Paper – 12: Company Accounts and Audit

The following table lists the learning objectives and the verbs that appear in the syllabus learning aims and examination questions:

	Learning objectives	Verbs used	Definition
LEVEL B	KNOWLEDGE What you are expected to know	List	Make a list of
		State	Express, fully or clearly, the details/facts
		Define	Give the exact meaning of
	COMPREHENSION What you are expected to understand	Describe	Communicate the key features of
		Distinguish	Highlight the differences between
		Explain	Make clear or intelligible/ state the meaning or purpose of
		Identity	Recognize, establish or select after consideration
		Illustrate	Use an example to describe or explain something
	APPLICATION How you are expected to apply your knowledge	Apply	Put to practical use
		Calculate	Ascertain or reckon mathematically
		Demonstrate	Prove with certainty or exhibit by practical means
		Prepare	Make or get ready for use
		Reconcile	Make or prove consistent/ compatible
		Solve	Find an answer to
		Tabulate	Arrange in a table
	ANALYSIS How you are expected to analyse the detail of what you have learned	Analyse	Examine in detail the structure of
		Categorise	Place into a defined class or division
		Compare and contrast	Show the similarities and/or differences between
		Construct	Build up or compile
		Prioritise	Place in order of priority or sequence for action
		Produce	Create or bring into existence

Paper – 12: Company Accounts and Audit

Full Marks: 100 **Time Allowed: 3 Hours**

This paper contains 4 questions. All questions are compulsory, subject to instruction provided against each question. All workings must form part of your answer. Assumptions, if any, must be clearly indicated.

1. **Answer all questions:** **[2×10=20]**

(a) State the types of lease to which AS-19 are not applicable.

Answer:

The Accounting Standard AS-19 is not applicable to the following types of Lease:

- Lease agreement to explore natural resources such as oil, gas, timber, metal and other material rights;
- Licensing agreements for motion picture film, video recording, plays, manuscripts , patents and other rights;
- Lease agreement to use land.

(b) There is an income tax demand of ₹ 7.5 lakhs against the company relating to prior years against which the company has gone on appeal to the appellate authority in the department. The ground of appeal deals with the points covering ₹ 5.4 lakhs of the demand. State how the matter will have to be dealt with in the financial account for the year.

Answer:

A provision of ₹ 2.1 lakhs and a contingent liability of ₹ 5.4 lakhs should be provided in the financial accounts for the year.

(c) A Company is planning to raise funds by making rights issue of equity shares to finance its expansion.
The existing equity share capital of the company is ₹ 150,00,000. The market value of its share is ₹ 42. The company offers to its shareholders the right to buy 2 shares at ₹ 11 each for every 5 shares held.
You are required to calculate the theoretical market price after rights issue.

Answer:

Market value of 5 shares already held by a shareholder @ ₹ 42	₹210
Add: Price to be paid by him for acquiring 2 more shares @ ₹ 11 per share	₹22
Total price of 7 shares after rights issue	₹232

∴ Theoretical market price of one share, (i.e., 232/7) = 33.14.

(d) The share capital of A Ltd. consists of 2,00,000 equity shares of ₹ 10 each, and 50,000 preference shares of ₹ 100 each, fully called up. Its securities premium account shows a balance

of ₹ 80,000 and general reserve of ₹ 14,00,000. The company decides to buy-back 40,000 equity shares of ₹ 12 each.

Pass the journal entry showing the transfer of amount from General Reserve to Capital Redemption Reserve only.

Answer:

Particulars		Dr. (₹)	Cr. (₹)
General Reserve A/c	Dr.	4,00,000	
To Capital Redemption Reserve A/c			4,00,000
(Transfer of nominal amount of equity shares bought-back.)			

(e) A company issued 10,000 15% debentures of ₹ 100 each at par redeemable at a premium of 15%.
After 8 years the company served notice of redemption and redeemed all debentures as per the terms of issue. You are required to make entry for the time of issue of debentures only.

Answer:

Particulars		Dr. (₹'000)	Cr. (₹'000)
Bank A/c	Dr.	1,000	
Loss on issue of debentures A/c	Dr.	150	
To 15% Debentures A/c			1,000
To Premium on redemption A/c			150
(10,000 15% Debentures of ₹100 each issued at per which are redeemable at a premium of 15%)			

(f) Discuss ESOP.

Answer:

ESOP means a scheme under which the company grants option (a right but not an obligation) to an employee to apply for shares of the company at a pre-determined price. This right is exercisable by the employee, during the specified period. Section 2(37) of the Companies Act, 2013 states that the "employee stock option" means the option given to the whole time director, officers or employees of a company which gives such directors, officers of employees the benefit or right to purchase or subscribe at a future date, the securities offered by the company at a pre-determined price.

(g) Discuss test checking in Audit Work.

Answer:

Test checking is concerned with selecting and examining a representative sample from a large number of similar items. There is no hard and fast rule of selecting item for the test checking. The justification for the test checking lies in the theory of probability which states that a sample selected from a series of items will tend to exhibit the same characteristics as present in the full series of items.

(h) State the purposes of Standards on Internal Audit (SIA).

Answer:

Purposes of Standards on Internal Audit (SIA) —

• To provide standards for quality of services during an internal audit;
• To codify the best practices in internal audit services.

(i) State the process of fixing remuneration of a company auditor as per Companies Act,2013 section 142.

Answer:

The remuneration of the auditor of a company shall be fixed in its general meeting or in such manner as may be determined therein.

Provided that the Board may fix remuneration of the first auditor appointed by it.

The remuneration under sub-section (1) shall, in addition to the fee payable to an auditor, include the expenses, if any, incurred by the auditor in connection with the audit of the company and any facility extended to him but does not include any remuneration paid to him for any other service rendered by him at the request of the company.

(j) Discuss the provisions of the Companies Act, 2013 regarding signing the Auditors Report by the Auditor as per section 141.

Answer:

The person appointed as an auditor of the company shall sign the auditor's report or sign or certify any other document of the company in accordance with the provisions of sub-section (2) of section 141, and the qualifications, observations or comments on financial transactions or matters, which have any adverse effect on the functioning of the company mentioned in the auditor's report shall be read before the company in general meeting and shall be open to inspection by any member of the company.

2. (Answer any 2 questions)

(a) (i) In April, 2014, Mukta Ltd. issued 36,00,000 Equity Shares of ₹10 each, ₹5 per share was called upon that date which was paid by all the shareholders. The remaining ₹5 was called upon 1-9-2014. All the Shareholders (except one having 7,20,000 shares) paid the sum in September 2014. The net profit for the year ended 31.03.2015 is ₹66 lakhs after dividend on Preference Shares and Dividend distribution tax of ₹13.20 Lakhs.

Compute the basic EPS for the year ended 31st March,2015 as per Accounting Standard – 20.[6]

Answer:

Basic Earnings per share (EPS) —

$$\frac{\text{Net profit attributable to equity shareholders}}{\text{Weighted average number of equity shares outstanding during the year}}$$

$$= \frac{66,00,000}{26,40,000 \text{ (as per working note)}} = ₹2.5 \text{ per share}$$

Working Note:

Calculation of weighted average number of equity shares

As per AS 20 'Earning per Share', partly paid equity shares are treated as a fraction of equity share to the extent that they were entitled to participate in dividend relative to a fully paid equity shares during the reporting period. Assuming that the partly paid shares are entitled to participate in the dividend to the extent of amount paid. Weighted average number of share will be calculated as follows:

Date	No. of equity shares	Amount paid par share	Weighted average no. of equity shares
	₹	₹	₹
01.04.2014	36,00,000	5	36,00,000× 5/10× 5/12 = 7,50,000
01.09.2014	28,80,000	10	28,80,000 × 7/12 = 16,80,000
01.09.2014	7,20,000	5	7,20,000 × 5/10× 7/12 = 2,10,000
Total			26,40,000

(ii) Y Ltd. sold machinery having WDV of ₹ 80 lakhs to X Ltd. for ₹100 lakhs and the same machinery was leased back by X Ltd. to Y Ltd. The lease back is operating lease. [2]

Comment if —

Fair value is ₹ 90 and sale price is ₹76 lakhs.

Answer:

Loss of ₹4 lakhs to be immediately recognized by Y Ltd. in its books provided loss is not compensated by future lease payment.

(b) (i) A Ltd. purchased fixed assets costing ₹ 5,100 lakhs on 1.1.10 and the same was fully financed by foreign currency loan (U.S. Dollars) payable in three annual equal installments. Exchange rates were 1 Dollar = ₹ 42.50 and ₹ 45.00 as on 1.1.10 and 31.12.10 respectively. First installment was paid on 31.12.10. The entire difference in foreign exchange has been capitalized.

You are required to state, how these transactions would be accounted for. [5]

Answer:

As per para 13 of AS 11 (Revised 2003) 'The Effects of Changes in Foreign Exchange Rates', exchange differences arising on the settlement of monetary items or on reporting an enterprise's monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, should be recognized as income or expenses in the period in which they arise. Thus exchange differences arising on repayment of liabilities incurred for the purpose of acquiring fixed assets are recognized as income or expense.

Calculation of Exchange Difference:

$$\text{Foreign currency loan} = \frac{₹\ 5,100 \text{ lakhs}}{₹\ 42.50} = 120 \text{ lakhs US Dollars}$$

Exchange difference = ₹120 lakhs US Dollars × (45.00 – 42.50)

= ₹ 300 lakhs (including exchange loss on payment of first installment)

Therefore, entire loss due to exchange differences amounting ₹ 300 lakhs should be charged to profit and loss account for the year.

(ii) The Following data apply to a company's defined benefit pension plan for the year:

Particulars	Amount (₹)
Fair market value of plan assets (begnning of year)	**4,00,000**
Fair market value of plan assets	**5,70,000**
Employer Contribution	**1,40,000**
Benefit Paid	**1,00,000**

Calculate the actual return on plan assets. **[3]**

Answer:

The actual return is computed as follows:

Particulars		Amount (₹)
Fair market value of plan assets (end of year)		5,70,000
Fair market value of plan assets (benning of year)		4,00,000
Change in plan assets		1,70,000
Adjusted for		
Employer contributions	1,40,000	
Less: Benefit Paid	1,00,000	40,000
Actual return on plan assets		1,30,000

(c) (i) On 1st January, 2015 Ambika Ltd. incurred organization cost/ preliminary expenses of ₹48,000. What portion of the organization costs will Ambika Ltd. defer to years subsequent to 2014? **[3]**

Answer:

As per Accounting Standard – 26 organisation costs/ preliminary expenses are those incurred in the formation of a corporation. Since uncertainity exists concerning the future benefit of these costs in future years, they are properly recorded as an expense in 2015.

(ii) State the disclosure requirement as per Accounting Standard – 20. [5]

Answer:

As per Accounting Standard 20 an enterprise should disclose the following:

– The amounts used as the numerators in calculating basic and diluted earnings per share, and a reconciliation of those amounts to the net profit or loss for the period;
– The weighted average number of equity shares used as the denominator in calculating basic and diluted earnings per share, and a reconciliation of these denominators to each other; and
– The nominal value of shares along with the earnings per share figures.

Additionally, if applicable the enterprise shall disclose —

– The Fact that Restatement has been made for events after Balance sheet date
– If a component of net profit is used which is not reported as a line item in the statement of profit and loss, a reconciliation should be provided between the component used and a line item which is reported in the statement of profit and loss.

3. (Answer any 2 questions)

(a) (i) From the following particulars of Uttam Ltd. you are required to calculate the Managerial Remuneration in the following situations:

- **There is only one Whole Time Director.**
- **There are two Whole Time Directors.**
- **There are two Whole Time Directors, a part time Director and a Manager.**

Particulars	₹
Net Profit before Income Tax and Managerial Remuneration, but after Depreciation and Provision for Repairs	**13,05,615**
Depreciation provided in the Books	**4,65,000**
Provision for Repairs for Machinery during the year	**37,500**
Depreciation Allowable under Schedule II	**3,90,000**
Actual Expenditure incurred on Repairs during the year	**22,500**

[6]

Answer:

A. Computation of Net Profits u/s 198 of the Companies Act

	Particulars	₹
	Net Profit before Provision for Income-tax and Managerial Remuneration, but after Depreciation and Provision for Repairs	13,05,615
Add:	Depreciation provided in the Books	4,65,000

	17,70,615
Less: Depreciation allowable under Schedule II	(3,90,000)
Net Profits under Section 198	13,80,615

Note: While computing the Net Profit u/s 198:

- All usual working charges will be allowed.
- Expenses on repairs, whether to movable / immovable property provided the repairs are not of capital nature will be allowed.
- Provision for Repairs of Machinery are usual working charges and hence allowed for computing Net Profit u/s 198.

B. Computation of Managerial Remuneration u/s 197

Situation	% of Remuneration	Managerial Remuneration
One Whole Time Director	5%	₹ 46,020.50
Two Whole Time Directors	10%	₹ 92,041.00
Two Whole Time Directors and Part Time Director and a Manager	11%	₹ 1,01,245.10

(ii) Following details are given for Sumangal Ltd. for the year ended 31st March, 2015:

(₹ in lakhs)

Sales:		
Food Products	**22,600**	
Plastic and Packing	**2,500**	
Health and Scientific	**1,380**	
Others	**648**	**27,128**
Expenses:		
Food Products	**13,340**	
Plastic and Packing	**1,700**	
Health and Scientific	**888**	
Others	**800**	**16,728**
Other Items:		
General corporate Expenses		**2,248**
Income from investments		**728**
Interest expenses		**260**
Identifiable assets:		
Food Products	**29,280**	
Plastic and Packing	**5,280**	
Health and Scientific	**4,200**	
Others	**2,660**	**41,420**
General Corporate Assets		**2,888**

Other Information:

- **Inter-segment sales are as below:**

(₹ in lakhs)

Food Products	**220**
Plastic and Packing	**288**
Health and Scientific	**84**
Others	**28**

- **Operating profit includes ₹132 lakhs on inter-segment sales.**
- **Information about inter-segment expenses are not available.**

You are required to prepare a statement showing financial information about Sumangal Ltd.'s operations in different industry segments. [10]

Answer:

Information about Sumangal Ltd.'s operations in different Industry segments is furnished in the following table :

	Food Products	**Plastic & Packaging**	**Health & Scientific**	**Others**	**Inter-segment Elimination**	**Consolidated**
External Sales	22,380	2,212	1,296	620	—	26,508
Inter-segment	220	288	84	28	620	-
Total	22,600	2,500	1,380	648	620	26,508
Segment Expenses	13,340	1,700	888	800	488	16,240
Operating Profit	9,260	800	492	(152)	132	10,268
General Corporate Expenses						(2,248)
Income from Invest.						528
Interest						(260)
Income from continuing operations						8,288
Identifiable assets	29,280	5,280	4,200	2,660		41,420
Corporate assets	—	—	—	—	—	2,888
Total assets						44,308

(b) M.P. Ltd. furnishes you the following Balance Sheet as at 31st March –

(₹ Crores)

Particulars	**₹**	**₹**
Sources of Funds		
Share Capital: Authorised		**300**
Issued: Equity Shares of ₹ 10 each fully paid	**75**	
15% Redeemable Preference Shares of ₹ 100 each fully paid	**225**	**300**
Reserves and Surplus: Capital Reserve	**45**	
Securities Premium	**75**	
Revenue Reserves	**780**	**900**

Total		**1,200**
Application of Funds:		
Fixed Assets: Cost	**300**	
Less: Provision for Depreciation	**300**	**NIL**
Investments at Cost (Market Value ₹ 1,200 Crores)		**300**
Net Current Assets: Current Assets	**1,020**	
Less: Current Liabilities	**120**	**900**
Total		**1,200**

The Company redeemed its preference shares on 1st April. It also Bought Back 150 Lakh Equity Shares of ₹ 10 each at ₹ 50 per share. The payments for the above were made out of the substantial Bank Balances, which appeared as part of current assets.

You are required to –

- **Pass the necessary Journal Entries to record the above.**
- **Prepare the Company's Balance Sheet after the above transactions.**
- **Value the Equity Shares on Net Assets Basis.** **[16]**

Answer:

1. Journal Entries in the Books of the Company (₹ Crores)

	Particulars	Debit	Credit
1.	15% Preference Share Capital A/c Dr. To Preference Shareholders A/c (Being Pref. Shares due for Redemption transferred to Pref. Shareholders A/c)	225	 225
2.	Preference Shareholders A/c Dr. To Bank A/c (Being amount settled to Preference Shareholders on Redemption)	225	 225
3.	Revenue Reserve A/c Dr. To Capital Redemption Reserve A/c (Being transfer to Capital Redemption Reserve consequent to Redemption of Preference Shares)	225	 225
4.	Equity Share Capital A/c Dr. Revenue Reserves A/c Dr. To Bank A/c (Being 150 lakh Equity Shares Bought Back at ₹50 vide Board resolution dated…., Share Capital cancelled, Premium on Buyback provided from Reserves)	15 60	 75
5.	Revenue Reserves A/c Dr. To Capital Redemption Reserve A/c (Being transferred to Capital Redemption Reserve on A/c of Shares being bought back)	15	 15

Note: For Redemption of Preference Shares – transfer to Capital Redemption Reserve can be only from divisible profits. Securities Premium cannot be used for the same. However, in respect of Buyback – Securities Premium can be utilized for transfer to Capital Redemption Reserve as per Companies Act, 2013.

2. Balance Sheet of M. P Ltd. (after redemption and buyback)

(₹ Crores)

	Particulars	Note	This Yr	Prev. Yr
I	Equity and Liabilities			
(1)	Shareholders' Funds:			
	(a) Share Capital	1	60	
	(b) Reserves & Surplus	2	840	
(2)	Current Liabilities		120	
	Total		1,020	
II	Assets			
(1)	Non-Current Assets			
	(a) Tangible Fixed Assets: (Gross Block 300 Less Provision for Deprn 300)		NIL	
	(b) Non-Current Investments at Cost (Market Value thereof ₹ 1,200 Crores)		300	
(2)	Current Assets (1,020 – 225 - 75)		720	
	Total		1,020	

Notes to the Balance Sheet (₹ Crores)

Note 1: Share Capital

Particulars	This Yr	Prev. Yr
Authorised Capital (Division of Shares and paid Up Value is not available in Quen):	300	
Issued, Subscribed & Paid up: 3 crore Equity Shares of ₹ 10 each	60	

Note: Reconciliation of Shares (Quantity & Value) will be provided by the Company along with annual Financial Statements.

Note 2: Reserves and Surplus

Particulars	This Yr	Prev. Yr
(a) Capital Reserve	45	
(b) Capital Redemption Reserve (225 +15)	240	
(c) Securities Premium Account	75	
(d) Revenue Reserves (780 – 240 – 60)	480	
Total	840	

3. Net Asset Value of an Equity Share

Total Assets=Fixed Assets (Book Value+ Investment (Market Value)+Net Current Assets (Book Value)

= Nil + 1,200 + 600 = ₹ 1,800 crores.

Value per Equity Share = ₹ 1,800 Crores ÷ 3 Crore Shares = ₹ 600 per share.

(c) (i) From the following Summary Cash Account of X Ltd. prepare Cash Flow Statement for the year ended 31st March, 2015 in accordance with AS 3 (Revised) using the direct method. The company does not have any cash equivalents.

Summary Cash Account for the year ended 31.03.2015

	₹ '000		₹ '000
Balance on 1.4.2015	**125**	**Payment to Suppliers**	**5,000**
Issue of Equity Shares	**750**	**Purchase of Fixed Assets**	**500**
Receipts from Customers	**7,000**	**Overhead expense**	**500**
Sale of Fixed Assets	**250**	**Wages and Salaries**	**250**
		Taxation	**625**
		Dividend	**125**
		Repayment of Bank Loan	**750**
		Balance on 31.3.2015	**375**
	8,125		**8,125**

[8]

Answer:

X Ltd.
Cash Flow Statement for the year ended 31st March, 2015
(Using the direct method)

	₹ '000	₹ '000
Cash flows from operating activities		
Cash receipts from customers	7,000	
Cash payment to suppliers	(5,000)	
Cash paid to employees	(250)	
Cash payments for overheads	(500)	
Cash generated from operations	1,250	
Income tax paid	(625)	
Net cash from operating activities		625
Cash flows from investing activities		
Payment for purchase of fixed assets	(500)	
Proceeds from sale of fixed assets	250	
Net cash used in investing activities		(250)
Cash flows from financing activities		

	₹ '000	₹ '000
Proceeds from issuance of equity shares	750	
Bank loan repaid	(750)	
Dividend paid	(125)	
Net cash used in financing activities		(125)
Net increase in cash		250
Cash at beginning of the period		125
Cash at end of the period		375

(ii) Prithvi Ltd. issued 40,000 Shares which are underwritten as follows:

Mr. A — 24,000; Mr. B — 10,000 and Mr. C — 6,000 Shares.

- **The Underwriters made applications for firm underwriting as under:**
  Mr. A — 3,200 Shares; Mr. B — 1,200 Shares; and Mr. C — 4,000 Shares.
- **The total subscriptions excluding Firm Underwriting but including marked applications were for 20,000 Shares.**
- **The marked applications were: Mr. A — 4,000 Shares; Mr. B — 8,000 Shares and Mr. C — 2,000 Shares.**
- **Show the allocation of liability of the underwriters.**

[8]

Answer:

Particulars	Mr. A	Mr. B	Mr. C	Total
Gross Liability	24,000	10,000	6,000	40,000
(-) Firm Application	(3,200)	(1,200)	(4,000)	(8,400)
(-) Marked Application	(4,000)	(8,000)	(2,000)	(14,000)
(-) Unmarked Application	(3,600)	(1,500)	(900)	(6,000)
Net liability under the Contract	13,200	(700)	(900)	11,600
(+)/(-) Surplus in Gross Liability Ratio	(1,600)	700	900	—
Liability of the Underwriter	11,600	—	—	11,600
(+) Firm Application	3,200	1,200	4,000	8,400
Total Liability of the Underwriter	14,800	1,200	4,000	20,000

Unmarked Applications = 6,000 i.e. Total Applications 20,000 — Marked Applications (4,000 + 8,000 + 2,000 = 14,000). These are distributed in the ratio of Gross Liability i.e. 12:5:3.

4. (Answer any 2 questions)

(a) (i) Verify the revenue recognition process for a Movie Ticket. [4]

Answer:

The recognition of any revenue should be as per Accounting Standard – 9.

As per AS – 9, revenue from service is generally recognized as the service is performed.If at the time of rendering of services or sale there is significant uncertainty in ultimate collection of the revenue, then the revenue recognition is postponed and in such cases revenue should be recognized only when it becomes reasonably certain that ultimate collection will be made.

In the present case the revenue should be recognized on rendering the service of showing the movie and not on sale of the movie tickets.

(ii) List the steps to Sales of a manufacturing unit. [5]

Answer:

It can be verified from the sales records, the Credit Sales from the Credit Sales Records and the Cash Sales from the Cash Sales Records.

For Sale of Goods, it is more reasonable to verify and cross check Sales from different sources like:

1. Statement of Export Sales
2. Sales as per CST Returns
3. Sales as per VAT Returns
4. Exempted Sales

Here, [1+2+3+4] should be equal to Sales as per Income Tax Returns.

This can again be cross verified with the production of goods (Excisable Goods) which is available from the Central Excise Returns.

(iii) Discuss the duties and the power of the company auditor in reference to the audit of the branch and the branch auditor. [3]

Answer:

Following are the duties and the power of the company auditor in reference to the audit of the branch and the branch auditor —

(1) For the purposes of sub-section (8) of section 143, the duties and powers of the company's auditor with reference to the audit of the branch and the branch auditor, if any, shall be as contained in sub-sections (1) to (4) of section 143.

(2) The branch auditor shall submit his report to the company's auditor.

(3) The provisions of sub-section (12) of section 143 read with rule 12 hereunder regarding reporting of fraud by the auditor shall also extend to such branch auditor to the extent it relates to the concerned branch.

(iv) Discuss — Audit Report versus Audit Certificate. **[4]**

Answer:

Audit report versus Audit certificate —

- Audit report is an expression of opinion on the truth and fairness of the accounts on the other hand an Audit certificate is authentication of true and correctness of the data or fact certified.
- The existence of opinion distinguishes a report from the certificate.
- The example of audit report is report issued by statutory auditor of a company under Section 143 of the Companies Act, 2013.
- The example for audit certificate is certification of consumption of imported items to be submitted to the Government department for obtaining some license etc.

(b) (i) Explain the matters that do and that do not affect the auditor's opinion. **[7]**

Answer:

Matters that do not affect the Auditor's Opinion: In certain circumstances, an auditor's report may be modified by adding an emphasis of matter paragraph to highlight a matter affecting the financial statements which is included in a note to the financial statements that more extensively discusses the matter. The addition of such an emphasis of matter paragraph does not affect the auditor's opinion. The paragraph would preferably be included preceding the opinion paragraph and would ordinarily refer to the fact that the auditor's opinion is not qualified in this respect.

The auditor should modify the auditor's report by adding a paragraph to highlight a material matter regarding a going concern problem where the going concern question is not resolved and adequate disclosures have been made in the financial statements.

The auditor should consider modifying the auditor's report by adding a paragraph if there is a significant uncertainty (other than going concern problem), the resolution of which is dependent upon future events and which may affect the financial statements. An uncertainty is a matter whose outcome depends on future actions or events not under the direct control of the entity but that may affect the financial statements.

Matters that do affect the Auditor's Opinion: An auditor may not be able to express an unqualified opinion when either of the following circumstances exists and, in the auditor's judgment, the effect of the matter is or may be material to the financial statements:

(i) there is a limitation on the scope of the auditor's work; or

(ii) there is a disagreement with management regarding the acceptability of the accounting policies selected, the method of their application or the adequacy of financial statement disclosures.

The circumstances described in (a) could lead to a qualified opinion or a disclaimer of opinion. The circumstances described in (b) could lead to a qualified opinion or an adverse opinion.

(ii) Discuss the disadvantages and the measures that can be taken to avoid those disadvantages of Continuous Audit. [6]

Answer:

Following are the disadvantages of Continuous Audit —

- The auditor checks the books of accounts in several visits. The items or figures or books of accounts may be tampered by the client's staff after the auditor has checked them during previous visits.
- The technique of continuous audit is not suitable for small concerns.
- Auditor's frequent visits may cause inconvenience to the client's staff.
- Further, friendly ties may develop between client's staff and the auditor' staff. This may lead to collusion among them.
- The work become too mechanical as it continues throughout the year.

These disadvantages can be avoided by taking the following measures:

- An audit programme should be prepared in a systematic manner.
- The auditor should use secret ticks and use different colours to denote the specific ticks during the course of checking the different entries.
- Specific instructions should be given to the client's staff not to alter or correct the audited figures.
- The visits should be at irregular intervals so that the staff of the client may not be able to prepare in advance against the possible queries.
- Adequate documentation, i.e., working papers should be maintained so that the thread of work is not lost.

(iii) "Internal Audit is an independent appraisal activity within the organization" — Discuss the features of Internal Audit. [3]

Answer:

Following are the features of an Internal Audit —

- It is an independent appraisal activity within the organization.
- It can be conducted by the staff of the entity or by an independent professional appointed for that purpose.
- It is conducted for review of accounting, financial and other operations and controls established within an organization.
- It is conducted as a service to the organization and is not a part of the organization.
- It intends to furnish the analysis, appraisals, suggestions and information concerning the activities reviewed to the management.
- Internal auditing functions as a continuous effort for promoting effective control at cost reasonable cost

(c)(i) Sun Ltd. is holding 80% of Equity Shares of Moon Ltd. and prepares the financial statement applying AS - 21, As an auditor how would you verify the cost of control and the minority interest as stated in the Consolidated Financial Statement. [9]

Answer:

Following are the areas to be covered during verification of Cost of Control —

- The percentage of holding;
- Is there any type of purchase of Preference Shares or not?
- Date of acquisition, if there is any purchase in lot considering the same;
- Date of holding;
- Date of balance sheet;
- Date of Consolidation;
- Whether there is any bonus issue of shares, whether it is before holding or after holding, whether the issue of bonus properly accounted for or not?
- Whether there is any event affecting the value of reserves or not, like revaluation of fixed assets, acquisition of debentures etc;
- Whether there is any payment of dividend by the subsidiary company? Whether the dividend pre or post acquisition? In case of purchase in lot whether proper analysis is done considering the percentage of acquisition of shares?
- Whether there is any proposed dividend? If yes, whether the same has been properly accounted for or not?
- Whether there is any incident of disposal of shares or not?

Following are the areas to be covered during verification of Minority Interest —

- Percentage of shares held by the minority shareholders;
- Whether there is any incident of disposal of shares or not?
- Proportion and amount of profit to be received by the minority shareholders;
- Whether there is any type of up-stream transaction?
- Whether there is any type of unrealized profits to be adjusted?
- Proportion of dividend to be received by the minority holders etc.

(ii) “Cost data are very much useful to a company” — discuss. [5]

Answer:

The cost data is useful to company in

- Price fixation of final products
- Controlling wasteful expenditure
- Reduction of waste and scrap
- Optimum utilisation of labour, material and machinery
- Deciding proper product mix to optimise production and profitability
- To eliminate loss making products
- improving efficiency
- Supplying cost data when required by Government
- Taking 'make or buy' decision
- Making break even analysis for decision making etc.

(iii) State what is Inherent Risk? [2]

Answer:

Inherent risk is the susceptibility of an assertion about a class of transaction, account balance or disclosure to a misstatement that could be material, either individually or when aggregated with other misstatements, before consideration of any related controls.