) Whether the expenditure qualified as a revenue and not capital expenditure;
- (iii) Whether the expenditure had a valid supporting like travel tickets, insurance policy, third party invoice etc.;
- (iv) Whether the expenditure has been classified under the correct expense head;
- (v) Whether the expenditure was authorised as per the delegation of authority matrix;
- (vi) Whether the expenditure was in relation to the entity's business and not a personal expenditure.

1 Mark for each Correct Point (Any Five)

Q.2 Audit of Trade Receivables:

In the given situation, the auditor is verifying Completeness assertion by ensuring that all goods dispatched prior to the year-end have been invoiced. **(1 Mark)**

Audit procedures to be adopted by the auditor to verify the Completeness assertion are as under:

- Check that in respect of invoices raised in last few days nearing the cut-off date, goods have been actually dispatched and not lying with the company.
- Test invoices listed in receivable report. Select few invoices from the accounts receivable ageing report and compare them to supporting documentation to see if they were billed with the correct amounts, to the correct customers, and on the correct dates.
- Match invoices to shipping/ dispatch log. Match invoice dates to the shipment dates for those items in the shipping/ dispatch log, to see if sales are being recorded in the correct accounting period. This can include an examination of invoices issued subsequent to the period being audited, to see if they should have been included in the period under audit.
- Assess bill and hold sales. If there is a situation where the Company is billing customers for sales despite still retaining the goods on-site (known as "bill and hold"), examine supporting documentation to determine whether a sale has actually taken place or not.
- Review the receiving log to see if the Company has recorded an inordinately large amount of customer returns after the audit period, which would suggest that the Company may have shipped more goods near the end of the audit period than what the customers had authorized to inflate the profits of the company.
- Review the process of giving discounts/ incentives and check whether the same were given as per the Company's policy/ general industry trends.

1 Mark for each Correct Point (Any Four Points)

Q.3 Audit of Purchases:

CA Amit is verifying Occurrence Assertion while verifying the existence of vendors and the actual receipt of goods or raw materials by the company. **(1 Mark)**

The audit procedures generally required to be undertaken while verifying Occurrence Assertion:

Ensure purchases are not understated/ overstated by performing following audit procedures:

- Whether any fictitious vendors have been booked or purchases have been recorded by reviewing the vendor selection process followed by the entity and also performing procedures to ensure existence of the vendors.
- Whether the goods were received at the factory gate and whether there exists an entry in the security gate inward register.
- Whether quality inspection of goods was done.
- Whether a goods receipt note was prepared and signed by an appropriate client personnel.
- Whether the purchase invoice was approved as per delegation of authority and whether a 3 or 2-way match was done.
- Whether stock record has been updated by the stores personnel.

1 Mark for each Correct Point (Any Two Points)

Special considerations during audit of purchases:

- The purchase invoice received should be the “Original” copy (and not photocopy/ carbon copy) against which the entity has recorded the purchase in its books of account.
- Purchase invoice should have been booked only once risk and reward incidental to ownership has been transferred to the entity. Specific consideration for cases where the terms of delivery as agreed with vendor are F.O.B., C.I.F. etc.
- Purchase invoice should be in the name of entity. However, in case of different branches, it should be addressed to the appropriate branch.
- Input tax component should have been booked in the input tax ledger. The auditor should obtain tax returns filed with the authorities and tally the input tax as reflected in the books to the amount disclosed in the returns.
- In case of purchases made from related parties or allied and associated concerns, the auditor needs to verify if requisite approval from Board of Directors (appropriate authority) has been obtained and should verify the selected samples and perform analytical procedures in relation to price of goods to confirm that the price charged is at arm’s length.
- The auditor should review whether purchases should be capitalized or expensed off in Statement of Profit and loss according to his professional judgement.
- Review journal entries for unusual transactions.

1 Mark for each Correct Point (Any Two Points)

Q.4 Audit Procedure to establish the Ownership Rights:

- (1) Vouch recorded purchases to underlying documentation (purchase requisition, purchase order, receiving report, vendor invoice and cancelled cheque or payment file).
- (2) Evaluate the consigned goods.
- (3) Examine client correspondence, sales and receivables records, purchase documents.
- (4) Determine existence of collateral agreements.
- (5) Review consignment agreements.
- (6) Review material purchase commitment agreements.
- (7) Examine invoices for evidence of ownership i.e. the invoices shall be in the name of the client.
- (8) Obtain confirmation for significant items of inventory.
- (9) For instances of inventory held by third party, auditor should insist on obtaining declaration from the third party on its business letterhead and signed by an authorized personnel of that third party confirming that the items of inventory belong to the entity and are being held by such third party on behalf of and for the benefit of the entity under audit.

1 Mark for each Correct Point (Any Five)

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