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:**

(i) Amrit Ltd. Granted 6,000 options on 1st May 2013 at ₹70 when the market price was ₹150. The vesting period is two years.
You are required to:
(a) Calculate the value of options
(b) Calculate the amount to be amortised every year.

Answer:

(a) Value of options = Number of options Granted × (Market Price – Exercise Price) = 6,000 × (₹150 – 70) = ₹4,80,000.
(b) 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 year = ₹4,80,000/2 = ₹2,40,000.

(ii) Income from operating Activities is ₹90 lakhs;
Fixed Asset sold for ₹120 lakhs;
Machinery purchased for ₹150 lakhs;
Income from Financing Activities is ₹(20) lakhs, copute the net effect on cash Flow.

Answer:

Particulars	₹ in lakhs	₹ in lakhs
Cash flow from operating Activities		90
Cash flow from Investing activities		
Sale of fixed Asset	120	
Purchase of machinery	150	(30)
Cash flow from Financing Activities		(20)
Net increase Cash Flow		40

(iii) 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.

(iv) A Company had `10,00,000 Authorised Capital on 31.3.2013 divided into shares of `100 each out of which 8,000 shares were issued and fully paid up. In September 2013 the Company decided to convert the issued Shares into Stock. Subsequently, in April 2014, the Company re-converted the stock into shares of `10 each fully paidup . Pass Journal Entries.

Answer:

Date	Particulars	Dr. (`)	Cr.(`)
Sept 2013	Equity Share Capital A/c(8,000 × `100) Dr. To, Equity Stock A/c (Being conversion of 8,000 fully paid Equity Shares of `100 into `8,00,000 Equity Stock as per resolution in General Meeting)	8,00,000	 8,00,000
Jan 2014	Equity Stock A/c Dr. To, Equity Share Capital A/c (80,000 × `10) (Being re-conversion of `8,00,000 Equity Stock into 80,000 Shares of `10 fully paid Equity Shares as per resolution in General Meeting)	8,00,000	 8,00,000

(v) State any four methods of redemption of debentures.

Answer:

Based on the terms of the issue, the liability on Debentures can be settled in any of the following ways —

- Redemption in equal annual Instalments over a period, out of cash accruals/ surplus.
- Redemption at the end of the stipulated period, i.e. after a fixed number of years, out of cash accruals/ surplus.
- Redemption at the end of the stipulated period , by creating a Sinking Fund (invested in outside securities).
- Conversion (in part or full) into shares.

(vi) Prafullya Ltd. issued 80,000 shares. Issued is underwritten by P,Q, and R in the ration of 5:3:2 respectively. Unmarked applications totaled 4,000 whereas Marked Applications are : P – 32,000 shares, Q – 11,400 shares and R – 16,600 shares.

Calculate the Gross Liability of each of the Underwriters.

Answer:

Statement of Underwriters' Gross Liability

Particulars	**P**	**Q**	**R**	**Total**
Gross Liability (5:3:2)	40,000	24,000	16,000	80,000

(vii) Discuss — Information Security Audit.

Answer:

Information Security Audit is an audit of the level of information security in an organization. The controls in any business organizations 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.

(viii) State what is Balance Sheet Audit.

Answer:

Balance sheet audit is generally synonymous with statutory audit. In a balance sheet audit, the auditor reviews and critically examines the Financial Statements, which include the Balance Sheet and Profit & Loss Account prepared by the management. He verifies each assertion in the Financial Statements, working backwards and checking through original entries made in the books of accounts and evidences to support the entries recorded.

(ix) Discuss — Test Control.

Answer:

Sampling risk arises from the possibility that the auditor's conclusion, based on a sample, may be different from the conclusion that would be reached if the entire population were subjected to the same audit procedure.
The auditor is faced with sampling risk in both tests of control and substantive procedures.

Tests of control consists of the following:

- Risk of Under Reliance: The risk that, although the sample result does not support the auditor's assessment of control risk, the actual compliance rate would support such an assessment.
- Risk of Over Reliance: The risk that, although the sample result supports the auditor's assessment of control risk, the actual compliance rate would not support such an assessment.

(x) List the uses of Interim Audit.

Answer:

Use of Interim Audit
It is useful for —

- Early detection and rectification of errors & frauds;
- Publishing of interim results in some cases;
- Timely completion of records and final audit;
- Moral checks on employees.

2. (Answer any 2 questions)

(a) (i) Define - Government, and Government Grants as per AS - 12. [3]

Answer:

Government refers to Government, Government Agencies and similar bodies, whether local, national or international.

Government Grants are assistance by Government, in cash or kind to an enterprise, for past or future compliance with certain conditions. They exclude - (a) those forms of Government assistance which cannot reasonably have a value placed upon them, and (b) transactions with Government which cannot be distinguished from the normal trading transactions of the enterprise.

(ii) At the beginning of a financial year, a Company issued 1,20,000 Equity Shares of ₹100 each, ₹50 per Share was called up on that date which was paid by all Shareholders. The remaining ₹50 was called up on 1st September. All Shareholders paid the sum in September, except one Shareholder having 24,000 Shares. The Net Profit for the relevant financial year is ₹2,64,000 after dividend on Preference Shares and Dividend Distribution Tax of ₹64,000. Compute the Basic EPS for the year as per AS-20. [5]

Answer:

A. Computation of weighted Average Number of Equity shares outstanding at end of the period

Date	No. of Equity Shares	Proportion of Paid-up Value to FV	Period Outstanding	Time Weighting Factor	Weighted Average No. of Shares
(1)	(2)	(3)	(4)	(5)	(6) = (2) × (3) ×(5)
1st Apr	1,20,000	₹ 50 ÷ ₹ 100 = 50%	5 months (upto 31st Aug)	5/12	25,000
1st Sep	96,000	₹ 100 ÷ ₹ 100 = 100%	7 months (upto 31st Mar)	7/12	56,000
	24,000	₹ 50 ÷ ₹ 100 = 50%	7 months (upto 31st Mar)	7/12	7,000
Weighted Average Number of Equity Shares Outstanding during the period					**88,000**

B. Basic EPS $\frac{\text{Net Profit or Loss attributable to Equity Shareholders}}{\text{Weighted Average Number of Equity Shares outstnding}}$

$= \frac{₹2,64,000}{88,000 \text{ Shares}}$ = ₹3.00 per Shares.

Note: It is assumed that Dividend is payable on paid- Up capital.

2. (b) The following balances are provided in respect of the US Branch of Prithvi Ltd.

Debit Balances (in USD):

Expenditure excluding depreciation - 68,730,

Cash & Bank Balances - 1,450,

Debtors - 4,910,

Fixed Assets (10% Depreciation) - 22,800,

Inventory Stock A - 3,680,

Inventory Stock B - 690.

Credit Balances (in USD):
Income - 88,000,
Creditors -10,380,
HO Control A/c - 3,880

The following additional information is provided –

- **The Average Rate during the above financial year was 1 USD = ₹45.00**
- **Fixed Assets were purchased when the exchange rate was 1 USD = ₹44.00**
- **Exchange Rate at the end of the financial year i.e. Closing Rate was 1 USD = ₹ 46.50.**
- **Stock Item A is valued at cost of USD 3,680, purchased when the exchange rate was ₹ 45.50. The present NRV of this item is ₹1,60,000.**
- **Stock Item B is carried at NRV of USD 690, but its cost is USD 710 (purchased when Exchange Rate was 1 USD = ₹43.20)**
- **Branch Control Account as per HO Books was ₹ 1,77,510.**

If the Branch is classified as an Integral Foreign Operation, show how it will be reflected in the Head Office Accounts [8]

Answer:

In the books of the Head Office

Particulars	Trial Bal. in USD		Rate and Reasons for Translation	Trial Bal. in Indian ₹	
	Dr.	Cr.		Dr.	Cr.
Income	-	88,000	Average Rate ₹ 45	-	39,60,000
Expenditure (excl.dep)	68,730	-	Average Rate ₹ 45	30,92,850	-
Cash and Bank	1,450	-	Cash, Drs & Crs are Monetary Items, hence taken at Closing Rate ₹ 46.50.	67,425	-
Debtors	4,910	-		2,28,315	-
Creditors	-	10,380		-	4,82,670
Fixed Assets (Net)	20,520	-	transaction Date Rate ₹44	9,02,880	-
Depreciation	2,280	-	Transaction Date Rate ₹ 44	1,00,320	-
Inventory Item A	3,680	-	See Note 1 below	1,60,000	-
Inventory Item B	690	-	See Note 2 below	30,672	-
HO Control Account	-	3,880	As per HO Books - Given	-	1,77,510
Exchange Difference	-	-	**Balancing Figure**	37,718	-
Total	**1,02,260**	**1,02,260**	**Total**	**46,20,180**	**46,20,180**

Notes:

1. **Inventory Item A**: Since this is a non-monetary item, it shall be translated at the rate which existed when the value is determined i.e. at cost. Hence, the cost of this stock is ₹45.50 × 3,680 USD = ₹1,67,440. Since the NRV is only ₹ 1,60,000 (given), this is written down to its NRV in Indian Rupees.

2. **Inventory Item B**: This is a non-monetary item and translated at the rate which existed when the value is determined, i.e. at Cost. Hence, the Cost of this Stock is ₹43.20 × 710 USD = ₹30,672. However, the Branch TB shows its valuation at NRV at the Closing Rate, i.e. ₹46.50 × 690 USD = ₹32,085. Since Inventories are carried at Cost or NRV, whichever is lower, the value adopted is ₹30,672 (i.e. cost) even if it written down to its NRV in the Branch TB.

2. (c) (i) Define -
Gross Investment,
Net investment, and
Unearned Finance Income as per AS – 19 for the lessor. [6]

Answer:

Gross Investment in the Lease, is the aggregate of the Minimum Lease Payments under a Finance Lease from the standpoint of the Lessor and any Unguaranteed Residual Value accruing to the Lessor.

Net Investment in the Lease is the Gross Investment in the Lease less Unearned Finance Income.

Unearned Finance Income is the difference between:
the Gross Investment in the Lease, and
the Present Value of -

- the Minimum Lease Payments under a Finance Lease from the standpoint of the Lessor, and
- any Unguaranteed Residual Value accruing to the Lessor,

at the interest rate implicit in the lease.

Thus, for the Lessor,

Gross Investment in the Lease= Minimum Lease Payments + Unguaranteed Residual Value	**GI = MLP + URV**
Unearned Finance Income = (MLP + URV) **less** (Present Value of MLP & URV)	**UFI = GI – (PV Of GI)**
Net Investment in the Lease = Gross Investment - Unearned Finance Income.	**NI = GI - UFI**

(c) (ii) Calculate from the following information- Theoretical ex-right fair value

- **Number of equity shares outstanding 4 lakhs**
- **Right issue 2 shares for each 5 shares**
- **Fair value per share before right ₹ 34.00**
- **Right issue price ₹ 20.00** **[2]**

Answer:

Determination of Theoretical Ex- Rights fair Value/Price:

$$\frac{(\text{Base Shares Quantity x Fair Value per Share Before Rights}) + (\text{Rights Issue} \times \text{Rights Issue Price})}{\text{Base Shares Quantity} + \text{Rights Shares Quantity}}$$

$$= \text{Theoretical ex-right fair} = \frac{(4,00,000 \times 34) + (1,60,000 \times 20)}{4,00,000 + 1,60,000} = ₹30$$

3. (Answer any 2 questions)

(a) (i) Asmaan Ltd. absorbs Vimaan Ltd. and the liquidation expense is ₹50,000. Give the journal entries in the books of if Transferor Company —

Case I: The expense is incurred by Transferor Company;
Case II: The expense is Incurred by Transferee Company;
Case III: The expense is Incurred by Transferor Company reimbursed by Transferee Company. **[4]**

Answer:

Case I — If the expense is incurred by Transferor Company

Particulars		L.F.	Dr. (₹)	Cr.(₹)
Realization A/c	Dr.		50,000	
To, Bank A/c				50,000

Case II — If the expense is Incurred by Transferee Company

Particulars	L.F.	Dr. (₹)	Cr.(₹)
No Entry			

Case III: The expense is Incurred by Transferor Company reimbursed by Transferee Company

Particulars		L.F.	Dr. (₹)	Cr.(₹)
i. **On incurring the expenses:**				
BB Ltd. A/c	Dr.		50,000	
To, Bank A/c				50,000
ii. **On reimbursement:**				
Bank A/c	Dr.		50,000	
To, Transferee Company A/c				50,000

(a) (ii) From the following particulars of Pintop 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	**8,70,410**
Depreciation provided in the Books	**3,10,000**
Provision for Repairs for Machinery during the year	**25,000**
Depreciation Allowable under Schedule II	**2,60,000**
Actual Expenditure incurred on Repairs during the year	**15,000**

[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	8,70,410
Add: Depreciation provided in the Books	3,10,000
	11,80,410
Less: Depreciation allowable under Schedule II	(2,60,000)
Net Profits under Section 198	9,20,410

B. Computation of Managerial remuneration

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

(a) (iii) Vima Ltd. has the following business / geographical segments. Examine which of these are Reportable Segments under AS – 17. (`'000)

Segments	Revenue	Profit/(Loss)	Assets
A	**9,600**	**1,750**	**4,100**
B	**300**	**180**	**450**
C	**100**	**70**	**450**

[6]

Answer:

Particulars	A	B	C	Total
A. Segment Revenue	9,600	300	100	10,000
B. Percentage of Segment Revenue	96%	3%	1%	100%
C. Segment Result i.e. Profit	1,750	180	70	2,000
D. Percentage of Segment Result, absolute amount of Profit or Loss, whichever is higher i.e. percentage of	87.5%	9%	3.5%	100%

`2,000				
E. Segment Assets	4,100	450	450	5,000
F. Percentage of Segment Assets	82%	9%	9%	100%
G. Reportable Segment	Yes	No	No	
H. Criteria Satisfied	All	None	None	

- Single Segment Principle: Disclosure of single segment information as per AS-17 is not required, if there is not more than one business/ geographical segment. This is because, the relevant information is available from the Balance Sheet.
- Since segments B and C do not meet the reportable segment criteria and also 75% condition is satisfied by Segment A alone, only Segment A is identified as a reportable segment.

3. (b) (i) Following is the summarized Balance Sheet of A Ltd. as at 31st March:

Equity and Liabilities	`'000	Assets	`'000
Shareholders' Funds:		**Non-Current Assets:**	
Share Capital		**Fixed Assets – Tangible**	
Equity Shares of (₹ 100)	**1,500**	**- Land & Buildings**	**1,000**
11% Pref. Shares of	**500**	**- Plant & Machinery**	**700**
Reserves & Surplus		**- Furniture & Fittings**	**200**
General Reserve	**300**		
Current Liabilities:		**Current Assets:**	
Trade Payables — Sundry Creditors	**200**	**Inventories**	**300**
		Trade Receivables	
		Debtors	**200**
		Cash & Cash Equivalents	**100**
Total	**2,500**	**Total**	**2,500**

M Ltd agreed to take over A Ltd on the following terms:

- **Each Equity Share in A Ltd for the purpose of absorption is to be valued at ₹80.**
- **Equity Shares will be issued by M Ltd by valuing its each Equity Share of ₹100 each at ₹ 120 per share.**
- **11% Preference Shareholders of A Ltd will give 11% Redeemable Debentures of M Ltd at equivalent value.**
- **All the Assets and Liabilities of A Ltd will be recorded at the same value in the books of M Ltd.**

Required:

- ✓ **Calculate the purchase Consideration.**
- ✓ **Pass Journal Entries in the books of M Ltd. for absorbing A Ltd.** **[7]**

Answer: **Note:** This is treated as Amalgamation in the nature of purchase.

Computation of purchase Consideration

Particulars	₹
Value of 15,000 Equity Shares of A Ltd at ₹ 80 per Share = ₹12,00,000 Shares to be issued by M Ltd ($\frac{₹12,00,000}{₹120 \text{ per Share}}$ = 10,000 Shares at ₹120 each)	12,00,000
11% preference Shareholders to be issued equivalent 11% redeemable Debentures by M Ltd.	5,00,000
Total Purchase consideration	17,00,000

Journal entries in the books of M Ltd.

S. No.	Particulars	Dr. (₹)	Cr. (₹)
1.	Business Purchase A/c Dr.	17,00,000	
	To Liquidator of A Ltd		17,00,000
	(Being the purchase of business from A Ltd, and consideration due thereon)		
2.	Land and Building A/c Dr.	10,00,000	
	Plant and Machinery A/c Dr.	7,00,000	
	Furniture and Fittings A/c Dr.	2,00,000	
	Stock in Trade A/c Dr.	3,00,000	
	Sundry Debtors A/c Dr.	2,00,000	
	Cash and Bank A/c Dr.	1,00,000	
	To Sundry Creditors A/c		2,00,000
	To Capital Reserve A/c **(balancing figure)**		**6,00,000**
	To Business Purchase A/c		17,00,000
	(Being the value of Assets and Liabilities taken over from A Ltd)		
3.	Liquidator of A Ltd A/c Dr.	17,00,000	
	To Equity Share Capital A/c		10,00,000
	To Securities Premium A/c		2,00,000
	To 11% Redeemable Debentures A/c		5,00,000
	(Being Purchase Consideration discharged)		

(b) (ii) Prepare Cash Flow Statement of K Ltd for the year as per AS-3, from the following data.

Particulars	**(₹ in lakhs)**
Net Profit	**25,000**
Dividend (including Dividend Tax) paid	**8,535**
Provision for Income Tax	**5,000**
Income Tax paid during the year	**4,248**
Loss on Sale of Assets (Net)	**40**
Book Value of Assets sold	**185**
Depreciation charged to Profit & Loss Account	**20,000**

Amortisation of Capital Grant	**6**
Profit on Sale of Investments	**100**
Carrying Amount of Investments sold	**27,765**
Interest Income on Investments	**2,506**
Interest Expense	**10,000**
Interest paid during the year	**10,520**
Increase in Working Capital (excluding Cash & Bank Balance)	**56,075**
Purchase of Fixed Assets	**14,560**
Investments in Joint Venture	**3,850**
Expenditure on Construction Work-in-Progress	**34,740**
Proceeds from Calls-in-Arrears	**2**
Receipt of Grant for Capital Projects	**12**
Proceeds from Long-Term Borrowings	**25,980**
Proceeds from Short-Term Borrowings (assume as Financing Activities)	**20,575**
Opening Cash & Bank Balance	**5,003**
Closing Cash & Bank Balance	**6,988**

[9]

Answer:

Cash Flow Statement for the year ……….

Particulars	**₹ Lakhs**	**₹ Lakhs**
A. CASH FLOW FROM OPERATING ACTIVITIES		
Net Profit before Taxation (25,000 + 5,000)	30,000	
Adjustments for : Depreciation	20,000	
Loss on Sale of Assets (Net)	40	
Amortisation of Capital Grant	(6)	
Profit on Sale of Investments	(100)	
Interest Income from Investments	(2,506)	
Interest Expense	10,000	
Operating Profit before Working Capital changes	57,428	
Add /(Less): Changes in Working Capital (Excluding Cash & Bank Balance)	(56,075)	
Cash Generated from Operations	1,353	
Less: Income Taxes paid	(4,248)	
Net Cash Flow from / (used in) Operating Activities [A]		**(2,895)**
B. CASH FLOW FROM INVESTING ACTIVITIES		
Sale of Assets Book Value 185 less Loss on Sale 40)	145	
Sale of Investments (27,765 + 100)	27,865	
Interest Income on Investments (assumed as received fully during the year)	2,506	
Purchase of Fixed Assets	(14,560)	
Investment in Joint Venture	(3,850)	
Expenditure on Construction Work-in-Progress	(34,740)	
Net Cash Flow from / (used in) Investing Activities [B]		**(22,634)**
C. CASH FLOW FROM FINANCING ACTIVITIES		
Proceeds from Calls-in-Arrears	2	
Receipt of Grant for Capital Projects	12	
Proceeds from Long-Term Borrowings	25,980	
Proceeds from Short-Term Borrowings	20,575	
Interest paid	(10,520)	
Dividend (including Dividend Tax) paid	(8,535)	
Net Cash Flow from / (used in) Financing Activities [C]		**27,514**
D. Net Increase / (Decrease) in Cash and Cash Equivalents (A + B + C) E. Cash and Cash Equivalents at the beginning of the period		1,985 5,003

F. Cash and Cash Equivalents at the end of the period (D + E)		6,988

3. (c) (i) On 1st January 2010, Q Ltd. issued 10,000, 15 year Debentures of ₹ 100 each bearing interest at 12% per annum. One of the conditions of issue was that the debentures could be redeemed by giving six months notice at any time after 5 years, at a premium of 10% either by payment in cash or by allotment of preference shares and / or other debentures according to the option of debenture holders on 1st April, 2015 either by payment in cash or by allotment of 8% Preference Shares of ₹ 100 each at ₹ 125 per share or by allotment of 13% Second Debentures of ₹ 100 each at ₹ 96 per debenture. Holders of 4,000 debentures accepted the offer of the Preference Share and Holders of 4,800 debentures accepted the offer of the 13% Second Debentures and the rest demanded cash. Redemption of debentures was completed on 1st October, 2015. Give Journal entries to record the transactions, relating to redemption. [10]

Answer:

In the books of Q Ltd.

Journal Entries

Date	Particulars	L.F	Dr. (₹)	Cr. (₹)
2015 Oct.1	6% Debentures A/c Dr. Premium on Redemption of Debentures A/c Dr. To Debenture holders A/c (Amount due for redemption of 1,000 6% Debentures at a premium of 4%)		10,00,000 1,00,000	 11,00,000
Oct.1	Debenture holders A/c Dr. To 8% Preference Share Capital A/c To Securities Premium A/c (Conversion of amount payable on 4,000 12% Debentures into 3,520 8% Preference Shares of 100 each at a premium of 25%.)		4,40,000	 3,52,000 88,000
Oct.1	Debenture holders A/c Dr. Discount on Issue of Debentures A/c Dr. To 7% Second Debentures A/c (Conversion of amount payable on 4800 12% Debentures into 5500 13% Second Debentures at a discount of 4%.)		5,28,000 22,000	 5,50,000
Oct.1	Debenture holders A/c Dr. To Bank A/c (Holders of 1200 12% Debentures paid off in cash)		1,32,000	 1,32,000
Oct.1	Securities Premium A/c Dr. Profit & Loss A/c Dr. To Premium on Redemption of Debentures A/c To Discount on Issue of Debentures A/c (Premium on Redemption of Debentures and Discount on issue of Debentures written off).		88,000 34,000	 1,00,000 22,000

Working Notes:

- No. of 8% Preference Shares issued = (4,000 × 110)/125 = 3,520 shares.
- No. of 13% Second Debentures Issued = (4,800 × 110)/96 = 5,500 Now debentures.

(c) (ii) State the disclosure requirement under schedule III of the following items:

- **Debit balance of Profit & Loss account**
- **Unsecured Bank loan** **[2]**

Answer:

- **Debit balance of Profit & Loss account -** To be shown as a negative figure under "Surplus".
- **Unsecured Bank loan -** If it is repayable after 12 months – to be sub-classified under "Long-term Borrowing" to be presented as a separate line item. Also state the terms of repayment, and If it is repayable within twelve months – to be sub – classified under "other current liabilities. To be shown as a separate line item.

(c) (iii)Following is the Balance Sheet of Urmila Ltd. for the year ended 31st March,2014 —

Liabilities	Amount	Assets	Amount
Equity Shares of ₹100 each fully paid up	20,00,000	Fixed Assets	19,00,000
Reserves and Surplus	4,00,000	Current Assets	11,00,000
Current Liabilities	6,00,000		
	30,00,000		30,00,000

Kapila Ltd. takes over all the assets and liabilities of Urmila Ltd. at their books value except a machinery of ₹8 lakhs taken over at ₹6 lakhs.

Kapila Ltd. issued requisite number of equity shares at par for the assets and liabilities taken over.
Compute the purchase consideration and determine whether the above should be treated as an amalgamation in the nature of Merger or in the nature of Purchase. **[4]**

Answer:

As per Accounting Standard – 14 [Accounting for Amalgamation]:

The assets taken over should be recorded in the transferee company books at the same values at which they appeared in the books of transferor company the amalgamation will be treated as an amalgamation in the nature of Merger.

In the present case as all the assets and liabilities except one asset is taken over at their book value it will not be treated as an amalgamation in the nature Merger. Hence, this is an amalgamation in the nature Purchase.

Computation of Purchase Consideration:

Particulars	₹ in Lakhs
Fixed Assets (19,00,000 – 8,00,000 + 6,00,000)	17,00,000
Current Assets	11,00,000
	28,00,000
Less: Current Liabilities	6,00,000
	22,00,000

Number of Shares to be issued to Urmila Ltd. = ₹22,00,000/₹100 = 22,000 Shares.

4. (Answer any 2 questions)

(a) (i) Discuss Government Expenditure Audit . [5]

Answer:

Expenditure Audit: The basic standards set for audit of expenditure are to ensure that there is provision of funds authorized by competent authority fixing the limits within which expenditure can be incurred. Some standards are briefly explained below:

- **Audit against Rules & Orders:** It is also known as Regularity Audit. Under this, the auditor has to see that the expenditure incurred conforms to the relevant provisions of the statutory enactment and is in accordance with the financial rules and orders framed by the competent authority.

- **Audit of Sanctions:** The auditor has to ensure that each item of expenditure is covered by a sanction, either general or special, accorded by the competent authority, authorizing such expenditure. In case expenditure exceeds the sanctioned limit, objection is raised.

- **Audit against Provision of Funds:** It contemplates that there is a provision of funds out of which expenditure can be incurred and the amount of such expenditure does not exceed the sanctioned amount as well as examine whether the money has been spent for the specified purpose.

- **Audit of financial propriety:** The auditor has to ensure that the expenditure incurred are with respect to the recognized standards of financial propriety i.e. quantity, quality, morality and ethics.

(a)(ii) Discuss Surprise Check in the context of audit. [6]

Answer:

Auditor and his staff have to visit the client's place for carrying out the audit. Normally, the visit is given to understand the accounting system, to evaluate the system of internal controls, stock taking etc. It is well accepted that the audit constitutes a moral check on the employees of the client and thus have a deterrent effect. But at the same time, if the auditor or his staff visits at regular intervals, the client or his staff may get time to be well prepared in advance for the audit queries. This may impair the deterrent effect. Thus, there is a need of element of surprise.

An element of surprise can significantly improve the effectiveness of an audit and therefore, wherever practicable, an element of surprise should be incorporated into the audit programme.

The Council of ICAI has made the following recommendations in this regard:

- Surprise checks should be considered as a desirable part of each audit.
- The areas over which surprise checks should be employed would depend upon the circumstances of each audit but should normally include:
  - Verification of cash and investments.
  - Test verification of stores and stocks and the records relating thereto.
  - Verification of books of prime entry and statutory registers normally required to be examined for the purposes of audit.

- The frequency of surprise checks may be determined by the auditor in the circumstances of each audit but should normally be at least once in the course of an audit.
- The results of the surprise checks should be communicated to the management if they reveal weakness in the internal control system or the existence of fraud or error.
- The auditor should satisfy himself that adequate action is taken by the management on the matters communicated by him.
- The results of surprise checks should be included in the audit report if they are material and affect the true and fair view of the accounts on which the reporting is done.

(a)(iii) State the procedure for removal of statutory auditor before the expiry of his term as per Companies Act, 2013. [5]

Answer:

Removal of auditor before expiry of his term [Section 140 (1) of Companies Act, 2013]:

(a) Resolution : Such removal requires a special resolution.
(b) Previous approval of the Central Government must be obtained in the manner prescribed.
(c) Procedure for obtaining approval of the Central Government and passing Special Resolution (Rule 7) —
  (i) An application shall be made to the Central Government in Form ADT-2. The application shall be accompanied with the prescribed fees.
  (ii) The application shall be made to the Central Government within 30 days of passing of the Board resolution.
  (iii) The company shall hold the general meeting within 60 days of receipt of approval of the Central Government for passing the special resolution.

4. (b)(i) Distinguish Between Internal Audit And External Audit. [10]

Answer:

On accounting matters, the internal and external auditors operate mainly in the same field and they have a common interest in ascertaining that there is an effective system of internal control for presentation and detection of errors and frauds and to ensure that it is operating satisfactorily and that an adequate accounting system exists to provide the information necessary for preparing true and fair financial statements. There are some fundamental differences between the work of an internal auditor and that of an external auditor regarding the following:

- **Appointment:** The internal auditor is appointed by the management, generally the Directors and is responsible to them.
  The external or the statutory auditor is appointed according to the concerned statute. Generally, in case of company form of organization, the auditors are appointed by the shareholders in the annual general meeting.

- **Scope:** The extent of the work undertaken by the internal auditor is determined the management.
  The external auditor undertakes the area of the work which arises from the responsibilities placed on him by the governing statute.

- **Approach:** The internal auditor's approach is with a view to ensure that the accounting system is efficient, so that the accounting information presented to management throughout the period is accurate and discloses material facts.
  The external auditor's approach is governed by his responsibility to satisfy himself that the accounts to be presented to the shareholders show a true and fair view of the profit or loss for the financial period and of the company's state of affairs at the end of that period.

- **Responsibility:** The internal auditor's responsibility is to the management. It follows that the internal auditors, being a servant of the company, does not have independence of status.
  The external auditors, however, is responsible directly to the shareholders. Unlike the internal auditors, he is a representative of the shareholders and has independence of status.

- **Objective:** The main objective of internal audit is to ensure that the laid down policies, procedures and other internal control functions are functioning as designed.

  Whereas the objective of the external auditor is to express opinion and view to on financial statements whether those statements are showing true and fair view of the organisation.

- **Independence:** External auditor is more independent than internal auditor in the field of reporting. Except these important differences, the work of both the internal auditor and the external auditor, on matters of accounting, is carried out largely by similar means.

The wide experience of the external auditor may be of assistance to the internal auditor: while on the other side the latter's intimate acquaintance with business concern may be of help to the external auditors. Co-operation in planning of the respective auditors may save unnecessary works, although the external auditors must always satisfy himself as to the work carried out by the internal auditors.

(b) (ii) X Ltd. is going for liquidation it has liabilities of ₹120 consisting of secured creditors of ₹30, Creditors of ₹20 and Unsecured Creditors of ₹70. Net Assets after payment of both secured and Preferential Creditors is ₹30.

Liquidator is entitled to a remuneration of 2% on the on the payment made to unsecured creditors.

Guide the Accountant on the procedure to estimate the remuneration of the liquidator. [6]

Answer:

Following are the steps involved in this process;

1. Ascertain the value of assets and liabilities
2. Ascertain the amount of Secured creditors
3. Ascertain the amount of Preferential Creditors
4. Verify the agreement with the Liquidators and the terms involved in it
5. Discharge the liabilities

In this case, the as there is insufficient fund the liquidator will receive a remuneration of ₹70 × $\left[\frac{2}{102}\right]$ =₹1.37 .

4. (c) (i) Discuss the procedure of auditing Patents. [6]

Answer:

Following is the procedure of auditing Patents —

- Examine the patents and verify them with the help of the certificate from the party granting the patents.
- Ensure that the patents are duly registered in the name of the auditor.
- Verify the voucher, pass book, agreement, authorization etc., in case of outright purchases of patents and see that the cost is fully capitalized.
- Check the renewal fees, if any, paid is debited to Profit and Loss Account.
- In case of patents developed by the client, expenditure incurred on its development, should be capitalized.
- Call for schedule in case the number of patents is large and examine the dates and acquisition, description and expiry date etc.,
- Question of charge on patents does not arise as it itself is a right in use.
- See that proper depreciation is provided on patents as per the provision of the Companies Act.

(c)(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:

- 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.

(c)(iii) "Cost data are very much useful to a company" — discuss. [5]

Answer:

The cost data is useful to a 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.