# 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<br><br>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<br><br>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<br><br>How you are expected to apply<br>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<br><br>How you are expected to analyses the detail of what you have learned | Analyse | Examine in detail the structure of |
| | | Categories | Place into a defined class or division |
| | | Compare and contrast | Show the similarities and/or differences between |
| | | Construct | Build up or compile |
| | | Priorities | 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]**

**(i) ABC Ltd. developed a know-how by incurring expenditure of ₹20 lakhs. The know-how was used by the company from 01.04.2008. The useful life of the asset is 10 years from the year of commencement of its use. The company has not amortised the asset till 31.3.2015. Pass Journal entry to give effect to the value of know-how as per Accounting Standard-26 for the year ended 31.3.2015.**

**Answer:**

**Journal Entry**

| Particulars | Dr. (₹) | Cr. (₹) |
|---|---|---|
| Profit and Loss A/c (Prior period item) Dr. | 12,00,000 | |
| Depreciation A/c Dr. | 2,00,000 | |
| To Know-how A/c | | 14,00,000 |
| [Being depreciation of 7 years (out of which of 6 years charged as prior period item)] | | |

**(ii) Discuss about Going Concern assumption.**

**Answer:**

Under going concern assumption, the financial statements are normally prepared on the assumption that an entity is a going concern and will continue in operation for the foreseeable future. Therefore, it is assumed that the entity has neither the intention nor the need to liquidate or curtail materially the scale of its operations; if such an intention or need exists, the financial statements may have to be prepared on a different basis. In case going concern basis could not be used, the entity shall disclose the basis used as well.

**(iii) Hari Ltd had issued 30,000, 15% Convertible Debentures of ₹100 each on 1st April 2011. The Debentures are due for redemption on 1st March 2014. The terms of issue of Debentures provided that they were redeemable at a premium of 5% and also conferred option to the Debenture holders to convert 20% of their holding into Equity Shares (Nominal Value of ₹10) at a Price of ₹15 per Share. Debenture holders holding 2,500 Debentures did not exercise the option. Calculate the Number of Equity Shares to be allotted to the Debenture holders exercising the option to the maximum.**

**Answer:**

| | **Particulars** | **Nos,** |
|---|---|---|
| | Total Number of Debentures | 30,000 |
| **Less:** | Number of Debentures not opting for conversion | 2,500 |
| | Balance Debentures opting for conversion | 27,500 |
| | Convertible Portion Debentures = 20% of 27,500 | 5,500 |
| | Redemption Value of 5,500 Debentures (5,500 × ₹105) | ₹ 5,77,500 |
| Number of Equity-Shares to be allotted = 5,77,500 ÷ 15 = 38,500 Shares of ₹10 each | | |

**(iv) Z Ltd. took over the assets of ₹6,00,000 and liabilities of ₹80,000 of C Ltd. for an agreed purchase consideration of ₹5,40,000 to be satisfied by the issue of 10% Debentures of ₹1,000 each.**
**Show the necessary journal entries in the books of Z Ltd, assuming that—**
**Case (a) Such Debentures are issued at par;**

**Answer:**

**In the Books of Z Ltd.**
**Journal**

| Particulars | L. F. | Dr.(₹) | Cr.(₹) |
|---|---|---|---|
| Sundry Assets A/c Dr.<br>Goodwill A/c Dr.<br>To Sundry Liabilities A/c<br>To C Ltd.<br>(Being the purchase of assets and liabilities from C Ltd. as per agreement dated...) | | 6,00,000<br>20,000 | <br><br>80,000<br>5,40,000 |
| **Case (a) If Debentures are issued at par**<br>C Ltd. Dr.<br>To 10% Debentures A/c<br>(Being the issue of debentures at par to C Ltd. as per Board's resolution dated....) | | <br>5,40,000 | <br><br>5,40,000 |

**(v) List the factors that should be considered in identifying geographical segments.**

**Answer:**

Geographical segments include:
(a) Similarity of economic and political conditions;
(b) Relationships between operations in different geographical areas;
(c) Proximity of operations;
(d) Special risks associated with operations in a particular area;
(e) Exchange control regulations; and
(f) The underlying currency risks

**(vi) X Ltd. of India purchased machinery from U.S.A. at $ 1.5 million on 01/10/2011-2012. At that date the exchange rate was ₹42 per dollar. This machinery is to be depreciated @ 10% on SLM basis. The exchange rate on 31/03/2013 was ₹ 42.50 per dollar. How this transaction be shown in the financial statements of X Ltd. for the year 2012 - 2013.**

**Answer:**

**Calculation of amount to be recognized in Machinery a/c, Depreciation for the year and Closing balance of the Machinery Account.**

| | Particulars | Amount |
|---|---|---|
| A. | Cost of Machinery | $15,00,000 |
| B. | Exchange rate per dollar existing on date of transaction | ₹42.00 |
| C. | Cost of Machinery to be recognized (A × B) | ₹6,30,00,000 |
| D. | Depreciation for the year (C × 10% × 0.5) | ₹31,50,000 |
| E. | Closing balance of the Machinery (C – D) | ₹5,98,50,000 |

**(vii) State the meaning of the term 'substantive tests'.**

**Answer:**

Substantive procedures (or substantive tests) are those activities which are performed by the auditor during the substantive testing stage of the audit that gather evidence as to the completeness, validity and/ or accuracy of account balances and underlying classes of transactions.

Management impliedly asserts that account balances and underlying classes of transaction do not contain any material misstatements: in other words, that they are materially complete, valid and accurate. Auditors gather evidence about these assertions by undertaking activities referred to as substantive procedures.

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

**Answer:**

Objectives of Social Audit

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

**(ix) 'The auditor is faced with sampling risk in substantive procedures' - Discuss.**

**Answer:**

Substantive Procedures:

(i) Risk of Incorrect Rejection: The risk that, although the sample result supports the conclusion that a recorded account balance or class of transactions is materially misstated, in fact it is not materially misstated.
(ii) Risk of Incorrect Acceptance: The risk that, although the sample result supports the conclusion that a recorded account balance or class of transactions is not materially misstated, in fact it is materially misstated.,

**(x) "To verify the secret reserve, the auditor should keep in mind the following points.' – List the points.**

**Answer:**

To verify the secret reserve, if any, the auditor should keep in mind the following points:

(i) Carefully enquire into the necessity of creating such reserve.
(ii) Don't qualify audit report if it is found that the intention of the company is honest and the amount is reasonable.
(iii) May pass a remark in audit report that the assets are understated,
(iv) Discuss the fact, if found, that the director's intention behind creating secret reserve was not honest and only to facilitate improper dealing in shares.

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

**(a) On 1st April, 2010. BHARAT Ltd. purchased a Fixed Asset worth ₹149.50 lakhs for which it got Government grant of ₹24.50 lakhs. The Salvage Value at the end of useful life of 4 years was estimated at ₹51.20 lakhs. X Ltd. decides to treat the Grant as Capital Receipt. During 2012-2013 the Grant has become refundable due to non-fulfillment of certain conditions.**

**Calculate the amount of the Depreciation to be recognized every year in Profit and Loss Account during the useful life of the machinery if the company followed (a) W.D.V Method. [8]**

**Answer:**

As per AS 12 on Accounting Government Grants, the amount refundable in respect of a government grant related to a specific fixed asset is recorded by increasing the book value of the asset. Depreciation on the revised book value is provided prospectively over the residual useful life of the asset.

**Statement showing the Book Value, WDV Depreciation Charged and Recording of refund of Grant**

| | Particulars | ₹ (in lakhs) |
|---|---|---|
| | Cost of Fixed Asset | 149.50 |
| | Less: Grant received | (24.50) |
| A | Net Cost of Fixed Asset | 125.00 |
| B | Less: Depreciation @ 20% | (25.00) |
| C | Book value of the machinery at the end of 1st year (A - B) | 100.00 |
| D | Less: Depreciation @ 20% | (20.00) |
| E | Book value of the machinery at the end of 2nd year (C - D) | 80.00 |
| F | Add: Grant refunded | 24.50 |
| G | Revised Book Value | 104.50 |
| H | Less: Depreciation @ 30% | (31.35) |
| I | Book Value of Machinery at the end of 3rd year (G - H) | 73.15 |
| J | Less: Depreciation @ 30% | (21.95) |
| K | Book Value of Machinery at the end of 4th year (I-J) | 51.20 |

**Working Notes:** Calculation of WDV rate of Depreciation

(i) WDV Depreciation rate (on 01.04.2010)

$$= 1 - \sqrt[4]{\text{Residual Value / Net cost}}$$
$$= 1 - \sqrt[4]{51.20 \text{ lakhs} / 125 \text{ lakhs}}$$
$$= 1 - \sqrt[4]{0.4096} = 1 - 0.8 = 0.2 \text{ or } 20\%$$

(ii) WDV Depreciation rate (on 01.04.2012)

$$= 1 - \sqrt{\text{Residual Value / Revised Book Value}}$$
$$= 1 - \sqrt{51.20 \text{ lakhs} / 104.50 \text{ lakhs}}$$
$$= 1 - \sqrt{0.49} = 1 - 0.7 = 0.3 \text{ or } 30\%$$

**(b) (i) X Ltd. sold JCB Machine having WDV of ₹50 Lakhs to Y Ltd. for ₹60 Lakhs and the same JCB was leased back of Y Ltd to X Ltd. The lease is operating lease.**

**Comment according to relevant Accounting Standard if**
**(i) Sale price of ₹60 Lakhs is equal to fair value**
**(ii) Fair Value is ₹ 50 Lakhs and sale price is ₹ 45 Lakhs.**
**(iii) Fair value is ₹ 55 Lakhs and sale price is ₹ 62 Lakhs.**
**(iv) Fair value is ₹ 45 Lakhs and sale price is ₹ 48 Lakhs [4]**

**Answer:**

According to AS 19, following will be the treatment in the given situations:

(i) X Ltd. should immediately recognize the profit of ₹ 10 lakhs (i.e. 60 - 50) in its books.
(ii) The loss of ₹5 lakhs (50 - 45) to be immediately recognized by X Ltd. in its books provided

loss is not compensated by future lease payments.

(iii) Profit of ₹5 lakhs (55 - 50) to be immediately recognized by X Ltd. in its books and balance profit of ₹ 7 lakhs (62-55) is to be amortised/deferred over lease period.

(iv) The loss of ₹ 5 lakhs (50 - 45) to be immediately recognized by X Ltd. in its books and profit of ₹ 3 lakhs (48 - 45) should be amortised/deferred over lease period.

**(b) (ii) Sterling Ltd. purchased a plant for US $20,000 on 31st December, 2013 payable after 4 months. The company entered into a forward contract for 4 months @ ₹48.85 per dollar. On 31st December, 2013, the exchange rate was ₹ 47.50 per dollar.**

**How will you recognize the profit or loss on forward contract in the books of Sterling Limited for the year ended 31st March, 2014. [4]**

**Answer:**

Calculation of Profit or Loss to be recognized in the books of Sterling Limited

| Particulars | ₹ |
|---|---|
| Forward contract rate | 48.85 |
| Less: Spot rate | 47.50 |
| Loss | 1.35 |
| Forward Contract Amount | $20,000 |
| Total loss on entering into forward contract = ($20,000 × ₹ 1.35) | ₹ 27,000' |
| Contract period | 4 months |
| Loss for the period 1st January, 2014 to 31st March, 2014 i.e. 3 months falling in the year 2013-2014 will be (₹ 27,000 × 3/4) | 20,250 |

Balance loss of ₹6,750 (i. e. ₹27,000 – ₹20,250) for the month of April, 2014 will be recognized in the financial year 2014 – 2015.

**(c) (i) An engineering goods company provides after sales warranty for 2 years to its customers. Based on past experience, the company has the following policy for making provision for warranties on the invoice amount, on the remaining balance warranty period:**
**Less than 1 year: 2% provision**
**More than 1 year: 3% provision**
**The company has raised invoices as under:**

| Invoice date | Amount ₹ |
|---|---|
| **19th January, 2011** | **40,000** |
| **29th January, 2012** | **25,000** |
| **15th October, 2012** | **90,000** |

**Calculate the provision to be made for warranty under Accounting Standard 29 as at 31st March, 2012 and 31st March, 2013. Also compute amount to be debited to Profit and Loss Account for the year ended 31st March, 2013. [4]**

**Answer:**

A. Provision as at 31-3-2013 = ₹25,000 × 0.02 + ₹ 90,000 × 0.03 = ₹3,200

B. Less: Provision as at 31-3-2012 = ₹ 40,000 × 0.02 + ₹25,000 × 0.03 = ₹1,550

C. Amount debited to Profit and Loss Account (A - B) = ₹ 1,650

Note: No provision is to be made on 31-3-2013 in respect of sales amounting to ₹40,000 made on 19-01-2011 because the warranty period of 2 years has already expired.

**(c) (ii) From the following information compute diluted earnings per share.**

| | |
|---|---|
| **Net Profit for the year** | **₹12,00,000** |
| **Weighted average number of equity shares outstanding** | **5,00,000 shares** |
| **Average fair value of one equity share** | **₹20** |
| **Weighted average number of shares under option** | **1,00,000 shares** |
| **Exercise price per share under option** | **₹15** |

**[4]**

**Answer:**

**Computation of Diluted Earnings per Share**

| Particulars | Earnings (₹) | Shares | Earnings per share (₹) |
|---|---|---|---|
| Net Profit for the year | 12,00,000 | | |
| Weighted average number of equity shares outstanding | | 5,00,000 | |
| Basic earnings per share (12,00,000/5,00,000) | | | 2.40 |
| Weighted average number of shares under option | | 1,00,000 | |
| Number of shares that would have been issued at fair value (1,00,000 ×15.00)/ 20.00 | | (75,000) | - |
| Diluted earnings per share (12,00,000/5,25,000) | 12,00,000 | 5,25,000 | 2.29 |

*The earnings have not been increased as the total number of shares has been increased only by the number of shares (25,000) deemed for the purpose of computation to have been issued for no consideration.

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

**(a) (i) X Ltd. went into liquidation when its position was as given below:**

1. **Position of Share Capital:**

| Name of Share Holder | Number and Nature of Share held | Nominal Value per Share ₹ | Called up amount per Share ₹ | Paid up amount per Share ₹ |
|---|---|---|---|---|
| **'A'** | **6,000,10% Pref. Shares** | **100** | **50** | **50** |
| **'B'** | **500 Equity Shares** | **100** | **100** | **100** |
| **'C'** | **1,000 Equity Shares** | **75** | **50** | **50** |
| **'D'** | **600 Equity Shares** | **75** | **50** | **53** |
| **'E'** | **400 Equity Shares** | **75** | **50** | **47** |
| **'F'** | **1,000 Equity Shares** | **50** | **25** | **25** |

2. **Unsecured Creditors ₹99,000**
3. **Liquidator's Remuneration ₹1,000**

**Prepare Liquidator's Final Statement of Account in the following case.**
**If the assets are realized for ₹4,00,600** **[10]**

**Answer:**

**(a) LIQUIDATOR'S FINAL STATEMENT OF ACCOUNT**

| Receipts | ₹ | Payments | ₹ |
|---|---|---|---|

| | | | |
|---|---|---|---|
| Assets realised | 4,00,600 | Liquidator's Remuneration | 1,000 |
| Call on Contributories: | | Unsecured Creditors | 99,000 |
| 'C' — @ ₹ 2.50 on 1,000 Shares | 2,500 | Pref. Share holders | 3,00,000 |
| 'E'— @ ₹ 5.50 on 400 Shares | 2,200 | Equity Share holders: | |
| 'F' — @ ₹ 10 on 1,000 Shares | 10,000 | 'B'—@ ₹30 on 500 Shares | 15,000 |
| | | 'D'—@ ₹ 0.50 on 600 Shares | 300 |
| | 4,15,300 | | 4,15,300 |

**Working Notes:**

**(i) Calculation of % of Deficiency**

| | | ₹ |
|---|---|---|
| A. | Total paid up Equity Share capital | 1,75,600 |
| B. | Less: Cash Available | 600 |
| C. | Deficiency to be borne (A – B) | 1,75,000 |
| D. | Total Nominal Equity Share Capital | 2,50,000 |
| E. | Deficiency as % of Normal capital | 70% |

**(ii) Calculation of Net amount returnable/receivable Per Share from the Contribution**

| Name of Share holder | | B ₹ | C ₹ | D ₹ | E ₹ | F ₹ |
|---|---|---|---|---|---|---|
| A. | Paid up amount/Share | 100 | 50 | 53 | 47 | 25 |
| B. | Less: Deficiency to be borne @ 70% of Nominal Value | 70 | 52.50 | 52.50 | 52.50 | 35 |
| C. | Net Amount returnable (receivable) | 30 | (2.50) | 0.50 | (5.50) | (10) |

**(a) (ii) T (ESOP) Ltd provides you the following particulars in respect of stock options granted:**

| | |
|---|---|
| **Grant Date** | **April 1, 2010** |
| **Number of Employees covered** | **1050** |
| **Number of Options granted per Employee** | **50** |
| **Vesting Condition: Continuous employment for 3 years** | |
| **Nominal Value per share (₹)** | **100** |
| **Exercise Price per share (₹)** | **125** |
| **Market Price per share on Grant Date (₹)** | **149** |
| **Vesting Date** | **March 31, 2013** |
| **Exercise Date** | **March 31, 2014** |
| **Fair Value of Option per share on Grant Date (₹)** | **30** |

| **Position on** | **31.03.11** | **31.03.12** | **31.03.13** |
|---|---|---|---|
| **Estimated Annual Rate of Departure** | **2%** | **3%** | |
| **Number of employees left** | **30** | **20** | **16** |
| **Number of employees entitled to exercise** | | | **984** |

**On 31st March, 2014, 960 Employees exercised the option and 24 Employees did not exercise the option.**
**Compute Expenses to be recognised in each year by (i) Fair Value Method.**

**[6]**

**Answer:**

**(i) Fair value method**

**EXPENSE TO BE RECOGNISEDIN EACH YEAR**

| Particulars | | 2010 -11 | 2011 -12 | 2012 - 13 |
|---|---|---|---|---|
| A. | No. of Employees entitled to option | =1050*0.98*0.98 | = 1020*0.97*0.97 | 984 |
| B. | No. of options per Employee | 50 | 50 | 50 |
| C. | Fair Value of Option per Share | 30 | 30 | 30 |
| D. | Total Fair Value of Option [A*B*C] | 14,82,000 | 14,39,580 | 14,76,000 |
| E. | Expense to be recognized [Total Fair Value* No of years expired/vesting Period] – [Expenses already recognized during previous years] | = 14,82,000/3 =4,94,000 | = [14,39,580*2/3] – [4,94,000] = 4,65,720 | = 14,76,000 – 4,94,000 – 4,65,720 = 5,16,280 |

Value of options Forfeited = [(984 – 960) × 50 × ₹30] = ₹36,000

**(b) (i) CAMID Limited planned to set up a unit for manufacture of bulk drugs. For the purpose of financing the unit the Board of Directors have issued 15,00,000 equity shares of ₹10 each. 30% of the issue was reserved for promoters and the balance was offered to the public. A, B and C have come forward to underwrite the public issue in the ratio of 3:1:1 and also agreed for firm undertaking of 30,000; 20,000 and 10,000 shares, respectively. The underwriting commission was fixed at 4%. The amount payable on application was ₹ 2.50 per share. The details of subscriptions (excluding firm underwriting) are:**

| | Shares |
|---|---|
| **Marked forms of A** | **5,50,000** |
| **Marked forms of B** | **2,00,000** |
| **Marked forms of C** | **1,50,000** |
| **Unmarked forms** | **50,000** |

**(a) You are required to show the allocation of liability among underwriters with workings.**
**(b) Pass journal entries in the books of CAMID Limited:**
**(i) For underwriters' net liability and the receipt or payment of cash to or from underwriters.**
**(ii) Determining the liability towards the payment of commission to the underwriters.**
**[16]**

**Answer:**

**(a) STATEMENT SHOWING THE NET AND TOTAL LIABILITY OF UNDERWRITERS**

| Particulars | A (No. of Shares) | B (No. of Shares) | C (No. of Shares) | Total (No. of Shares) |
|---|---|---|---|---|
| A Gross Liability | 6,30,000 | 2,10,000 | 2,10,000 | 10,50,000 |
| B Less: Marked Applications | (5,50,000) | (2,00,000) | (1,50,000) | (9,00,000) |
| C Less: Unmarked Applications (in the ratio of 3 : 1 : 1) | (30,000) | (10,000) | (10,000) | (50,000) |
| D Less: Firm underwriting | (30,000) | (20,000) | (10,000) | (60,000) |
| E Balance | 20,000 | (20,000) | 40,000 | 40,000 |
| F Surplus of B distributed between A and C in the ratio of 3 : 1 | (15,000) | 20,000 | (5,000) | - |
| G Net liability | 5,000 | - | 35,000 | 40,000 |
| H Add Firm underwriting | 30,000 | 20,000 | 10,000 | 60,000 |
| I Total Liability | 35,000 | 20,000 | 45,000 | 1,00,000 |

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| Date | Particulars | L.F. | Dr. (₹) | Cr. (₹) |
|---|---|---|---|---|

| | | | | |
|---|---|---|---|---|
| | A Dr.<br>C Dr.<br>To Equity Share Capital A/c<br>(Allotment of shares to underwriters: 5,000 shares to A and 35,000 shares to C) | | 12,500<br>87,500 | <br><br>1,00,000 |
| | Underwriting Commission A/c Dr.<br>To A<br>To B<br>To C<br>(Underwriting commission payable @ 4% on the amount of shares underwritten) | | 4,20,000 | <br>2,52,000<br>84,000<br>84,000 |
| | A Dr.<br>B Dr.<br>To Bank A/c<br>(Amount paid to A and B in final settlement) | | 2,39,500<br>84,000 | <br><br>3,23,500 |
| | Bank A/c Dr.<br>To C<br>(Amount received from C on shares allotted less underwriting commission) | | 3,500 | <br>3,500 |

**Working Notes:**

(i) Calculation of amounts payable to/by underwriters:

| | A | B | C |
|---|---|---|---|
| Liability (No. of shares) | 35,000 | 20,000 | 45,000 |
| Less: Firm underwriting (No. of shares) | 30,000 | 20,000 | 10,000 |
| Net Liability (No. of Shares) | 5,000 | - | 35,000 |

| | ₹ | ₹ | ₹ |
|---|---|---|---|
| Amount payable on application @ ₹2.50 per share | 12,500 | - | 87,500 |
| Less: Underwriting commission receivable by underwriters @ 4% | (2,52,000) | (84,000) | (84,000) |
| Amount payable from underwriters | 2,39,500 | 84,000 | - |
| Amount receivable from underwriters | - | - | 3,500 |

(ii) No Journal entry is shown for firm underwritings by the underwriters on the assumption that the amounts have been already paid by the underwriters at the opening days of the issue. Alternatively, the students may pass entries for firm underwriting on the ground that the allotment of shares will be made by the company at a time.

**(c) (i) B Ltd. provides you the following information:**
**Issued Capital: 2,00,000 Equity Shares of ₹10 each**
**Reserves & Surplus: Capital Reserve ₹10,00,000**
**Securities Premium ₹18,00,000**
**Revenue Reserve ₹30,00,000**
**Profit & Loss A/c ₹40,00,000**
**Resolution passed to buy back: 25% of its Equity Shares @ ₹50 per share.**
**Pass journal entries to record the above transactions assuming that the company achieved the target of buy-back. 6**

**Answer:**

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| Date | Particulars | L.F. | Dr. (₹) | Cr. (₹) |
|---|---|---|---|---|

| | | | | |
|---|---|---|---|---|
| 1. | Equity Shares Buy Back A/c Dr.<br>To Bank A/c<br>[Being the payment made on buy-back of 50,000 shares @₹50] | | 25,00,000 | <br>25,00,000 |
| 2. | Equity Share Capital A/c Dr.<br>Securities Premium A/c Dr.<br>Revenue Reserve A/c Dr.<br>To Equity Share Buyback A/c<br>[Being the cancellation of equity shares bought back] | | 5,00,000<br>18,00,000<br>2,00,000 | <br><br><br>25,00,000 |
| 3. | Revenue Reserve A/c Dr.<br>To Capital Redemption Reserve A/c<br>Being the amount equal to nominal value of equity shares bought back out of free reserves transfer to CRR) | | 5,00,000 | <br>5,00,000 |

**(c) (ii) The promoters of H Ltd. took over on behalf of the company a running business with effect from 1st April, 2014. The company got incorporated on 1st August, 2014. The annual accounts were made up to 31st March, 2015 which revealed that the sales for the whole year totaled ₹1,600 lakhs out of which sales till 31st July, 2014 were for ₹400 lakhs. Gross profit ratio was 25%.**

**The expenses from 1st April 2014 till 31st March 2015 were as follows:**

| | **(₹ in lakhs)** |
|---|---:|
| **Salaries** | **69** |
| **Rent, Rates and Insurance** | **24** |
| **Sundry Office Expenses** | **66** |
| **Travelers' Commission** | **16** |
| **Discount Allowed** | **12** |
| **Bad Debts** | **4** |
| **Directors' Fee** | **25** |
| **Audit Fee** | **9** |
| **Depreciation on Tangible Assets** | **12** |
| **Debenture Interest** | **11** |

**Prepare a statement showing the calculation of Profits for the pre-incorporation and post incorporation periods. [10]**

**Answer:**

Statement showing the calculation of Profits for the pre-incorporation and post-incorporation periods

| | **Total Amount** | **Basis of allocation** | **Pre-incorporation** | **Post-incorporation** |
|---|---:|:---:|---:|---:|
| | (₹ in lakhs) | | (₹ in lakhs) | (₹ in lakhs) |
| Gross Profit (25% of ₹1600) | 400 | Sales | 100 | 300 |
| Less: Salaries | 69 | Time | 23 | 46 |
| Rent, rates and insurance | 24 | Time | 8 | 16 |
| Sundry office expenses | 66 | Time | 22 | 44 |
| Travellers' commission | 16 | Sales | 4 | 12 |
| Discount Allowed | 12 | Sales | 1 | 9 |
| Bad Debts | 4 | Sales | 1 | 3 |

| | | | | |
|---|---|---|---|---|
| Directors' fee | 25 | Post | - | 25 |
| Audit Fees | 9 | Sales | 2.25 | 6.75 |
| Depreciation on tangible assets | 12 | Time | 4 | 8 |
| Debenture Interest | 11 | Post | - | 11 |
| Net Profit | 152 | | 32.75 | 119.25 |

**Working Notes:**

1. Sales Ratio

| | (₹ in lakhs) |
|---|---|
| Sales for the whole year | 1,600 |
| Sales upto 31st July 2014 | 400 |
| Therefore, sales for the period from 1st August 2014 to 31st March 2015 | 1,200 |

Thus sale ratio = 400:1200 = 1:3

2. Time ratio

1st April, 2014 to 31st July, 2014 : 1st August ,2014 to 31st March, 2015
= 4 months: 8 months = 1:2
Thus, time ratio is 1:2.

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

**(a) (i) Write a note on (A) Public Deposits (B) Deposit of Statutory Dues [3+5]**

**Answer:**

**Public Deposits:** In case company has accepted deposits from the public whether the directions issued by the Reserve Bank of India and the provisions of Sections 73 to 76 or any other relevant provision of the Companies Act and the rules framed there under where applicable, have been complied with, if not, the nature of contraventions should be stated; if an order has been passed by Company Law Board or National Company Law Tribunal or Reserve Bank of India or any court or any other tribunal whether the same has been complied with or not.

**Deposit of Statutory Dues:** The company auditor has to report that –

(a) Is the company regular in depositing undisputed statutory dues including Provident Fund Employees State Insurance, Income tax, Sales tax, Wealth Tax, Service tax, Custom Duty, Excise Duty, Value Added Tax, cess and any other statutory dues with the appropriate authorities and if not the extent of arrears of outstanding statutory dues as at the last day of the financial year concerned for a period of more than six months from the date they became payable, shall be indicated by the auditor.

(b) In case dues of Income tax, Sales tax, Wealth tax, Service tax, Custom Duty, Excise Duty, Value Added Tax, Cess have not been deposited on account of any dispute, then the amounts involved and the forum where dispute is pending may be mentioned, but he should while reporting, remember that a mere representation to the department should not constitute a dispute.

Whether the amount required to be transferred to investor education and protection fund in accordance with the relevant provisions of the Companies Act, 1956(1of 1956) and rules made there under has been transferred to such fund with in time.

**(a) (ii) Discuss the objectives of SAE 3402 Assurance Reports on Controls At a Service Organization. [4]**

**Answer:**

The objectives of the service auditor are:

(a) To obtain reasonable assurance about whether, in all material respects, based on suitable criteria:
   (i) The service organization's description of its system fairly presents the system as designed and implemented throughout the specified period (or in the case of a type 1 report, as at a specified date);
   (ii) The controls related to the control objectives stated in the service organization's description of its system were suitably designed throughout the specified period (or in the case of a type 1 report, as at a specified date);
   (iii) Where included in the scope of the engagement, the controls operated effectively to provide reasonable assurance that the control objectives stated in the service organization's description of its system were achieved throughout the specified period.

(b) To report on the matters in (a) above in accordance with the service auditor's findings.

**(a) (iii) Write a note on Adverse or Negative Report. [4]**

**Answer:**

- An Adverse or negative report is given when the Auditor concludes that based on his examination, he does not agree with the affirmations made in the Financial Statements/Financial Report.
- The Auditor states that the Financial Statements do not present a true and fair view of the state of affairs and the working results of the organization.
- The Auditor should state the reasons for issuing such a report.

- An Adverse Opinion should be expressed when the effect of a disagreement is so material and pervasive to the Financial Statements, that the Auditor Concludes that a qualification of the report is not adequate to disclose the misleading or incomplete nature of the Financial Statements.

**(b) (i) Discuss the overall maximum managerial remuneration and managerial remuneration in case of absence or inadequacy of profits as per section 197 of Companies Act, 2013. [6]**

**Answer:**

Ceiling of Total Managerial Remuneration:

The total managerial remuneration payable by a public company, to its directors, including managing director and whole-time director, and its manager in respect of any financial year shall not exceed eleven per cent. of the net profits of that company for that financial year computed in the manner laid down in section 198 except that the remuneration of the directors shall not be deducted from the gross profits.

Provided that the company in general meeting may, with the approval of the Central Government, authorise the payment of remuneration exceeding eleven per cent. of the net profits of the company, subject to the provisions of Schedule V.

**Provided further that, except with the approval of the company in general meeting,—**

(i) the remuneration payable to any one managing director; or whole-time director or manager shall not exceed five per cent. of the net profits of the company and if there is more than one such director remuneration shall not exceed ten per cent, of the net profits to all such directors and manager taken together;

(ii) the remuneration payable to directors who are neither managing directors nor whole-time directors shall not exceed,—

  (A) one per cent. of the net profits of the company, if there is a managing or whole-time director or manager;

  (B) three per cent. of the net profits in any other case.

The percentages aforesaid shall be exclusive of any fees payable to directors under sub-section (5).

If, in any financial year, a company has no profits or its profits are inadequate, the company shall not pay to its directors, including any managing or whole-time director or manager ,by way of remuneration any sum exclusive of any fees payable to directors under sub-section (5) hereunder except in accordance with the provisions of Schedule V and if it is not able to comply with such provisions, with the previous approval of the Central Government.

**(b) (ii) State the advantages of Internal Controls. [3]**

**Answer:**

A good internal control system ensures that the resources are utilized only for their intended purposes and helps to overcome the risk associated with the misuse of organization's funds and other resources.

It prevents errors and irregularities by detecting them in a timely manner, thereby promoting reliable and accurate accounting records. Safeguard from irregularities or misappropriations.

It protects the interest of employees by segregation of duties and delegation of responsibilities.

**(b) (iii) Describe the Audit of a Recreation club. [7]**

**Answer:**

(i) Examine the constitution, powers of governing body and relevant rules relating to preparation and finalisation of accounts. In case, it is constituted as a company limited by guarantee, application of provisions of the Companies Act, 2013 should also be seen.

(ii) Vouch the receipt on account of entrance fees with member's applications, counterfoils issued to them, and minutes of the Managing Committee.

(iii) Vouch Members' subscription with the counterfoils of receipts issued to them. Trace receipts for a selected period to the Register of members; reconcile the amount of total subscription due with the amount collected and the outstanding. Check totals of various columns of the Register of Members and tally them across. See the Register of Members to ascertain the Member's dues which are in arrear and enquire whether necessary steps have been taken for their recovery. The amount considered irrecoverable, if any should be written off.

(iv) Ensure that arrears of subscriptions for the previous year have been correctly brought over and arrears for the year under audit and subscription received in advance have been correctly adjusted.

(v) Verify the internal check as regards members being charged with the price of foodstuffs and drinks provided to them and their guests as well as with the fees chargeable for the special service rendered such as billiards, tennis, etc. Trace debits for a selected period from subsidiary registers maintained in respect of supplies and services to members to confirm that the account of every member has been debited with amounts recoverable from him.

(vi) Vouch purchase of sports items, furniture, crockery, etc., and trace their entries into the respective stock registers. Vouch purchases of food-stuffs, cigars, wines, etc. and test their sale price so as to confirm that the normal rates of profit have been earned on their sales.

The stock of unsold provisions and stores, at the end of the year should be verified physically and its valuation checked.

(vii) Check the stock of furniture, sports material and other assets physically with the respective stock registers or inventories prepared at the end of the year.

(viii) Inspect the share scrips and bonds in respect of investments, check their current values for disclosure in final accounts, also ascertain that the arrangements for their safe custody are satisfactory, check the accrual of income there from and provision of income tax thereon.

**(c) (i) List the points for verifying assets and liabilities. [4]**

**Answer:**

He should keep in mind the following points while verifying the assets & liabilities –

a. Whether the assets and liabilities are properly traced from ledger to Balance Sheet
b. Whether the assets are acquired for the business and liabilities got created for the purpose of business and are clearly stated in the Balance Sheet.
c. Whether the assets and liabilities are properly grouped under specified heads in the Balance Sheet.
d. Whether the assets & liabilities are in actual existence on Balance Sheet date.
e. Whether along with ownership the possession of assets lies with the client.
f. Whether the assets are properly valued in the Balance Sheet
g. Whether the liabilities stated in the Balance Sheet tallies with the confirmation certificate.

**(c) (ii) 'Vouching is the foundation over which the structure of auditing is erected' – Discuss [4]**

**Answer:**

"Vouching is the foundation over which the structure of auditing is erected"

i. **Serves as evidence:** Vouching being an important auditing procedure helps in obtaining evidence with respect to transactions recorded, which ultimately ensures the completeness, accuracy, genuineness and validity of the transactions.

ii. **Assurance:** With the help of vouching, the auditor is ensured about recording of transaction, proper allocation to accounting period, occurrence of transaction, and further classification and disclosure of transactions as per the standard accounting principles and policies.

iii. **Preliminary for Verification:** Vouching serves as a basis of verification of assets and liabilities. Examination of the source documents justifying the amount of assets and liabilities stated in the Balance Sheet can be done by vouching.

iv. **Establishes Authenticity:** It facilitates authenticity of the transactions recorded in the primary books of accounts.

**(c) (iii) State the auditor's duty in regard to issue of debentures. [5]**

**Answer:**

**Auditor's Duty:**

- ❖ The auditor should verify that the prospectus had been duly filed with the registrar before the date of allotment of debentures.
- ❖ He should check the amount collected in the cash book with the counterfoils of receipts issued to the applicants and also cross check the amount into the application and allotment book.
- ❖ He should examine the debenture trust deed and note the conditions contained therein as to issue and repayment.
- ❖ If the debentures are covered by a mortgage of a charge, it should be verified that the charge has been correctly recorded in the register of mortgage and charges and it has also been registered with the registrar of the companies.
- ❖ Compliance with SEBI guidelines should also be ensured.
- ❖ Where debentures have been issued as fully paid up to vendors as a part of the purchase consideration, the contract in this regard should be checked.

**(c) (iv) List the matters that need to be reviewed on a timely basis. [3]**

**Answer:**

- ❖ Overall audit plan and the audit programme
- ❖ Assessment of inherent and control risks as well as any modifications made to the overall audit plan and programme
- ❖ Documentation of the audit evidence obtained from substantive procedures and the conclusions drawn there from
- ❖ Any proposed adjustments to the financial statements arising out of auditor's examination and observations.