

# Checklist For Finalization of Accounts and Audit

(Baroda CPE Study Circle of WIRC)



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## Introduction: Maintenance of Books of Accounts

- Whether Maintenance of Books of Accounts is compulsory?
- Whether Company Law/Income Tax Law requires compulsory maintenance of books of accounts?
- What are the Methods of Accounting?
- Whether a person is free to select any method of accounting?
- Whether he can change the Method of Accounting?

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## Introduction: Maintenance of Books of Accounts

- As per the provisions of Sec.44AA and Rule 6F of I.Tax Rules:
  - (a) A person carrying on a specified profession and having gross receipts exceeding Rs.1,50,000/- shall maintain prescribed books of accounts.
  - (b) A person carrying on a specified profession and having gross receipts not exceeding Rs.1,50,000/- shall maintain such books of accounts as will enable the AO to compute his total income.
  - (c) A person carrying on any business or a non-specified profession having income from business/ profession exceeding Rs.2,50,000/-\* (1,20,000/- up to A.Y.17-18) or having total sales/ gross receipts exceeding Rs.25,00,000/-\* (10,00,000/- up to A.Y.17-18) in any of the three years immediately preceding the previous year or likely to exceed in the first year of such business shall maintain such books of accounts as will enable the AO to compute his total income.

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## Introduction: Maintenance of Books of Accounts

- As per the provisions of Sec.44AD & 44ADA of I.Tax Act:
  - (a) An Eligible Assessee (Resident Individual, HUF or Partnership Firm) carrying on any business and having total turnover/ gross receipts not exceeding Rs.2 Crore (from A.Y.17-18) can opt for presumptive taxation scheme under Sec.44AD where the income shall be estimated @ 8% (6% for digital turnover) of the gross receipts/ turnover and,
  - (b) In case of Professionals, if the gross receipts don't exceed Rs.50.00 lakh, the income will be estimated @ 50% of total receipts u/s 44ADA (from A.Y.17-18).
  - (c) Such assessee shall be exempted from maintenance of books of accounts related to such business as required under Sec.44AA of the Act.
  - (d) If the taxpayer wants to declare the income at a lower rate than 8% (or 6%) then, he shall have to maintain the books of accounts as per Sec.44AA if his total income exceeds the exemption limit and he shall have to get his accounts audited under Sec.44AB irrespective of the amount of the turnover.

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## Introduction: Method of Accounting

- As per the provisions of Sec.145 of the Income Tax Act :
- Income chargeable under the head “PGBP” or “Income from Other Sources” is to be computed in accordance with the method of accounting regularly employed by the Assessee.
- Mainly there are two types of accounting methods – Mercantile System and Cash System of Accounting.
- Under the Mercantile System, Income or Expenses are recorded at the time of their occurrence as per accrual system. As per the provisions of the Companies Act,2013; it is mandatory for every company to follow the Mercantile System of Accounting.
- Under the Cash System of Accounting, Income or Expenses are recorded at the time of actual receipt or payment thereof.

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## Method of Accounting

- Choice and Change in the Method of Accounting:
- An Assessee may select Cash or Mercantile System of Accounting. The choice of method of accounting lies with the Assessee but, he must show that, he has regularly followed the method of accounting chosen.
- An Assessee may change the method of accounting for bona fide and justifiable reasons and then the changed method should be followed consistently.
- CBDT has notified Income Computation and Disclosure Standards (ICDS) vide Notification No.32/2015 dated 31.03.2015 applicable from the A.Y.2016-17 which are to be followed for the computation of PGBP and Income from Other Sources and not for the purpose of maintenance of books of accounts of the Assessee.

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## Method of Accounting

- Best Judgement Assessment under Section 144:
- In the following cases, the Assessing Officer may make a best judgment assessment under Sec.144 of the Act:
- (a) Where the AO is not satisfied about the correctness or completeness of the accounts of the Assessee.
- (b) Where the method of accounting as mentioned in Sec.145 has not been regularly followed by the Assessee.
- (c) Where the Tax Accounting Standards as notified by the Government have not been followed by the Assessee.
- Section 145(3) empowers the Assessing Officer to make a Best Judgment Assessment when he is not satisfied about the correctness or completeness of the accounts of the Assessee.

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## Checklist - Finalization of Accounts

- Some Simple Steps :
- The Process of Finalization of Accounts presupposes that –  
.....Accounting has been done properly.....
- So, First Step is to ensure that - Accounting has been done in a proper manner in accordance with GAAP.
- How to Verify – Take the Last Year's Audited Financial Statements  
.....And Compare and Analyse all the items....one by one from the Books of Accounts prepared by you..
- If there are any missing items of Expenses or Incomes ...Examine the Reasons...and ensure that there are no omissions/ duplications..
- Carry out Complete Scrutiny of All Ledger Accounts with an Auditor's Eye...
- Ensure Compliance with Income Tax, Excise/VAT/Ser.Tax/GST Law.
- Check Primary Ratios like GP-NP and RM Consumption Ratio.

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## Checklist - Finalization of Accounts

- Verify the following:
- Year End Cut-off Transactions for Purchase, Sales, Cash etc. Ensure that there is no omission/duplication of the A/c. Transactions..
- Identify Expenses Due but not paid, Prepaid Expenses, Income due but not received and Income Received in Advance.
- Entries for Provisions to be made – Provision for Depreciation, Provision for Salary/Wages Payable, Provision for Bonus & Ex-Gratia Payments, Provision for Audit and Professional Fees, Provision for Taxation, Provision for Other Expenses..
- Stock-Taking at the year end, Physical Verification of Stock – Preparing the Detailed Stock Statement with item-wise quantity and value thereof. Valuation of Stock to be done at the Cost or NRV whichever is less.

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## Detailed Process – Analyze P&L Items

- Start with P&L A/c....Income Side:
- (a) Sales – Ensure that all sale transactions are fully recorded. Cut-off procedures have been applied..Sales Data matches with Excise Records/ VAT Returns/ GST Returns.
- (b) Other Operating Incomes – Ensure that Operating Incomes like Job Work/Labour Income, Erection Income etc. are duly accounted.
- (c) Other Income - Ensure that Other Income like Interest Income, Dividend, Rent Income etc. are duly accounted.
- (d) Closing Stock –
  - - Complete Stock Taking should be done at the year-end.
  - - Prepare complete stock details with quantity, rate and total value. Follow Proper method of Valuation consistently.
  - ..No change in method of valuation without justified reasons...

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## Detailed Process – Analyze P&L Items

- Now, P&L A/c....Expense Side:
- (a) Purchases – Ensure that all purchase transactions are fully recorded. Cut-off procedures have been applied..Purchase figures matches with Excise Records/VAT/GST Returns.
- (b) Employee Cost–Wages, Salaries & Labour Charges - Ensure that these expenses are duly accounted and unpaid expenses have been provided for..Provision for bonus, gratuity and ex-gratia to be done...
- (c) Other Expenses - Ensure that Other Expenses like Administrative and Selling Expenses are duly accounted...Provision for Unpaid Expenses like Rent, Ele.bills, Tel.Bills, Sales Commission etc. Prepaid Expenses if any like Insurance, AMC etc..to be accounted properly..
- (d) Interest and Financial Charges – Ensure that Interest Payable on Term Loans, Vehicle Loans, Cash Credit etc. is fully accounted... Bank charges debited by Bank are fully accounted. In respect of Interest on unsecured loans, provision of interest is made and TDS is deducted.

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## Reconciliation with GST Returns

- In view of Introduction of GST from 01.07.2017:
- It is important to verify Sales, Purchases and Other Expenses with GST Returns and prepare a Reconciliation Statement thereof..
- (a) Sales – Verify and Reconcile the Sales Data filed in Form 3B with GSTR-1 filed by the Company.. Check the correctness of IGST, CGST and SGST charged and Paid and Reconcile the same..
- (b) Purchases – Ensure that all purchase transactions are fully recorded with proper GST details like Supplier's GST Regn. Details, HSN Codes, GST Tax Classification (IGST/CGST/SGST) and ensure that eligible GST Input Credit has been claimed.
- Verify that GST Input Credit as claimed and as reflected in GSTR-2A from GST Site are matching... If not, prepare a Reconciliation Statement and ask the party to take necessary actions.. If wrong Input credit has been taken, the same needs to be reversed..
- This exercise will facilitate GST Audit process also....

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## Analyze BS Items – Fixed Assets & Inv

- Now, Analyze Balance-Sheet Items...
- Asset Side:
- (a) Fixed Assets – Tangible & Intangible Assets –
- - Working of Gross Block, Depreciation and Net Block of Fixed Assets...Selection of Method of Depreciation & Rates..
- - In case of a Company, Rates of Depreciation as per Co.Law.
- - Working of Capital Work in Progress..
- List of Additions to Fixed Assets with Copies of the Bills, Depreciation Calculation – Details..
- Compliance of AS-10 relating to PPE and AS-26.
- (b) Investments – Long Term and Current Investments..
- - Proper Valuation of Investments.. Provision for Diminution in the Value of Investments.. (Compliance with AS-13 relating to Investments)

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## Analyze BS Items – Current Assets

- Current Assets :
- (a) Inventory/Stock – Detailed Stock Statement with details of method of Valuation of Stock Items..
- Verify the consistency in the method of valuation of stock..
- (b) Sundry Debtors – Obtain Balance Confirmation/ Reconcile.. Prepare List of Bad and Doubtful Debts....
- Bad Debts to be written off with Approval from Management.
- Doubtful Debts – Provision to be made with Mgmt. Approval.
- Prepare the break-up of Debts outstanding for more than six months...Also segregate Debts due from Related Parties – Firms/Cos. In which Partners/Directors are interested.
- Slow Collection -Useful MIS Report for the Management

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## Analyze BS Items – Current Assets

- (c) Bank Accounts –
  - Obtain Bank Statements and Balance Confirmation Certificates from Bank for all Bank Accounts.
  - Prepare Bank Reconciliation Statements..
- (d) Deposits and Loans & Advances Granted –
  - Prepare the List of Deposits and Loans & Advances Granted.. Verify whether these Deposits/Loans & Advances are really Recoverable???
  - Verify the Original Documentary Evidences for the Deposits/TDRs/Loans / Advances Granted...
  - Verify whether Interest/ Principal is regularly recovered as per terms on the Loans Granted???
  - If Recovery is Doubtful...Insist for Necessary Provision.. Qualify the Audit Report, if required..

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## Analyze BS Items – Share Capital

- Share Capital :
  - Whether increase in Autho. Share Capital during the year??
  - Verify Documentary Evidences like Copy of SH-7 filed with ROC with Challans, Resolutions etc..for Audit Purposes.
  - Details of New Shares issued/ Share Transfers during the year..
  - Keep Ready Documentary Evidences like Form PAS-3 filed with ROC with Challans, Resolutions, , Transfer Forms etc..for Audit Purposes.
  - Update all Statutory Records/Registers..Keep Ready for Audit.
  - Verify List of Shareholders as at the beginning and end of the year and check the reconciliation thereof. Verify the list of shareholders holding more than 5% of the equity shares in the Company. Verify details of fresh issue/ rights/ bonus issue or buyback/redemption during last 5 years.

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## Analyze BS Items – Secured Loans

- Secured Loans :
  - Verify Sanction Letter /Loan Agreements for the Loans taken..
  - Whether any new Loans Taken during the year??
  - Charge Registration done with ROC??
  - Auditor to verify Documentary Evidences like Copy of Charge Regn. Certi., ROC Forms with Challans, Resolutions etc...
  - Verify Repayment Schedules of Loans, Loan Account Statements and Balance Confirmation Certificates For Loan Accounts. Classify the Loan Installments due in next 12 months as Current Liability separately.
  - Whether Co. is regular in Repayment of Principal & Interest??
  - Whether Interest up to year-end charged to Loan A/c.?
  - Details of Security given for the Loans to be verified.. Whether property/ assets given as Security has been regularly insured??

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## Analyze BS Items – Unsecured Loans

- Unsecured Loans:
  - Verify the List of Unsecured Loans as at the year end...
    - Whether any new Loans Taken during the year??
    - Verify - Copy of the PAN Card, Last IT Return and Confirmation from Depositor with proof of source of funds/bank statement.
    - Whether Co. is regular in Repayment of Principal & Interest??
    - Whether Rate of Interest is reasonable??
    - Whether Interest up to year-end charged to Loan A/c.?
  - In respect of Loans/Deposits taken..... Check the Compliance of Income Tax and Company Law Provisions.. Loans from Related parties to be disclosed separately... Compliance of AS-18 Related Parties...
  - Whether TDS deducted from Interest Paid on Loans.. Whether TDS deposited in time and TDS Return filed in time?? Ensure Compliance of TDS Provisions..

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## Analyze BS Items – Current Liabilities

- Sundry Creditors :
  - Distinguish and Prepare/Verify List of Creditors for Goods, Expenses and Capital Goods at the year end...
  - Analyze Long Outstanding Unpaid Creditors -Whether any Debit Note/ Adjustments for Returns/Rejections pending??
  - Obtain PAN No. and Balance Confirmation from Creditors.
  - Identify Creditors which are MSME Units and ensure compliance of MSME Act...as to timely payment of such creditors.
  - If any Creditors are Related Parties...Ensure Compliance of Income Tax and Co. Law Provisions..
  - Whether TDS deducted from Creditors for Expenses – like Labour Charges, Contract Payments, Technical/Prof. Fees, Sales Commission etc... Ensure Compliance of TDS Provisions..

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## Analyze BS Items – Current Liabilities

- Other Current Liabilities & Provisions:
- Identify the Expenses for which Provisions are to be made at the year end – Provision for Depreciation, Provision for Salary/Wages Payable, Provision for Bonus & Ex-Gratia Payments, Provision for Audit and Professional Fees, Provision for Taxation, Provision for Other Expenses..like Rent – Electricity Bills, Telephone Bills Payable....etc.
- Ensure that, the opening balances of provisions (provisions made in previous year) have been reversed by payment/transfer to respective Expense A/cs.
- Provision for Gratuity – Verify as per Actuarial Valuation Report.. If not, qualify.... Reporting under AS-15 Employee Benefits..
- TDS on Provisions like Provision for Audit/ Professional Fees ..

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## Finalization of A/cs & Audit –Important Points

- Important Checklist :

- Verify Opening Balances in books with Last Year's Balance Sheet.
- Make Sure that there are no entries on National Holidays.
- Scrutinize and Verify Special Items like – Creditors with Debit Balance and Debtors with Credit Balance.
- Check if Cash Balance is Negative at any time during the year.
- Ensure that Monthly Expenses like Rent, Salary, Wages, Electricity Charges, Telephone Bills etc. have been accounted for all 12 months..
- Insurance Charges, Subscription, Advertisement and AMC Expenses – Ensure that Entries for the Prepaid Expenses have been made in books.
- Reconcile Yearly Sales and Purchases with figures of Excise/Service Tax /VAT/ GST Returns.

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## Finalization of A/cs & Audit –Important Points

- Verify TDS Entries with 26AS and ensure that, all the Income like Contract Income, Interest etc. as per 26AS is fully reflected in books of accounts.
- Reconcile data in TDS Returns with respective ledger accounts.
- Reconcile Bank Accounts and examine if any of the pending reconciliation entries are more than 3 months old..
- Ratio Analysis - Compare Material Consumption Ratio, Labour Cost Ratio, GP Ratio and NP Ratio with previous year... If major variations, analyze the reasons..
- Check that, all Debit Notes, Credit Notes and Journal Vouchers are duly authorized and properly entered in the books of accounts..
- Check that, All items of Major Discount to Customers, Bad Debts, Write Backs are duly authorized and properly entered in the books.

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## Finalization of Audit – Some Important Points

- Verify that – Financial Statements have been prepared in accordance with the legal requirements and as per the prescribed format as applicable to the entity... e.g. In case of Company as per Revised Sch.VI or in case of Banking Co./Insurance Co.... As per relevant law.
- In case of a Company other than OPC, Small Company and Dormant Company and Start Up Company, Cash Flow Statement is also part of the mandatory Financial Statements to be prepared by the Company..
- Sec 2(85) ‘small company’ means a company, other than a public company, –  
(i) paid-up share capital of which does not exceed **fifty lakh rupees** or such higher amount as may be prescribed which shall not be more than **five crore rupees**; and
- (ii) turnover of which as per its last profit and loss account does not exceed **two crore rupees** or such higher amount as may be prescribed which shall not be more than **twenty crore rupees**:

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## Finalization of Audit – Some Important Points

Section 129 of the Companies Act, 2013 deals with Financial Statements of the Company..

Every company (listed/unlisted) (public/private) shall prepare financial statements which shall give:

- a. true and fair view of the state of affairs of the company,
- b. comply with accounting standards notified u/s 133 and
- c. shall be in form as may be provided for different classes of companies in Schedule III.

Verify the Compliance of various Accounting Standards in the preparation and presentation of Financial Statements.

Please refer to the list of all the Mandatory Accounting Standards as applicable to the entity... AS-1 to AS-29 (Except AS-6 and AS-8).

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## Finalization of Audit – Some Important Points

In case of Company Audit, where CARO,2016 requirements are applicable u/s 143(11) of the Co. Act, verify the compliance of CARO requirements and obtain necessary information from the Company so as to facilitate the CARO reporting requirements.

- **Companies not covered under CARO,2016:**

1. Banking Companies as defined under section 5(c) of the Banking Regulation Act, 1949
2. Insurance Company as defined under the Insurance Act, 1938
3. Companies Incorporated with Charitable objects etc, i.e. companies licensed to operate under section 8 of Act 2013
4. One company as defined under section 2(62) of the 2013 Act
5. Small Company as defined under 2(85) of the 2013 Act
6. Private company not being a holding or a subsidiary company of a public company:
  - with a paid up capital and reserves and surplus not more than INR 1crore
  - does not have total borrowings exceeding INR 1crore from any bank or any financial institution at any point of time during the FY and
  - does not have total revenue as defined in schedule III, to the 2013 Act (including revenue from discontinuing operations) exceeding INR 10 crore during the financial year as per the financial statements.

In case of an entity covered by Tax Audit, collect the relevant information and prepare annexure for the Tax Audit Reporting requirements....

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## Finalization of Audit – Some Important Points

- **AS-1 Disclosure of Accounting Policies:**
- All significant accounting policies adopted in the preparation and presentation of financial statements should be disclosed.
- The disclosure of the significant accounting policies as such should form part of the financial statements and the significant accounting policies should normally be disclosed in one place.
- Any change in the accounting policies which has a material effect in the current period or which is reasonably expected to have a material effect in later periods should be disclosed.
- Ensure that, Disclosure of Accounting Policy under AS-2 Valuation of Inventories, AS-9 – Revenue Recognition, AS-10 Property, Plant & Equipment, AS-11 Effects of Changes in Foreign Exchange Rates and other Significant Accounting Policies are invariably covered in Disclosure of A/c. Policies.... **Compliance with Tax A/c. Standards....**

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## Checklist for Audit – Some Important Points

1. Ensure that your Appointment has been made properly in accordance with the provisions of Section 139 of Co. Act, 2013.
  - a. Before appointment of auditor, auditor has to give written consent u/s 139 of Companies Act,2013.
  - b. Company has to inform ROC and auditor about the appointment.
  - c. Form ADT-1 is to be filled by the company within 15 days from the meeting in which auditor is appointed.
2. Obtain Audit Engagement Letter (SA 210 : Agreeing to the terms of Audit Engagement) : and also make a communication about the terms of the audit engagement with management or those charged with governance in accordance with SA-260 (Communication with those charged with Governance).

The agreed terms shall be recorded in the Audit Engagement Letter.

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## Checklist for Audit – Some Important Points

3. Prepare and Maintain Proper Audit Documentation (Audit Working Papers) in respect of the Audit work carried out.

As per SA - 230 , "Audit Documentation" means :

The record of audit procedures performed, relevant audit evidence obtained, and conclusions the auditor reached.

It supports the basis for the auditor's conclusions concerning every relevant financial statement assertions and demonstrates that the work has in fact been performed....and very useful in defending the auditor...

4. Audit Report:

Ensure that, the Audit Report has been prepared in accordance with the provisions of the Sec. 143 of the Companies Act and applicable Standards on Auditing (SA-700 to SA-706)...

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## Finalization of Audit – Some Important Points

- The Companies Act lays down various provisions for reporting by Statutory Auditors under Section 143 of Companies Act, 2013.
- Sec. 143 only lays down the various points to be included in an audit report and the matters to be specifically verified and reported by the Auditor.
- Standards on Auditing (SAs) i.e. SA 700 to SA 706 issued by ICAI prescribe the Format of the Audit Report..
  1. SA 700 - Forming an Opinion and Reporting on Financial Statements
  2. SA 701 - Communicating Key Audit Matters in the Auditor's Report
  3. SA 705 - Modifications to the Opinion in the Auditor's Report
  4. SA 706 - Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report.

Please note that, New Audit Report format prescribed by SA-700 will be applicable for the Audit Period starting from 01.04.2018....

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