

It is often said that "when the going is tough the tough gets going". We should have this spirit to march ahead in these tough days when the economy has slowed down in our country and the rest of the world is suffering from the worst recession. In our reverse gear travel we have considered four risk factors in respect of which an auditor has to be cautious for proper discharge of attest functions. We travel through other risk factors against which an auditor has to be cautious.

5. Loans and Advances: Companies may give loans and/ or advances (referred to as "**Loans**" in this reverse gear travel) to holding companies, subsidiary companies, group companies or related parties or the firms or companies in which they or their related parties are interested. The relationship need not be a direct relationship; it may be an indirect relationship or they may be remotely related. By giving loans the working capital and liquidity of the auditee company suffers. This is not a healthy financial position at any point of time and more so in these difficult days. The loans might not have been given in the current financial year. They might have been given in the earlier year(s) and outstanding during the year under audit. During the course of audit, the auditor has to focus attention in respect of:

- a. Loans given during the year - the auditor will do well to verify all the loans given during the year to ascertain whether any of those loans are to related party;
- b. Loans outstanding at any point during the year - the auditor is advised to verify all the loans outstanding not only at the end of the year, but any time during the year (i.e. beginning, middle or end of the year) to satisfy that the entity does not suffer from insufficiency of funds due to lending by the company;
- c. Loans squared up during the year - auditor should satisfy that loan accounts were squared by repayment but not other modes (e.g. allotment of shares, adjustment or otherwise);
- d. Purpose of lending or advancing;
- e. Terms on which advanced, viz. rate of interest, repayment schedule, securities or guarantees obtained;

- f. Adherence to repayment of principal/ installment and interest;
- g. Whether the loan was given out of loans obtained from any third party and the terms and conditions thereof;
- h. Financial health of the borrower;
- i. Compliance with provisions of Company law other statutes;
- j. Any securities or guarantees given by the company to a third party for the benefit of the above related parties.

6. Change in Accounting Policy or Method of Estimates:

- a. Financial statements are drawn based on the company's accountancy policies followed consistently year after year. It is a known fact that certain Accounting Standards suggest alternative methods of accounting. A change in the policy will have a bearing on the financial results and state of affairs of the company. As per AS-1 'Disclosure of Accounting Policies' an entity shall follow the accounting policies consistently. The financial statements should not only disclose the policies, but any change therein shall also be disclosed. AS-5: 'Net Profit for the Period, Prior Period Items and Changes in Accounting Policies' specifies the principles based on which accounting policies can be changed; i.e. (a) If change is required as per any statute; (b) Change in compliance with an accounting standard; (c) if change in accounting policy would result in a more appropriate presentation of the financial statements. Where the entity has changed its accounting policy, apart from statutory requirements enshrined in AS-1 and AS-5, the auditor should satisfy that change in policy is resorted for the benevolent purpose; the change should not be taken as a cover for distorted presentation of financial statements. Following are a few examples of policies suggesting alternatives accounting policies:
 - i. 'Valuation of inventories (AS-2)' - cost or net realizable value;
 - ii. Cost formula for valuation of inventories - 'Valuation of

- inventories (AS-2)' - FIFO, LIFO, Weighted Average etc.
- iii. Depreciation Accounting (AS-6) - Straight Line or Written down value;
 - iv. Construction Contracts (AS-7) - completion method or proportional completion method;
 - v. Revenue Recognition (AS-9) - discussed in the Sep 2007 to May 2008 months of our Accountancy Travelogue;
 - vi. Method of Accounting - Cash or Accrual Method - applicable in respect of non-corporate entities (since companies have to follow accrual system u/s 209 of the Companies Act);
 - vii. Accounting for Government Grants (AS-12) - Assets disclosed at gross value or net of grants received.
- b. Financial Statements are based method of estimates or method of valuation of various items. As per para 20 to 27 of AS-5 disclosure requirements in respect of estimates are identical to changes in accounting policies. A few examples of change in estimates are:
- i. Techniques for measurement of inventories - Standard cost, marginal cost;
 - ii. Provision for slow moving and non-moving stocks;
 - iii. Estimate of loss in respect of disputed liabilities or assets;
 - iv. Provision for bad and doubtful debts;
 - v. Provision for warranty claims;
 - vi. Provision for taxation.
- 7. Compliance with Accounting Standards:** Companies have to comply with Accounting Standards in letter and spirit not only in times of growth, but in times of economic slow down. Compliance with following AS and their adequate disclosure is particularly important in the present times. Auditor has to verify
- that the company has complied with all the AS particularly the following As with focus on important issues.
- i. AS-24 Discontinuing Operations - Recognition of discontinuing operations, initial disclosure of discontinuance of operations, Separate measurement of financial results from continuing operations and discontinued operations, Updating disclosures of discontinued operations;
 - ii. AS-26 Intangible Assets - Not to recognise internally generated goodwill, Other internally generated intangible assets to be recognised strictly in accordance with AS, Amortisation of assets, review of usefulness of intangible assets each year in the changing circumstances;
 - iii. AS-28 Impairment of Assets - Identification and recognition of impaired assets, provision for impaired assets, review of impairment year after year;
 - iv. AS-29 Provisions, Contingent Liabilities and Contingent Assets - To recognise present obligation as a result of past event, not to recognise future operating losses, to provide for unavoidable costs of onerous contracts, provision should not be discounted at present values and measured before tax, to review provision each year.
- 8. Following Standards of Auditing (SA):** In discharge of his professional responsibility auditor has to comply with the entire SA. He has to follow the SA not only by rules but even by principal. He has to follow SA in all walks of auditing viz. planning, execution, collection of evidence, documentation and reporting. This will help him in Peer Review or in defending any liability. It is desirable to obtain a Management Representation Letter, though auditor cannot shelter under such a Letter. Only by following AS and SA we will be able to shoulder the onerous responsibility of marching forward when the economy is traveling in the reverse gear.
- We travel further in the reverse gear, certainly to march forward. ■