

# Answer to PTP\_Intermediate\_Syllabus 2012\_Dec2014\_Set 3

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## 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) Purva Ltd. presented the following particulars. How will you deal with the following? Purva Ltd. applied for a Govt. grant to set up a new factory premises amounting to ₹ 50,00,000 which has been sanctioned/approved. The amount had not been received by Purva Ltd. But the factory premise was completed within the year.

**Answer:**

Accrual basis of Accounting is followed for recording the transactions related to Govt. grants. As such, the same may be treated as an accrued income and should be recorded in the books and will appear in the assets side of Balance Sheet.

- (b) Tulip Engineering Ltd. Granted 4,000 options on 1<sup>st</sup> May 2013 at ₹ 60 when the market price was ₹ 150. The vesting period is two years.

**You are required to:**

- (i) Calculate the value of options
- (ii) Calculate the amount to be amortised every year.

**Answer:**

(i) Value of options = Number of Options Granted x (Market Price – Exercise Price) = 4,000 x (₹ 150 – 60) = ₹ 3,60,000.

(ii) Vesting period is two years. This value of options shall be amortised on a straight line basis over the vesting period. Therefore, the amount to be amortised every year = ₹ 3,60,000 / 2 = ₹ 1,80,000.

- (c) What we understand by the term “Obligation”?

**Answer:**

- It is duty to perform in a particular manner, for example to pay interest of a loan at the end of every quarter and repay the principal on a specific date.
- It may be legally enforceable but that is not a necessary condition.

Obligations also arise, however, from normal business practice, custom and a desire to maintain good business relations or act in an equitable manner. An announcement to pay bonus to employees becomes an obligation because of normal business practice or custom although there is no legally enforceable agreement.

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- (d) Vikas Ltd. took over assets of ₹ 460 Lakh and liabilities of ₹ 60 Lakh of Prakash Ltd. for the purchase consideration of ₹ 440 Lakh. The Vikas Ltd. paid the purchase consideration issuing debentures of ₹ 100 each at 10% premium. Give journal entries in the books of the Vikas Ltd.

**Answer:**

Particulars		Dr. (₹)	Cr. (₹)
Sundry Assets A/c	Dr.	460	
Goodwill A/c	Dr.	40	
To, Liabilities A/c			60
To, Prakash Ltd. A/c			440
(Being purchase of assets and liabilities of Prakash Ltd.)			
Prakash Ltd. A/c	Dr.	440	
To, Debentures A/c			400
To Securities premium A/c			40
(Being issue of debenture at 10% premium)			

- (e) On 01.01.2009, Fine Ltd. issued 1,000, 15% Convertible Debentures of ₹ 200 each at a discount of 5% redeemable at par after 4 years by converting their holdings into equity shares of ₹ 100 each at a premium of 25%.

Give the journal entry as on 31.12.2013.

**Answer:**

Date	Particulars		Dr. (₹)	Cr. (₹)
31.12.2013	15% Debentures A/c	Dr.	50,000	
	To, Discount on issue of debentures A/c			2,500
	To, Equity Share Capital A/c			38,000
	To, Securities Premium A/c			9,500
	(Being the issue of 380 shares at 25% premium to a holder of 500 Debentures as per Board Resolution dated.....)			

- (f) On January 1, 2013 Fast Ltd. incurred organization costs/preliminary expenses of ₹48,000. What portion of the organization costs will Fast Ltd. defer to years subsequent to, 2013?

**Answer:**

As per AS -26, organization costs/preliminary expenses are those incurred in the formation of a corporation. Since uncertainty exists concerning the future benefit of these costs in future years, they are properly recorded as an expense in 2013.

- (g) "There is no difference between the term Original Voucher and the term Collateral Vouches" – comment.

**Answer:**

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

- (h) What is meant by the term "Voluntary Audit"?

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**Answer:**

Voluntary audits are non-statutory audits. There is no statutory requirement for audits of sole trader, partnership firm (except for a statutory tax audit u/s 44AB required as per the Income Tax Act, 1961, e.g. when such an entity exceeds the turnover of certain limit). The sole proprietors and partnership firms may get their accounts audited voluntarily on their own because of certain advantages.

**(i) What is meant by the term “Information Security Audit”?**

**Answer:**

Information Security Audit is an audit of the level of information security in an organization. The controls in any business organization can be classified as technical, physical and administrative controls.

Thus, information security audit involves checking of security controls from the physical security of data centres to the logical security of databases.

When centred on the IT aspects of information security, it can be seen as a part of an information technology audit, However, information security encompasses much more than IT.

**(j) List the advantages that are associated with proper verification of assets.**

**Answer:**

Proper verification of assets fetches the following advantages to the client –

- (i) It avoids manipulation of accounts;
- (ii) It guards against improper use of assets;
- (iii) It ensures proper recording and valuation of assets;
- (iv) It exhibits true and fair view of the state of affairs of the Company.

**2. (Answer any 2 questions)**

- (a) (i) Moon Ltd. has entered into a sale contract of ₹4 crores with Poonam Ltd. during 2012-13 financial year. The profit on this transaction is ₹60 lakhs. The delivery of goods to take place during the first month of 2013-14 financial year. In case of failure of Moon Ltd. to deliver within the schedule a compensation of ₹1.20 crore is to be paid to Poonam Ltd. Moon Ltd planned to manufacture the goods during the last month of the 2012-13 financial year. As on Balance Sheet date 31.3.13, the goods were not manufactured and it was unlikely that Moon Ltd. will be in a position to meet the contractual obligation.**

**Should Moon Ltd. provide for contingency as per AS- 29?**

**[4]**

**Answer:**

The Company has not yet manufactured the product, and hence cannot recognize the sale transaction as at 31<sup>st</sup> March 2013. Sale and the resultant profit cannot be recognized unless and until the product is ready and delivered to the Customer (assuming, transfer of property in goods takes place at the time of delivery, and not before). It is unlikely that Moon Ltd will be in a position to meet the contractual obligation, and it is more likely to pay the compensation and such payment is also quantifiable.

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Moon Ltd should create a provision for the compensation payable, and not just disclose as a contingent liability, it is an obligation out of a past event. Provision should be measured at the total compensation and not at the excess over the profit, since profit can be booked only independently in the next year, upon actual occurrence of the sale transaction.

**(ii) Discuss the uses of the general purpose financial statements by the cross-section of users. [4]**

**Answer:**

Uses of general purpose financial statements by the cross-section of users:

- to decide when to buy, hold or sell any equity investment;
- to assess the accountability of management;
- to assess the ability of the entity to pay and provide other benefits to its employees;
- to assess the security for amounts lent to the entity;
- to determine taxation policies;
- to determine distributable profits and dividends;
- to prepare and use national income statistics, etc.

**(b) Tarun Ltd. has taken an asset on lease from Barun Ltd for a period of 3 years. Annual Lease rental are ₹8 lakhs payable at the end of every year. The residual value guaranteed by Tarun is ₹3 lakhs whereas Barun expects the estimated salvage value to be ₹6 lakhs at the end of the lease term. If the fair value of the asset at the lease inception is ₹15 lakhs and the interest rate implicit in the lease is 18%, compute the Net Investment in the lease from the viewpoint of Barun Ltd and the annual finance income. [8]**

**Answer:**

Minimum Lease Payment (MLP) = ₹8 Lakhs x 3 years = ₹24,00,000

Guaranteed Residual Value (GRV) = ₹3,00,000

MLP from the viewpoint of the Lessor (Barun) = MLP + GRV = ₹27,00,000

Unguaranteed Residual Value (URV) = Total Residual Value – GRV = ₹3,00,000

Gross Investment in the Lease = MLP for Lessor + URV = ₹30,00,000

PV of MLP, GRV and URV (working) = ₹21,04,600

Unearned Finance Income = ₹30,00,000 – ₹21,04,600 = ₹8,95,400

Net Investment in the Lease = ₹30,00,000 - ₹8,95,400 = ₹21,04,600

**Working:**

**Present Value (PV) of gross Investment in the Lease is computed as under –**

PV of MLP = ₹8,00,000 x PVF at 18% for 3 years = ₹8,00,000 x (0.847+0.718+0.609) = ₹17,39,200

PV of (GRV+URV) = ₹6,00,000 x PVF at 18% for year 3 = ₹6,00,000 x 0.609 = ₹3,65,400

**Total of the above = ₹21,04,600**

**Recognition of finance Income by Lessor**

Year	Net Investment in the Lease = Receivable	Finance Income at 18% on NI	Total Lease Payments received from Lessee	Balance Reduction in Receivable (i.e. Principle)
(1)	(2)	(3)= (2) x 18%	(4)	(5)= (4) – (3)

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1	₹21,04,600	₹21,04,600 × 18% = 3,78,828	₹8,00,000	₹8,00,000 - ₹3,78,828 = ₹4,21,172
2	₹21,04,600 - ₹4,21,172 = ₹16,83,428	₹16,83,428 × 18% = ₹3,03,017	₹8,00,000	₹8,00,000 - ₹3,03,017 = ₹4,96,983
3	₹16,83,428 - ₹4,96,983 = ₹11,86,445	₹11,86,445 × 18% = ₹2,13,560	₹8,00,000	₹8,00,000 - ₹2,13,560 = ₹5,86,440
3 (end)	₹11,86,445 - ₹5,86,440 = ₹6,00,005	Nil	₹6,00,000	Nil (difference ₹5 due to R/Off)

**(c) (i) What do you mean by Integral & Non-integral foreign operation? Give one example of Integral & Non-integral foreign operation each. [4]**

**Answer:**

**Integral Foreign Operation:** An Integral Foreign Operation is an operation which is managed & finance in such a manner that any change in the exchange rate has almost immediate effects on the cash flow of the reporting enterprise. Further they are also seen as an extension of the operation of the reporting enterprise.

Example: Foreign Branch

**Non-integral foreign operation:** It is a Foreign Operation that is not an Integral Foreign Operation. The business of Non-integral foreign operation is carried on in a substantially independent manner by accumulating cash and other monetary items, incurring expenses, generating income and arranging borrowings, in its local currency. Change in the exchange rate affects the reporting enterprise's Net Investment in the Non-integral foreign operation, rather than the individual monetary and non-monetary items held by that Non-integral foreign operation.

Example: Subsidiaries in foreign Countries are called Non-integral foreign operation.

**(ii) In the context of relevant Accounting Standards, give your comment on the following matter for the financial year ending 31st March, 2013:**

**“Increase in pension liability on account of wage revision in 2012-13 is being provided for in 5 instalments commencing from that year. The remaining liability of ₹ 600 lakhs as redetermined in actuarial valuation will be provided for in the next 2 years”.** [4]

**Answer:**

As per AS-15, the costs arising from an alteration in the retirement benefits to employees should be treated as follows:

(i) The cost may relate to the current year of service or to the past years of service.

(ii) In case of costs relating to the current year, the same may be charged to Profit and Loss Account.

(iii) Where the cost relates to the past years of service these should be charged to Profit and Loss Account as 'prior period' items in accordance with AS-5.

(iv) Where retirement benefit scheme is amended in a manner which results in additional benefits being provided to retired employees, the cost of the additional benefits should be taken as " Prior Period and Extraordinary Items" as per AS-5.

In view of the above, the method adopted for accounting the increase in pension liability is not in consonance to the provisions mentioned in AS-15.

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### 3. (Answer any 2 questions)

- (a) (i) Cool & Care Ltd. planned to set up a unit for manufacture of bulk drugs. For the purpose of financing the unit, the Board of Directors have issued 20,00,000 Equity Shares of ₹10 each. 25% of the issue was reserved for Promoters and the balance was offered to the public. P Ltd., Q Ltd. and R Ltd. have come forward to underwrite the public issue in the ratio of 3:2:1 and also agreed for Firm Underwriting of 50,000, 35,000, 15,000 Shares respectively. The Underwriting Commission was fixed at 5%. The amount payable on application was ₹ 2.50 per share. The details of subscriptions are:

Particulars	Marked Forms of P	Marked Forms of Q	Marked Forms of R
No. of Shares	6,50,000	3,00,000	2,00,000

Unmarked Forms were received for 1,20,000 Shares. From the above, you are required to show the allocation of liability among underwriters with workings. Also, pass Journal Entries in the books of the Company for

- a. Underwriters' net liability and the receipt or payment of cash to or from underwriters
- b. Determining the liability towards the payment of commission to the Underwriters. [12]

**Answer:**

#### A. Computation of liability of underwriters (No. of shares):

Particulars	P	Q	R	Total
Gross Liability (3:2:1)	7,50,000	5,00,000	2,50,000	15,00,000
Less: Firm underwriting	50,000	35,000	15,000	1,00,000
	7,00,000	4,65,000	2,35,000	14,00,000
Less: Marked application	6,50,000	3,00,000	2,00,000	11,50,000
	50,000	1,65,000	35,000	2,50,000
Less: Unmarked applications distributed to P, Q and R in 3:2:1 ratio	60,000	40,000	20,000	1,20,000
	(10,000)	1,25,000	15,000	1,30,000
Less: Surplus of P distributed to Q & R in 2:1 ratio	10,000	6,667	3,333	
Net Liability (excluding firm underwriting)	Nil	1,18,333	11,667	1,30,000
Add: Firm underwriting	50,000	35,000	15,000	1,00,000
Total Liability (No. of Shares)	50,000	1,53,333	26,667	2,30,000

#### B. Computation of amounts receivable from / payable to underwriters:

Particulars	P	Q	R	Total
a. Total Liability (incl. Firm underwriting) (share)	50,000	1,53,333	26,667	2,30,000
b. Amount due at 2.50 per share (a x 2.50)	1,25,000	3,83,333	66,667	5,75,000

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c. Amount paid for firm Underwriting at 2.50 per share	1,25,000	87,500	37,500	2,50,000
d. Balance due from Underwriters (b-c)	Nil	2,95,833	29,167	3,25,000
e. Underwriting commission payable by company	7,50,000 x 10 x 5% =3,75,000	5,00,000 x 10 x 5% =2,50,000	2,50,000 x 10 x 5% =1,25,000	7,50,000
f. Amount due to / (payable by) co. (d-e)	(3,75,000)	45,833	(95,833)	(4,25,000)

### C. In the Books of Cool & Care Ltd.

#### Journal Entries

Particulars	Dr.(₹)	Cr.(₹)
Bank A/c To Equity Share Capital A/c P Ltd -50,000 x 2.5 Q Ltd – 35,000 x 2.5 R Ltd – 15,000 x 2.5 (Being allotment of shares against amounts received towards subscription for Firm Underwriting at 50,000 ;35,000 and 15,000 shares respectively from P, Q, R at ₹2.50)	Dr. 2,50,000	1,25,000 87,500 37,500
Q A/c (1,18,333 x 2.50) R A/c (11,667 X 2.50) To Equity Share Capital A/c (Being allotment of share to underwriters. Application and allotment money credited to Equity Share Capital A/c)	Dr. Dr. 2,95,833 29,167	3,25,000
Underwriting Commission A/c To P A/c To Q A/c To R A/c (Being the underwriting Commission payable to P,Q and R at 5% of the normal value of the share underwritten)	Dr. 7,50,000	3,75,000 2,50,000 1,25,000
P A/c R A/c To Bank A/c (Being the amount paid to P and R in final settlement of underwriting commission due less amount receivable from them on share allotted)	Dr. Dr. 3,75,000 95,833	4,70,833
Bank A/c To Q A/c (Being the amount received from Q on shares allotted less underwriting Commission payable to him)	Dr. 45,833	45,833

- (ii) **Green India Ltd. has five segments namely T, P, R, S & U. The total assets of the company are ₹22 crores, segment T has ₹ 4 crores., segment P has ₹6 crores., segment R has ₹3 crore, S has ₹5.5 crores, and U has ₹3.5 crores, deferred tax assets included in the assets of each segments are T - ₹1.50 crores; P - ₹1.29 crores; R - ₹1.10 crores; S - ₹2.25 crores & U - ₹1.35 crores. The accountant contended that all the five segments are reportable segments. Comments. [4]**

**Answer:**

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Segment Assets do not include income tax assets. Therefore, the revised total assets is [22 Crores – (1.50+1.29+1.10+2.25+1.35)] = 14.51 Crores, which is analysed as under –

Assets excluding DTA		Percentage of Total
T	4.00 – 1.50 = 2.50	17.23%
P	6.00 – 1.29 = 4.71	32.46%
R	3.00 – 1.10 = 1.90	13.09%
S	5.50 – 2.25 = 3.25	22.40%
U	3.50 – 1.35 = 2.15	14.82%
Total	14.51	

Thus all the five segments hold more than 10% of the Total Assets, all segments are Reportable Segments.

(b) (i) X Ltd. has the following balances as on 1st April, 2012

	₹
<b>Fixed Assets</b>	<b>16,40,000</b>
<b>Less: Depreciation</b>	<b><u>4,36,000</u></b>
	<b>12,04,000</b>
<b>Stocks and Debtors</b>	<b>7,25,000</b>
<b>Bank Balance</b>	<b>1,22,500</b>
<b>Creditors</b>	<b>2,24,000</b>
<b>Bills payable</b>	<b>1,76,000</b>
<b>Capital (Shares of ₹100 each)</b>	<b>7,50,000</b>

The Company made the following estimates for financial year 2012-13:

- (i) The company will pay a free of tax dividend of 20% the rate of tax being 30%.
- (ii) The company will acquire fixed assets costing ₹3,20,000 after selling one machine for ₹45,000 costing ₹1,95,000 and on which depreciation provided amounted to ₹1,66,500.
- (iii) Stocks and Debtors, Creditors and Bills payables at the end of financial year are expected to be ₹6,70,000, ₹1,88,000 and ₹1,52,800 respectively.
- (iv) The profit would be ₹2,04,500 after depreciation of ₹2,14,000.

Prepare the projected cash flow statement and ascertain the bank balance of X Ltd. at the end of Financial year 2012-13.

[8]

**Answer:**

**Working:**

	₹
<b>Cash Flow from Operation</b>	
Profit for the year	2,04,500
Add: Depreciation (Non-cash Item)	<u>2,14,000</u>



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	4,18,500
Less: Profit on sale of Machine	<u>16,500</u>
	4,02,000
Add: Decrease in stocks & Debtors (₹7,25,000 – ₹6,70,000)	<u>55,000</u>
	4,57,000
Less: Decrease in	
Creditors (₹2,24,000 - ₹1,88,000)	36,000
Bills Payable (₹1,76,000 – ₹152,800)	<u>23,200</u>
Cash from Operations	<u>3,97,800</u>
(ii) Payment of Dividend	
20% on Capital ₹7,50,000	1,50,000
Tax 30%	<u>45,000</u>
Total Dividend	<u>1,95,000</u>

It is assumed that income tax on company's profit ignore.

### Projected cash flow statement for the year ended on 31st March, 2013

	₹	₹
Bank Balance as on 1st April, 2012		1,22,500
Add: Inflow of cash		
Sale of Machine	45,000	
Cash from operation	<u>3,97,800</u>	<u>4,42,800</u>
		5,65,300
Less: Outflow of Cash		
Purchase of Fixed Assets	3,20,000	
Payment of Dividends	1,50,000	
Tax Paid	<u>45,000</u>	<u>5,15,000</u>
Bank Balance on 31 <sup>st</sup> March, 2013		<u>50,300</u>

(ii) The following are the Balance Sheets of Tufan Ltd. and Tuhin Ltd. for the year ending on 31st March, 2013.

(₹ in Crores)

	Tufan Ltd.	Tuhin Ltd.
<b>Equity Share capital @ ₹ 10 each</b>	<b>100</b>	<b>80</b>
<b>Preference Share capital - in 12% preference shares of ₹ 100 each</b>	<b>–</b>	<b>120</b>
<b>Reserves and surplus</b>	<b><u>400</u></b>	<b><u>300</u></b>
	<b>500</b>	<b>500</b>
<b>Loan - Secured</b>	<b>200</b>	<b>200</b>

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Total	700	700
Fixed assets (at cost less depreciation) - Tangible	300	300
Current assets less Current liabilities	400	400
<b>Total</b>	<b>700</b>	<b>700</b>

**Note : Secured Loan to repayable within 12 months.**

The present worth of Fixed assets of Tufan Ltd. is ₹400 crores and that of Tuhin Ltd. is ₹858 crores.

Goodwill of Tufan Ltd. is ₹80 crores and of Tuhin Ltd. is ₹150 crores.

Tuhin Ltd. absorbs Tufan Ltd. by issuing equity shares at par in such a way that intrinsic network is maintained.

Goodwill account is not to appear in the books. Fixed assets are to appear at old figures

- Draft a statement of valuation of shares on intrinsic value basis and prove the accuracy of your workings; and
- Journal entries in the books of Tuhin Ltd. [8]

**Answer:**

### Purchase consideration

#### Intrinsic Value of Equity Shares

(₹ in Crores)

Particulars	Tufan Ltd.	Tuhin Ltd.
a) <b>Assets :</b>		
i. Goodwill	80	150
ii. Fixed assets	400	858
iii. Current asset less Current liabilities	<u>400</u>	<u>400</u>
	880	1,408
b) <b>Liabilities</b>		
i. Secured Loans	(200)	(200)
ii. 12% Preference Share capital	<u>-</u>	<u>(120)</u>
c) Net Assets attributable to Equity shareholders	680	1,088
d) Number of Shares (in Crores)	10	8
e) Value per share of ₹ 10 each	<u>₹ 68</u>	<u>₹ 136</u>

### Determination of Exchange Ratio and the number of shares to be issued

Exchange Ratio is based on intrinsic value per share of the companies

	Tufan Ltd. :	Tuhin Ltd.
i. Intrinsic value	₹ 68	₹ 136
ii. Exchange ratio	1	2

1 share of Tuhin Ltd. for 2 shares of Tufan Ltd.

Therefore, Number of shares to be issued = Number of shares of Tufan Ltd. × %  
 = 10 crores × 50% (i.e. ratio is 1:2 =50%)

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= 5 crores

### Journal Entries in the books of Tuhin Ltd.

- Nature of Amalgamation - Purchase
- Method of Accounting - Purchase

(₹ in Crores)

Particulars	Debit ₹	Credit ₹
1. For Business Purchase		
Business Purchase A/c	Dr. 50	
To Liquidator of Tufan Ltd.		50
2. For assets and liabilities taken over :		
Fixed Assets A/c	Dr. 300	
Net Current Assets A/c	Dr. 400	
To Secured Loans A/c		200
To Capital Reserve A/c		450
To Business Purchase A/c		50
3. For Discharge of Purchase Consideration :		
Liquidator of Tufan Ltd. A/c	Dr. 50	
To Equity Share Capital A/c		50

### Statement to prove the accuracy of workings

(₹ in Crores)

(i) Equity Share capital (after absorption)	130
Add: Reserves Surplus (after absorption)	750
Add: Unrecorded value of goodwill (80+150)	230
Add: Unrecorded incremental value of Fixed assets (100+558)	658
Value of the Business	1,768
(ii) Number of Equity shares (8 + 5)	13 Crores
(iii) Intrinsic value of an equity share (₹1,768/13)	₹ 136

### (c) The draft balance sheet of H Ltd. as on 31.3.13:

(Figures in ₹ Lakhs)

Liabilities	Amount	Assets	Amount
Equity Share Capital (in equity shares of ₹ 10 each)	4.00	Fixed Assets less depreciation to date	6.00
10% Preference Share Capital	3.00	Stock and debtors	5.30
General Reserve	1.00	Cash and Bank	0.70
Profit & Loss Account	1.00		
Creditors	3.00		
	12.00		12.00

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M Ltd. another existing company holds 25% of equity Share capital of H Ltd. purchased at ₹10 per share.

It was agreed that M. Ltd. should take over the entire undertaking of H Ltd. on 30.9.13 on which date the position of Current assets (except cash and bank balances) and creditors was as follows.

Stock and debtors	4 lakhs
Creditors	2 lakhs

Profits earned for half year ended 30.9.13 by H Ltd. was ₹ 90,000 after charging depreciation of ₹ 32,500 on fixed assets. H Ltd. declared 10% dividend for 2012-13 on 30.8.13 and the same was paid within a week.

Goodwill of H Ltd. was valued at ₹ 1,20,000 and block assets were valued at 10% over their book value as on 31.3.13 for purposes of take over. Preference shareholders of H Ltd. will be allotted 10% preference shares of ₹ 10 each by M Ltd. Equity share holders of H Ltd. will receive requisite number of equity shares of ₹ 10 each from M Ltd. valued at ₹ 10 per share.

- Compute the purchase consideration.
- Explain, how the Capital reserve or goodwill, if any, will appear in the balance sheet of M Ltd. after absorption. [16]

**Answer:**

### Draft balance sheet of H Ltd. as at 30.09.13

<i>Liabilities</i>	<i>Amount ₹</i>	<i>Assets</i>		<i>Amount ₹</i>
Equity Share capital (40,000 equity shares of ₹ 10 each)	4,00,000	Block Assets	6,00,000	
10% Preference Share capital	3,00,000	Less: Depreciation	<u>(32,500)</u>	5,67,500
Reserves and surplus		Stock and Debtors		4,00,000
General Reserve	1,00,000	Cash and Bank (balancing figure)		1,52,500
Profit and Loss A/c*	1,20,000			
Creditors	2,00,000			
	<b>11,20,000</b>			<b>11,00,500</b>

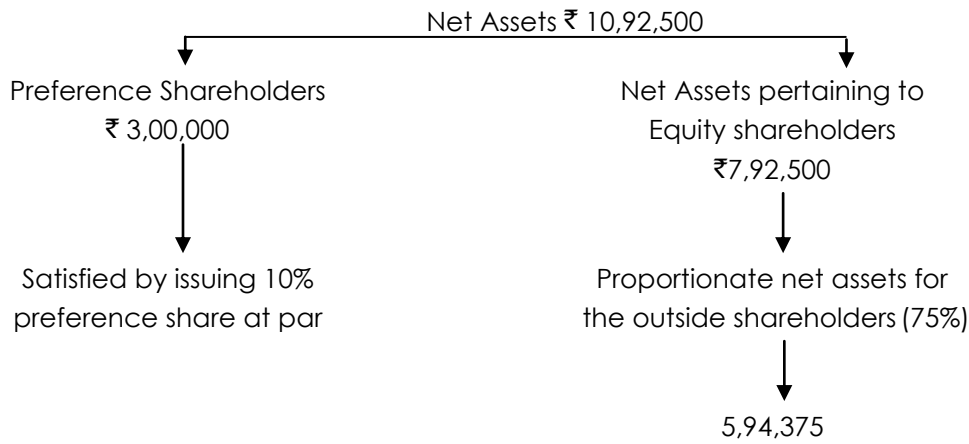
### Profit & Loss Account (draft)

<i>Particulars</i>	<i>Amount</i>
Opening Balance	1,00,000
Add: Half year profit	90,000
Less: Preference dividend @ 10%	(30,000)
Less: Equity dividend @ 10%	<u>(40,000)</u>
Closing balance	1,20,000

## Answer to PTP\_Intermediate\_Syllabus 2012\_Dec2014\_Set 3

### a. Purchase Consideration - Net Assets Method

Particulars	Amount	Amount
Fixed assets	6,60,000	
Stock and Debtors	4,00,000	
Cash and Bank	1,52,500	
Goodwill	<u>80,000</u>	12,92,500
Less: Creditors		<u>(2,00,000)</u>
<b>Net Assets Taken over</b>		<b>10,92,500</b>



Total Purchase Consideration

Particulars	Amount ₹
a. 10% Preference Share Capital	3,00,000
b. Equity Share Capital (Outsiders)	<u>5,94,375</u>
c. <b>Total</b>	<b><u>8,94,375</u></b>

### Calculation of Capital Reserve

Particulars	Amount ₹
a. Net Assets takeover	10,92,500
b. Less:	
i) Preference shares to be allotted	3,00,000
ii) Equity shares to be allotted	5,94,375
iii) Cost of Investments	<u>1,00,000</u>
	<u>(9,94,375)</u>
c. <b>Capital Reserve</b>	<b>98,125</b>

## **Answer to PTP\_Intermediate\_Syllabus 2012\_Dec2014\_Set 3**

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### **Balance sheet of M Ltd. as on 30th September 2013 (Extracts)**

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<b>Liabilities</b>	<b>₹</b>	<b>Assets</b>	<b>₹</b>
		Intangible Assets	
		Goodwill	1,20,000
		Less: Capital Reserve	<u>98,125</u>
			21,875

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#### **4. (Answer any 2 questions)**

**(a) (i) External confirmations are more reliable evidence than internal confirmations - Comment. [5]**

**Answer:**

External Confirmations minimize the possibility that the result of the confirmation process will be biased because of the interception and alteration of confirmation request or responses. SA 500 (Revised) indicates that the reliability of audit evidence is influenced by its source and by its nature, and is dependent on the individual circumstances under which it is obtained. That SA also includes the following generalizations applicable to audit evidence:

- Audit evidence is more reliable when it is obtained from independent sources outside the entity.
- Audit evidence obtained directly by the auditor is more reliable than audit evidence obtained indirectly or by inference.
- Audit evidence is more reliable when it exists in documentary form, whether paper, electronic or other medium.

Accordingly, depending on the circumstances of the audit, audit evidence in the form of external confirmations received directly by the auditor from confirming parties may be more reliable than evidence generated internally by the entity. This SA is intended to assist the auditor in designing and performing external confirmations procedures to obtain relevant and reliable audit evidence.

**(ii) State the essentials of an Internal Control System. [3]**

**Answer:**

An efficient internal control system should provide the following:

- i. For proper division of functional responsibilities;
- ii. For proper authorization and assignment of duties to perform and record the transactions;
- iii. For adoption of proper practices for adherence with management policies;
- iv. For proper review and authorization of all transactions before they are recorded in the books; and
- v. Safeguard of all business assets;
- vi. Proper internal checks; and
- vii. Proper internal audit system.

**(iii) List the scope of efficiency cum performance audit. [3]**

**Answer:**

## **Answer to PTP\_Intermediate\_Syllabus 2012\_Dec2014\_Set 3**

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- **Economy Audit:** It ensures that entity has acquired the financial, human and physical resources economically. It implies that resources have been procured in appropriate quantity, quality and at minimum cost.
- **Efficiency Audit:** It ensures the economical execution of various schemes and policies. It refers to the relationship between inputs and output i.e. the goods and services produced and resources used to produce them, yielding the expected results.
- **Effectiveness:** It is an appraisal of the performance of schemes and projects with reference to the overall targeted objectives as well as efficiency of the ways and methods adopted for the attainment of objectives.

**(iv) List the objectives of Social Audit.**

**[2]**

**Answer:**

Objectives of Social Audit:

- Assessing the needs of the society and resources available for fulfilling them.
- Spreading awareness among beneficiaries about the business' efforts towards attaining social objectives.
- Increasing efficacy and effectiveness of the organization's corporate social responsibility (CSR) programmes.
- Scrutiny of policy decisions, keeping in view the interests of stakeholders.

**(v) Discuss the areas to be covered by an auditor while splitting the shares of face value from ₹ 10 to ₹ 2 per share of a company.**

**[3]**

**Answer:**

- Confirm that alteration was authorised by articles.
- Verify the minutes of the Board meeting and ordinary resolution passed in the general meeting in which the approval of members is obtained.
- Verify also with reference to Form filed with the ROC.
- Verify that alteration had been effected in copies of Memorandum Articles, etc.
- Verify that proper accounting entries have been passed. Register of members may also be checked to see that the necessary alteration have been effected therein.

**(b) (i) Mr. Jaggu, Auditor of Baiju Limited is of the opinion that 'Standards on Auditing' are meant only for reference purpose and it is not necessary to follow such standards while auditing. Give your comments.**

**[5]**

**Answer:**

Contention of Mr. Jaggu is totally wrong and is against the fundamental assumptions and guidelines governing auditing and assurance standards. As per ICAI, while discharging their attest function, it will be the duty of the members of the Institute to ensure that the Auditing Standards are followed. The Auditing Standards will apply whenever an independent financial audit is carried out to express an opinion thereon. The member of the Institute must follow the Auditing Standards. The auditors must draw attention to the material departures from Auditing

## **Answer to PTP\_Intermediate\_Syllabus 2012\_Dec2014\_Set 3**

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Standards in their audit report along with the reasons for such departure. Auditors in their report have to mention that audit was conducted in accordance with "Generally accepted auditing standards" in Indian context. Hence Mr. Jaggu is duty bound to follow the Auditing Standards.

**(ii) Discuss – “appointment of auditors in the case of a company in voluntary liquidation”. [3]**

**Answer:**

Appointment of auditors in the case of a company in voluntary liquidation:

No question of fresh appointment of auditors for this specific purpose envisaged by Sec 224 of the Companies Act, 1956.

But if the winding up proceeding continues for more than one year, then it is left to members or creditors, as the case may be, to decide whether or not the auditors are to be appointed to audit the liquidators account.

**(iii) Discuss the areas to be considered by an auditor regarding Salaries and Wages of an organization, during his audit. [8]**

**Answer:**

The auditor should take into consideration the following points:

- **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.
- **Other matters:**
  - a. **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.
  - b. **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.
  - c. **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.
  - d. **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.
  - e. **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.



## **Answer to PTP\_Intermediate\_Syllabus 2012\_Dec2014\_Set 3**

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**f.** 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.

**g.** 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.

**h.** 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.

**(c) (i) Write a note on - Teeming & Lading/ Lapping**

**[7]**

**Answer:**

Teeming & Lading 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. E.g., a salesman recovers ₹ 20,000 from customer M and misappropriates the same, but to conceal the misappropriation, he declares ₹ 20,000 received later from another customer P as received from M so that the balance of M confirms to the client's debtor list, and so on for recovery from N of same amount declared as from P.

Teeming and lading 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 lading:

- 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.
- Reconcile individual cash amounts as per receipts with records in the Rough Cash Book.
- Reconcile the receipts as recorded in the Rough Cash Book, main Cash Book, pre-numbered Cash Memos, with counterfoils of the pay-in-slips.
- Ensure whether cash receipts are deposited in the bank on a timely basis.
- Examine the Debtors Ledger, especially entries showing part payments, to satisfy that the debtors concerned have indeed made part payments.
- Confirmations may be obtained from the debtors from time to time.

**(ii) Discuss the way of verification work conducted in case of revalued fixed assets.**

**[5]**

**Answer:**

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:

## **Answer to PTP\_Intermediate\_Syllabus 2012\_Dec2014\_Set 3**

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- 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.

**(iii) State the reasons for disqualification of a voucher.**

**[4]**

**Answer:**

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

- i. 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.
- ii. If the voucher is not passed by the authorized personnel in the organization.
- iii. The amount of the voucher differs in words and figures.
- iv. The nature of payment in the voucher does not relate to the business.
- v. The amount of voucher does not tally with the amount entered in the Cash Book.
- vi. The voucher is in the name of an employee/director, and not in the name of the client's company.