Paper 12 - Company Accounts & Audit

Full Marks: 100

Section A

(1) Answer the following (compulsory) [2x2=4]

(i) What is meant by Reasonable assurance?

Answer:

For Government Grants recognition, reasonable assurance is that –

(a) The enterprise will comply with the conditions attached to them, and
(b) The grant will be received.

However, the mere receipt of a Grant is not necessarily a conclusive evidence that conditions attaching to the Grant have been or will be fulfilled.

From Auditing Dictionary –

- Reasonable assurance (in Audit Report): An auditor works within economic limits. The audit opinion, to be economically useful, must be formed in a reasonable time and at reasonable cost. The auditor must decide, exercising professional judgment, whether evidence available within limits of time and cost is sufficient to justify an opinion.
- Reasonable assurance (in Internal Control): An internal control, no matter how well designed and operated, cannot guarantee that an entity's objectives will be met because of inherent limitations in all internal control systems.

(ii) What are the basic assumptions for the preparation of financial statement of an organization?

Answer:

Underlying assumptions for the preparation and presentation of financial statements are accrual and going concern.

Under accrual assumption, the effects of transactions and other events are recognised when they occur (and not as cash or its equivalent is received or paid) and they are recorded in the books of account and reported in the financial statements of the periods to which they relate. It helps in performance measurement in a better manner and identifying the financial position appropriately.

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.

(2) Answer any two Questions [2x8=16]

(a) (i) Surplus Ltd. received a grant of ₹6 crores from the Central Govt. for the purpose of a special machinery during 2008-09. The cost of machinery was ₹30 crores and had a useful life of 12 years. During 2013-14, the grant has become refundable due to non-fulfillment of certain conditions attached to it.

Assuming the entire grant was deducted from the cost of Machinery in the year of acquisition, state, with reasons, the accounting treatment to be followed in the year 2013-14. [4]

Answer:

As per para 11.3, AS 12, the amount refundable in respect of a Govt. grant related to a specific fixed asset is recorded by increasing the book value of the asset and depreciation on the revised book value is provided prospectively over the residual useful life of the asset.

In the present case, in the year 2013-14, book value of machinery will be increased by ₹ 6 crores. Therefore, deprecations on machinery will be computed as:

Deprecation (on straight line method)

$$= \frac{\text{Cost Price - Grant Received - Scrap Value}}{\text{Estimated Life}}$$

$$= \frac{₹30 \text{ crores - } ₹6 \text{ crores - Nil}}{12}$$

= 2 crores

∴Total depreciation for 5 years 2008 - 09 to 2012-13 @ ₹ 2 crores = ₹ 10 crores.

Revised Book Value = Book Value in 2013-14 (₹ 24 crores – ₹ 10 crores) = ₹ 14 crores

Add: Grant Refunded = ₹ 6 crores

Revised Book Value = ₹ 20 crores

$$\therefore \text{ Revised Annual Depreciation} = \frac{\text{Revised Book Value}}{\text{Rest useful life}} = \frac{₹20 \text{ crores}}{7 \text{ years}}$$

= ₹ 2.857 crores

During the next seven years, depreciation will be charged @ ₹ 2.857 crores per year and book value of machinery as on 2013-14 will be ₹ 20 crores.

(ii) HUM Ltd. is engaged in research on a new process design for its product. It had incurred an expenditure of ₹338.78 lakhs on research upto 31st March, 2012. The development of the process began on 1st April, 2012 and the Development Phase Expenditure was ₹180 lakhs upto 31st March, 2013. From 1st April, 2013 the Company will implement the new process design which will result in an after-tax cost saving of ₹60 lakhs per annum for the next 5 years. The Company's Cost

of Capital is 10%. At what cost should the asset be recorded and what is its amortisation amount? [4]

Answer:

Research Expenditure: As per AS-26, the expenditure on research ₹ 338.78 lakhs should be expensed in the year in which it is incurred. It is presumed that the entire expenditure of ₹ 338.78 lakhs is incurred in financial year 2011-2012. Hence, it should be written off as an expense in that year itself.

Development Expenditure: As per AS-26, the expenditure on development can be treated as an asset only if all the conditions listed in that paragraph are satisfied. It is presumed that the company has duly complied with this requirement.

Cost of internally generated intangible asset: AS-26 specifies the items which can be included in the cost of an internally generated intangible asset; it also specifies the exclusions therefrom. It is presumed that the expenditure of ₹180 lakhs is determined in accordance with AS-26.

Discounting Future Cash Flows: As per Para 30 of AS-26, fair value of an intangible asset can be estimated by discounting estimated future net cash flows. Even if this paragraph is primarily related to estimation of fair value of an intangible asset acquired in the course of amalgamation in the nature of purchase, the concept can be extended for internally generated intangible asset also.

Cost savings from the new process design for five years = ₹60 lakhs per annum

Company's Cost of Capital =10%

Annuity Factor at 10% for five years (from the annuity tables) = 3.7908

Present value of future cash flows = ₹60 X 3.7908 = ₹227.45 lakhs

Carrying Amount of the Asset: Since the Present Value of Future Cash Flows is ₹227.45 lakhs (which is higher than the cost of ₹180 lakhs). Therefore carrying amount of the Asset is ₹180 lakhs.

Amortisation Period and Amount: The Company can amortise ₹180 lakhs over a five year period by charging ₹36 lakhs per annum from the financial year 2013-2014 onwards.

(b)(i) DND Ltd. acquired a Pentium-IV computer on lease, for 3 years on 1-1-2011. The fair value of the computer is ₹1,80,000 and carrying value in the books of vendor is ₹1,71,000. DND Ltd. and lease vendor respectively incurred ₹5,000 and ₹5,500 on negotiating lease. The amount payable is in 4 instalments viz., ₹1,05,000 (1-1-2011), ₹68,000 (31-12-2011), ₹30,000 (31-12-2012), ₹9,000 (31-12-2013). The lessee has also guaranteed as residual value at the end of economic life on 31-12-2013 of 5% of its cost to him. The computer is to be depreciated on SLM. Identify the nature of the lease and make relevant accounts in the book of DND Ltd. when financing cost transacted was 14% per annum:

(Discount factor 14% p.a. For 0,1,2,3 years are 1.000, .8772, .7695, 0.6750, respectively.)

Open ledger accounts in the books of lessee & lessor both.

a) If lessee has guaranteed as residual value at the end of economic life on 31 -12-2013 at 5% of its cost to him, at what value the computer will be recorded in books of DND Ltd.

b) The lessee guarantees only 2% of fair value whereas residual value is 5% of fair, value, find the recording value of computer in books of DND Ltd. [4]

Answer:

Present value of minimum lease payment:

Annual lease rental x P.V. Factor + Present value of Guranteed residual value

Year	Installment	Discounting Factor	Present Value
0	1,05,000	1.000	1,05,000
1	68,000	0.8772	59,650
2	30,000	0.7695	23,085
3	9,000	0.6750	6,075
Guaranteed	1,80,000 x 5% =9,000	0.6750	6,075
Present value of minimum lease payment			1,99,885

The present value of lease payments i.e., ₹1,99,885 more than 100% of the fair market value i.e., ₹1,80,000. As the present value of minimum lease payment substantially covers the initial fair value of the lease assets and lease term. Therefore, it constitutes a financial lease.

Leased asset as well as liability for lease should be recognized at the lower of –

- Fair value of the lease asset at the inception of lease or
- Present value of minimum lease payment from the lessee point of view, whichever is lower.

Apportionment of Finance lease: Rate of Interest = 14%

Year	Liability	MLP	Finance Charge	Principal amount of reduction
0	1,80,000	1,05,000	-	1,05,000
1	75,000	68,000	10,500	57,500
2	17,500	30,000	2,450	17,500
3	-	9,000	-	-

Books of DND Ltd

Extract of Profit and Loss Account

1st Year	To Finance Charge To Depreciation on lease asset under SLM	10,500 60,000
2nd Year	To Finance Charge To Depreciation on lease asset under SLM	2,450 60,000
3rd Year	To Depreciation on lease asset under SLM	60,000

Extract of Balance Sheet

Liability	₹	Assets	₹
1st year			
Lease liability A/c	75,000	Fixed Assets under finance lease Less: Depreciation	1,80,000 60,000
			1,20,000
2nd Year			
Lease liability A/c	17,500	Fixed Assets under finance lease Less: Depreciation	1,20,000 60,000
			60,000
3rd Year			
Lease liability A/c	Nil	Fixed Assets under finance lease Less: Depreciation	60,000 60,000
			Nil

(i) In the books of lessor, Asset will be recorded at fair value ₹1,80,000 + ₹5,000 = ₹185,000
(ii) In the books of lessee, Asset will be recorded at fair value ₹1,80,000 + ₹5,000 = ₹185,000

(ii) Calculate the basic and diluted EPS

a) Income after tax ₹ 54,00,000
b) Weighted average number of equity shares outstanding is 1,20,000 shares
c) Tax rate 30%
d) Option to purchase 20,000 equity shares at ₹ 48 per share. The options were outstanding all year.
e) Option to purchase 25,000 equity shares at ₹ 18 per share. The average market price of equity share during the year was ₹ 70
f) 12% convertible bonds, 500 bonds, each convertible into 10 equity shares. The bonds were outstanding during the entire year. The bonds were issued at par ₹1000 per bond and no bonds were converted during the year.
g) 8% Convertible cumulative preferred stock per ₹100, 8000 shares issued and outstanding the entire year. Each preferred share is convertible into one equity share. The preferred share was issued at par and no shares were converted during the year. [4]

Answer:

A. Computation of additional Earning per Incremental Share to determine sequence

Particulars	Options-1	Options-2	7% Convertible Bond	Convertible Preference Shares
1. Additional Net Profit after adjusting tax expenses	Nil	Nil	(500 x 1000 x 12%) x 70% = 42,000	(8,000x100x8%) + 30% their on =83,200
2. Additional No. of equity share	20,000x(70-48)/70 = 6,286	25,000x(70-18)/70 = 18,571	500 x 10 = 5,000	8,000 x 1 = 8,000

including for Diluted EPS				
3. Earning per Incremental share	Nil	Nil	42,000/ 5,000 = 8.40	83,200/ 8,000 = 10.40
B. Priority in Sequence	I	II	III	IV

C. Computation of Diluted EPS in the above sequence

Particulars	Net profit attributable to equity shareholder	Number of Equity Shares outstanding	Earning per share	Nature of potential Equity Share
(1)	(2)	(3)	(4) = (2)/(3)	(5)
1. Net profit for Equity shareholder 2. Add: adjustment for option -1	53,36,000 Nil	1,20,000 6,286	₹44.47	Basic EPS
3. After Option-1 adjustment 4. Add: adjustment for option -2	53,36,000 Nil	1,26,286 18,571	₹42.25	Dilutive
5. After Option-2 adjustment 6. 12% convertible bonds	53,36,000 42,000	1,44,857 5,000	₹36.84	Dilutive
7. After convertible bonds 8. Adjustment for Preference Shares	53,78,000 83,200	1,49,857 8,000	₹35.89	Dilutive
9. After Pref. Share Adjustment	54,61,200	1,57,857	₹34.60	Dilutive

Hence, Basic EPS = 44.47 per share, Diluted EPS = 34.60 per share.

(c) (i) MLN Ltd. is developing a new production process. During the financial year 31st March, 2013, the total expenditure incurred on this process was ₹105 lakhs. The production process met the criteria for recognition as an intangible asset on 1st December, 2012. Expenditure incurred till this date was ₹ 48 lakhs.

Further expenditure incurred on the process for the financial year ending 31st March, 2014 was ₹80 lakhs. As at 31 March, 2014, the recoverable amount of know-how embodied in the process is estimated to be ₹165 lakhs. This includes estimates of future cash outflows as well as inflows.

You are required to work out:

(a) What is the expenditure to be charged to the profit and loss account for the financial year ended 31st March, 2013? (Ignore depreciation for this purpose)

(b) What is the carrying amount of the intangible asset as at 31st March, 2013?

(c) What is the expenditure to be charged to profit and loss account for the financial year ended 31st March, 2014? (Ignore depreciation for this purpose)

(d) What is the carrying amount of the intangible asset as at 31st March, 2014? [4]

Answer:

(a) Expenditure incurred up to 1-12-2012 will be taken up to profit and loss account for the financial year ended 31-3-2013 = ₹ 48 lakhs

(b) Carrying amount as on 31-3-2013 will be the expenditure incurred after 1-12-2012 = ₹ 57 lakhs

(c) Book cost of intangible asset as on 31-3-2011 is worked out as:

Carrying amount as on 31-3-2013	- ₹ 57 lakhs
Expenditure during 2013-14	- ₹ 80 lakhs
Total Book Cost	- ₹ 137 lakhs
Recoverable amount, as estimated	- ₹ 165 lakhs

Difference to be charged to profit and loss account as impairment - Nil

(d) Carrying amount of the Intangible Asset as on 31.3.2014 will be ₹137 lakhs

(ii) What would be the exchange rate of the translation of following items while translating the financial statement of foreign operation, if these are part of non-integral foreign operation?

(a) Depreciation
(b) Salaries and wages
(c) Opening Stock
(d) Closing Stock
(e) Debtors
(f) Fixed assets (these were acquired out of funds raised from issue of equity shares)
(g) Accounts payable
(h) Provision for taxes
(i) Head office account. [4]

Answer:

The translation of the financial statements of an Integral foreign operation involves the following step

(a) Depreciation – Rate used for respective Fixed Assets.
(b) Salaries and wages – Average Rate
(c) Opening Stock – Opening Rate
(d) Closing Stock – Closing Rate
(e) Debtors – Closing Rate

(f) Fixed assets (these were acquired out of funds raised from issue of equity shares) – Closing Rate
(g) Accounts payable – Closing rate
(h) Provision for taxes – Closing Rate
(i) Head office account – HO Book

Section B

(3) Answer the following (compulsory) [4x2=8]

(i) Explain the disclosure requirement under revised schedule VI of the following items:-

(a) Bank Overdraft
(b) Provision for Bonus

Answer:

(a) Bank Overdraft shall be classified under Short-term borrowings.

(b) Provision for Bonus shall be classified under Short-term Provisions.

(ii) What are the conditions should be satisfied under AS 17 by reportable segments?

Answer:

Reportable Segments -

A business segment or geographical segment should be identified as a reportable segment if:

(a) its revenue from sales to external customers and from transactions with other segments is 10 per cent or more of the total revenue, external and internal, of all segments; or

(b) its segment result, whether profit or loss, is 10 per cent or more of -

   (i) the combined result of all segments in profit, or
   (ii) the combined result of all segments in loss,

   whichever is greater in absolute amount; or

(c) its segment assets are 10 per cent or more of the total assets of all segments.

A business segment or a geographical segment which is not a reportable segment, may be designated as a reportable segment despite its size at the discretion of the management of the enterprise. If that segment is not designated as a reportable segment, it should be included as an unallocated reconciling item.

If total external revenue attributable to reportable segments constitutes less than 75 per cent of the total enterprise revenue, additional segments should be identified as reportable segments, even if they do not meet the 10 per cent, until at least 75 per cent of total enterprise revenue is included in reportable segments.

(iii) Distinguish between Mergers and Acquisition?

Answer:

Distinction between Mergers and Acquisitions -

Although they are often uttered in the same breath and used as though they were synonymous, the terms ''merger'' and "acquisition" mean slightly different things.

When a company takes over another one and clearly becomes the new owner, the purchase is called an acquisition. From a legal point of view, the target company ceases to exist and the buyer "swallows" the business, and stock of the buyer continues to be traded.

In the pure sense of the term, a merger happens when two firms, often about the same size, agree to go forward as a new single company rather than remain separately owned and operated. This kind of action is more precisely referred to as a "merger of equals." Both companies' stocks are surrendered, and new company stock is issued in its place. For example, both Daimler-Benz and Chrysler ceased to exist when the two firms merged, and a new company, DaimlerChrysler, was created.

In practice, however, actual mergers of equals don't happen very often. Often, one company will buy another and, as part of the deal's terms, simply allow the acquired firm to proclaim that the action is a merger of equals, even if it's technically an acquisition. Being bought out often carries negative connotations. By using the term "merger," dealmakers and top managers try to make the takeover more palatable.

A purchase deal will also be called a merger when both CEOs agree that joining together in business is in the best interests of both their companies. But when the deal is unfriendly–that is, when the target company does not want to be purchased–it is always regarded as an acquisition.

So, whether a purchase is considered a merger or an acquisition really depends on whether the purchase is friendly or hostile and how it is announced. In other words, the real difference lies in how the purchase is communicated to and received by the target company's board of directors, employees and shareholders.

(iv) What are the conditions to be fulfilled to attract the Pooling of Interest method in the case of Mergers and Acquisition?

Answer:

Amalgamation in nature of merger is an amalgamation, which satisfies all the following conditions:

i. All the assets and liabilities of the transferor company become the assets and liabilities of the transferee company;

ii. Shareholders holding not less than 90% of the face value of the equity shares of the transferor company (other than transferee company and its nominees) become equity shareholders of the transferee company after amalgamation;

iii. The consideration is to be discharged by way of issue of equity shares in the transferee company to the shareholders of the transferor company on the amalgamation;

iv. The business of the transferor company is to be carried on by the transferee company;

v. No adjustments are intended to be made to the book values of the assets and liabilities of the transferor company.

If any one or more of the aforesaid conditions are not satisfied then the amalgamation is in nature of purchase.

Amalgamation in the nature of merger is to be accounted as per the Pooling of Interest Method and in case of amalgamation in the nature of purchase accounting needs to be done as per the Purchase Method.

(4) Answer any two Questions [2x16=32]

(a) The following are the Balance sheets (as at 31.3.2013) of P Ltd. and Q Ltd.:

Liabilities	P Ltd.	Q Ltd.	Assets	P Ltd.	Q Ltd.
	₹	₹		₹	₹
Share Capital:			Fixed Assets(Tangible)	23,00,000	13,00,000
Equity Shares of ₹ 10 each	14,00,000	8,00,000	Investments	4,50,000	4,50,000
			Current Assets:		
10% Preference shares of ₹ 100 each	10,00,000	-	Stock	10,00,000	7,00,000
			Debtors	6,50,000	5,00,000
			Bills receivable	45,000	15,000
12% Preference shares of ₹ 100 each	-	4,00,000	Cash at Bank	55,000	35,000
Reserve and Surplus:					
Statutory Reserve	60,000	60,000			
General Reserve	12,40,000	8,40,000			
Secured Loan:					
15% Debentures	2,50,000	-			
12% Debentures	-	2,50,000			
Current Liabilities:					
Sundry creditors	5,20,000	6,20,000			
Bills payable	30,000	30,000			
	45,00,000	30,00,000		45,00,000	30,00,000

Contingent liabilities for bills receivable discounted ₹ 30,000.

(A) The following additional information is provided to you:

	P Ltd.	Q Ltd.
	₹	₹
Profit before Interest and Tax	8,40,000	4,20,000
Rate of Income-tax	30%	30%
Preference dividend	60,000	36,000

Equity dividend	**1,80,000**	**1,35,000**
Balance profit transferred to Reserve account.		

(B) The equity shares of both the companies are quoted on the Mumbai Stock Exchange. Both the companies are carrying on similar manufacturing operations.

(C) P Ltd proposes to absorb business of Q Ltd. as on 31.3.2013. The agreed terms for absorption are:

(i) 12% Preference shareholders of Q Ltd. will receive 10% Preference shares of P Ltd. sufficient to increase their present income by 20%.

(ii) The Equity shareholders of Q Ltd. will receive equity shares of P Ltd. on the following terms:

(a) The Equity shares of Q Ltd. will be valued by applying to the earnings per share of Q Ltd. 60 per cent of price earnings ratio of P Ltd. based on the results of 2012-13 of both the Companies.

(b) The market price of Equity shares of P Ltd. is ₹ 40 per share.

(c) The number of shares to be issued to Equity shareholders of Q Ltd. will be based on the 80% of market price.

(d) In addition to Equity shares, 10% Preference shares of P Ltd. will be issued to the equity shareholders of Q Ltd. to make up for the loss in income arising from the above exchange of shares based on the dividends for the year 2012-13.

(iii) 12% Debenture holders of Q Ltd. are to be paid at 8% premium by 15% debentures in P Ltd. issued at a discount of 10%.

(iv) ₹ 8,000 is to be paid by P Ltd. to Q Ltd. for liquidation expenses. Sundry Creditors of Q Ltd. include ₹10,000 due to P Ltd. Bills receivable discounted by P Ltd. were all accepted by P Ltd.

(v) Fixed assets of both the companies are to be revalued at 20% above book value. Stock in trade is taken over at 10%; less than their book value.

(vi) Statutory reserve has to be maintained for two more years

(vii) For the next two years no increase in the rate of equity dividend is anticipated.

(viii) Liquidation expense is to be considered as part of purchase consideration.

You are required to:

(i) Find out the purchase consideration.

(ii) Give journal entries in the books of P Ltd.

(iii) Give the Balance Sheet as at 31.3.2013 after absorption. [16]

Answer:

₹

(i) Computation of Purchase Consideration	
For Preference Shareholders	
Present Income of Preference Shareholders of Q Ltd.	48,000
Add: 20% increase	9,600

	57,600
10% Preference Shares to be issued of ₹ 5,76,000 (57,600/10x 100)	
For Equity Shareholders	
Valuation of Equity Shares of Q Ltd. = Number of shares x Value of one share (i.e. EPS of Q Ltd. x P/E ratio of P Ltd. x 60/100) EPS of Q = [(4,20,000 -30,000) x 70% -36,000]/ 80,000 = 2.9625 EPS of P = [(8,40,000 -37,500) x 70% - 60,000]/1,80,000 = 2.7875 ∴ P/E ratio of P = 40/ 2.7875 = 14.35 Valuation of Equity Shares of Q Ltd. = 80,000 × (₹ 2.9625 × 14.35 × 60%) = ₹ 20,40,570	
Issue of Equity Shares No. of Equity Shares to be issued at 80% of Market Price i.e. 20,40,570/ (80% of ₹ 40) = 63,768 shares	
Equity Share Capital = 63,768 × ₹ 10 = ₹ 6,37,680 Securities premium = 63,768 x ₹ 22 = 14,02,890 = ₹**20,40,570**	
Issue of Preference Shares Present Equity Dividend Less: Expected Equity Dividend from P Ltd. (6,37,680 × 12.86%) Loss in income 10% Preference Shares to be issued of ₹ 5,30,000 (53,000/10 × 100)	 ₹ 1,35,000 82,000 53,000 5,30,000
Purchase Consideration	
Preference Shares Capital [₹ 5,76,000 + ₹ 5,30,000]	11,06,000
Equity Share Capital (63,768 shares of ₹ 10 each at ₹ 32 per share)	20,40,570
Liquidation Expenses (in cash)	8,000
	31,54,570

(ii) Journal Entries in the Books of P Ltd.

	Particulars		Dr. (₹)	Cr. (₹)
1.	Fixed Assets A/c To Revaluation Reserve (Being fixed assets revalued at 120% of book value)	Dr.	4,60,000	 4,60,000
2.	Business Purchase A/c To Liquidator of Q Ltd. (Being purchase consideration payable for the business taken over from Q Ltd.)	Dr.	31,54,570	 31,54,570

	Particulars		Dr. (₹)	Cr. (₹)
3.	Fixed Assets A/c	Dr.	15,60,000	
	Investment A/c	Dr.	4,50,000	
	Stock A/c	Dr.	6,30,000	
	Debtors A/c	Dr.	5,00,000	
	Bills Receivable A/c	Dr.	15,000	
	Cash at Bank A/c	Dr.	35,000	
	Goodwill A/c (Balancing figure)	Dr.	8,84,570	
	To 12% Debentures in B Ltd.			2,70,000
	To Creditors			6,20,000
	To Bills Payable			30,000
	To Business Purchase A/c			31,54,570
	(Being incorporation of different assets and liabilities of Q Ltd. taken over at agreed values and balance debited to goodwill account)			
4.	Liquidator of Q Ltd.	Dr.	31,54,570	
	To Equity Share Capital A/c			6,37,680
	To Securities Premium A/c			14,02,890
	To Preference Share Capital A/c			11,06,000
	To Bank A/c			8,000
	(Being discharge of consideration for Q Ltd's business)			
5.	12% Debentures in Q Ltd.	Dr.	2,70,000	
	Discount on issue of Debentures	Dr.	30,000	
	To 15% Debentures			3,00,000
	(Being allotment of 15% Debentures to debenture holders at a discount of 10% to discharge liability of Q Ltd. debentures)			
6.	Sundry Creditors A/c	Dr.	30,000	
	To Sundry Debtors A/c			30,000
	(Being cancellation of Mutual owing)			
7.	Amalgamation Adjustment A/c	Dr.	60,000	
	To Statutory Reserve A/c			60,000
	(Being statutory reserve account is maintained under statutory requirements)			
8.	Securities Premium A/c	Dr.	30,000	
	To Discount on issue of Debentures A/c			30,000
	(Being discount on issue of Debentures written off out of securities premium)			

(iii)

Name of the Company: P Ltd

Balance Sheet (after absorption) as on 31st March, 2013

					(₹)
Ref No.	**Particulars**		**Note No.**	**As at 31st March, 2013**	**As at 31st March, 2012**
	1	**EQUITY AND LIABILITIES**			
		(a) Share capital	1	41,43,680	
		(b) Reserves and surplus	2	31,92,890	
		(c) Money received against share warrants			
	2	**Share application money pending allotment**			
	3	**Non-current liabilities**			
		(a) Long-term borrowings	3	5,50,000	
		(b) Deferred tax liabilities (Net)			
		(c) Other Long term liabilities			
		(d) Long-term provisions			
	4	**Current Liabilities**			
		(a) Short-term borrowings			
		(b) Trade payables	4	11,10,000	
		(c) Other current liabilities	5	60,000	
		(d) Short-term provisions			
		Total (1+2+3+4)		90,56,570	
	II	**ASSETS**			
	1	Non-current assets			
		(a) Fixed assets			
		(i) Tangible assets	6	43,20,000	
		(ii) Intangible assets	7	8,84,570	
		(iii) Capital work-in-progress			

					(₹)
Ref No.	**Particulars**		**Note No.**	**As at 31st March, 2013**	**As at 31st March, 2012**
		(iv) Intangible assets under development			
		(b) Non-current investments	8	9,00,000	
		(c) Deferred tax assets (Net)			
		(d) Long-term loans and advances			
		(e) Other non-current assets			
	2	**Current assets**			
		(a) Current investments			
		(b) inventories	9	16,30,000	
		(c) trade receivables	10	11,20,000	
		(d) Cash and cash equivalents	11	82,000	
		(e) Short-term loans and advances			
		(f) Other current assets	12	1,20,000	
		Total (1+2)		90,56,570	

Notes on Accounts

(₹)

Note 1. Share Capital	**As at 31st March, 2013**	**As at 31st March, 2012**
Authorized, Issued, Subscribed and paid-up share capital		
2,03,768 Equity share of ₹ 10 each fully paid (63,768 shares have been allotted as fully paid up for consideration other than cash)	20,37,680	
21,060, 10% Preference share of ₹ 100 each	21,06,000	
Total	41,43,680	

RECONCILIATION OF SHARE CAPITAL

FOR EQUITY SHARE	As at 31st March, 2013		As at 31st March, 2012	
	Nos.	Amount (₹)	Nos.	Amount (₹)
Opening Balance as on 01.04.11	1,40,000	14,00,000		
Add: Fresh Issue (Including Bonus shares, right shares, split shares, share issued other than cash)	63,768	6,37,680		
	2,03,768	20,37,680		
Less: Buy Back of share				
Total	2,03,768	20,37,680		

FOR 7% PREFERENCE SHARE	As at 31st March, 2013		As at 31st March, 2012	
	Nos.	Amount (₹)	Nos.	Amount (₹)
Opening Balance as on 01.04.11	10,000	10,00,000		
Add: Fresh Issue (Including Bonus shares, right shares, split shares, share issued other than cash)	11,060	11,06,000		
	21,060	21,06,000		
Less: Buy Back of share				
Total	21,060	21,06,000		

Note 2. Reserve and Surplus	As at 31st March, 2013	As at 31st March, 2012
Statutory reserve (60,000 + 60,000)	1,20,000	
Revaluation reserve	4,60,000	
General Reserve	12,40,000	
Securities Premium (14,02,890 – 30,000)	13,72,890	
Total	31,92,890	

Note 3. Long-term borrowings	As at 31st March, 2013	As at 31st March, 2012
15% debentures- secured Loan	5,50,000	

Total	5,50,000	

Note 4. Trade Payables	As at 31st March, 2013	As at 31st March, 2012
Sundry Creditors (5,20,000+6,20,000-30,000)	11,10,000	
Total	11,10,000	

Note 5. Other Current liabilities	As at 31st March, 2013	As at 31st March, 2012
Bills Payables (30,000+30,000)	60,000	
Total	60,000	

Note 6. Tangible Assets	As at 31st March, 2013	As at 31st March, 2012
Fixed assets (27,60,000+15,60,000)	43,20,000	
Total	43,20,000	

Note 7. Intangible Assets	As at 31st March, 2013	As at 31st March, 2012
Goodwill	8,84,570	
Total	8,84,570	

Note 8. Non Current Investment	As at 31st March, 2013	As at 31st March, 2012
Investment (4,50,000+4,50,000)	9,00,000	
Total	9,00,000	

Note 9. Inventories	As at 31st March, 2013	As at 31st March, 2012
Stock (10,00,000+6,30,000)	16,30,000	
Total	16,30,000	

Note 10.Trade receivables	As at 31st March, 2013	As at 31st March, 2012
Sundry Debtors (6,50,000+5,00,000-30,000)	11,20,000	
Total	11,20,000	

Note 11.Cash and cash equivalent	As at 31st March, 2013	As at 31st March, 2012
Cash at Bank (55,000 + 35,000 – 8,000)	82,000	
Total	82,000	

Note 12.Other Current assets	As at 31st March, 2013	As at 31st March, 2012
Bills receivables	60,000	
Amalgamation adjustment account	60,000	
Total	1,20,000	

Note: No footnote will appear for contingent liability as it has been converted into actual liability after absorption of Q Ltd.

(b) (i) The following was the balance sheet of Star Ltd. as at 31st March, 2013.

Liabilities	**₹ in lakhs**
10% Redeemable Preference Shares of ₹ 10 each, fully paid up	5,000
Equity Shares of ₹ 10 each fully paid up	16,000
Capital Redemption Reserve	2,000
Securities Premium	1,600
General Reserve	12,000
Profit and Loss Account	600
9% Debentures	10,000
Sundry creditors	4,600
Sundry Provisions	2,000
	53,800

Assets	**₹ in lakhs**
Fixed assets	28,000
Investments	6,000

Cash at Bank	3,300
Other Current assets	16,500
	53,800

On 1st April, 2013 the company redeemed all of its preference shares at a premium of 10% and bought back 25% of its equity shares @ ₹ 20 per share. In order to make cash available, the company sold all the investments for ₹ 6,300 lakh and raised a bank loan amounting to ₹4,000 lakhs on the security of the company's plant.

Pass journal entries for all the above mentioned transactions including cash transactions and prepare the company's balance sheet immediately thereafter. The amount of securities premium has been utilized to the maximum extent allowed by law. **[10]**

Answer:

Journal Entries

	Particulars		Debit	Credit
			₹	₹
1.	Bank A/c To Investment A/c To Profit and Loss A/c (Being sale of investments and profit thereon)	Dr.	6,300	 6,000 300
2.	Bank A/c To Bank Loan A/c (Being loan taken from bank)	Dr.	4,000	 4,000
3.	10% Redeemable preference Share capital A/c Premium on redemption of preference shareholder A/c To Preference shareholder A/c (Being redemption of preference shares)	Dr. Dr.	5,000 500	 5,500
4	Preference shareholders A/c To Bank A/c (Being payment of amount due to preference shareholders)	Dr.	5,500	 5,500
5.	Securities premium A/c To Premium on redemption of preference share A/c (Being use of securities premium to provide premium on redemption of preference shares)	Dr.	500	 500

	Particulars		Debit	Credit
			₹	₹
6.	Equity Share capital A/c	Dr.	4,000	
	Securities premium A/c [1,600 - 500]	Dr.	1,100	
	General reserves A/c [(400×20) - 4000 – 1,100]	Dr.	2,900	
	To Equity shareholders A/c			8,000
	(being buy back of equity shares)			
	Note : Balance of General Reserve [12,000 – 2,900] = ₹9,100.			
7.	General Reserves A/ c	Dr.	9,000	
	To Capital redemption reserve A/c (4,000 + 5,000)			9,000
	(Being creation of capital redemption reserve to the extent of the face value of preference share redeemed and equity shares bought back).			
	Note: Balance in General reserve as on 01.04.2012 (9,100 – 9,000) = ₹ 100.			
8.	Equity shareholders A/c	Dr.	8,000	
	To Bank A/c			8,000
	(Being payment of amount due to equity shareholders).			
	Note : Cash at Bank [3,300+6,300+4,000-5,500-8,000] = ₹100			

Balance Sheet of Star Ltd., as on 01.04.2013

Balance Sheet as at: 01.04.2013 (₹ in lakhs)

Ref No.	Particulars	Note No.	Current Year Reporting Period	Previous Year Reporting Period
			₹	₹
1	EQUITY AND LIABILITIES			
	(a) Share capital	1	12,000	
	(b) Reserves and surplus	2	12,000	
	(c) Money received against share warrants			
2	Share application money pending			

	allotment			
3	Non-current liabilities			
	(a) Long-term borrowings	3	14,000	
	(b)Deferred tax liabilities (Net)			
	(c) Other Long term liabilities			
	(d) Long-term provisions			
4	Current Liabilities			
	(a) Short-term borrowings			
	(b) Trade payables		4,600	
	(c)Other current liabilities			
	(d) Short-term provisions	4	2,000	
	Total(1+2+3+4)		44,600	
1	ASSETS			
	Non-current assets			
	(a) Fixed assets			
	(i) Tangible assets	5	28,000	
	(ii) Intangible assets			
	iii) Capital work-in-progress			
	(iv) Intangible assets under development			
	(b) Non-current investments (Market value of Investment)			
	(c)Deferred tax assets (Net)			
	(d) Long-term loans and advances			
	(e) Other non-current assets			
2	Current assets			
	(a)Current investments			
	(b) inventories			
	(c) trade receivables			

	(d) Cash and cash equivalents		100	
	(e)Short-term loans and advances			
	(f) Other current assets		16,500	
	Total(1+2)		44,600	

Notes on Accounts

(₹ in crores)

Note 1. Share Capital	Current Year Reporting Period (₹)	Previous Year Reporting Period(₹)
Issued Capital , Subscribed and Paid Up capital		
Equity Shares of ₹ 10 each	12,000	
Total	12,000	

Note 2. Reserve and Surplus	Current Year Reporting Period	Previous Year Reporting Period
Capital Redemption Reserve (2,000+9,000)	11,000	
General Reserve	100	
Profit and Loss(600+300)	900	
Total	12,000	

Note 3. Long Term borrowings	Current Year Reporting Period	Previous Year Reporting Period
9% Debenture	10,000	
Bank Loan	4,000	
Total	14,000	

Note 4. Short Term Provisions	Current Year Reporting Period	Previous Year Reporting Period
Sunday Provision	2,000	
Total	2,000	

Note 4. Tangible Assets	Current Year Reporting Period	Previous Year Reporting Period
Fixed Assets	28,000	
Total	28,000	

(ii) The following particulars in respect of stock options granted by a company are available:

Grant date	April 1, 2009
Number of employee covered	50
Number of option granted per employee	1000
Fair value of option per share on grant date (₹)	9

The option will vest to employees serving continuously for 3 years from vesting date, provided the share price is ₹70 or above at the end of 2011-12.
The estimates of number of employees satisfying the condition of continuous employment were 48 on 31.03.2010 & 47 on 31.3.2011. The number of employees actually satisfying the condition of continuous employment was 45.
The share price at the end of 2011-12 was ₹68.
Compute expenses to recognize in each year and show important accounts in books of the company. **[6]**

Answer:

The vesting of options is subject to satisfaction of two conditions viz. service condition of continuous employment for 3 years and market condition that the share price at the end of 2011-12 is not less than ₹70.

Since the share price on 31/03/12 was ₹68, the actual vesting as nil. Despite this, the company should recognise value of option over 3-year vesting period from 2009-10 to 2011-12.

Year 2009-10

Fair value of option per share = ₹9

Number of shares expected to vest under the scheme = 48 x 1,000 = 48,000

Fair value = 48,000 x ₹9 = ₹4,32,000

Expected vesting period = 3 years

Value of option recognised as expense in 2009-10 = ₹4,32,000 /3 = ₹1,44,000

Year 2010-11

Fair value of option per share = ₹9

Number of shares expected to vest under the scheme = 47 x 1,000 = 47,000

Fair value = 47,000 x ₹9 =₹4,23,000

Expected vesting period = 3 years

Cumulative value of option to recognise as expense in 2009-10 and 2010-11

= (₹4,23,000/3) x 2 = ₹2,82,000

Value of option recognised as expense in 2009-10 = ₹1,44,000

Value of option recognised as expense in 2010-11

= ₹2,82,000 - ₹1,44.000 = 1,38,000

Year 2011-12

Fair value of option per share = ₹9

Number of shares actually vested under the scheme = 45 x 1,000 = 45,000

Fair value = 45,000 x ₹9 = 4,05,000

Vesting period = 3 years

Cumulative value of option to recognise as expense in 2009-10, 2010-11 and 2011-12

= ₹4,05,000

Value of option recognised as expense in 2009-10 and 2010-11 = ₹2,82,000

Value of option recognised as expense in 2011-12

= ₹4,05,000 - ₹ 2,82,000 = ₹1,23,000

Employees' Compensation Alc

Year			Year		
2009-10	To ESOP Outstanding Alc	1,44 ,000	2009-10	By Profit & Loss Alc	1,44,000
		1,44,000			1 44 000
2010-11	To ESOP Outstanding A/c	1,38,000	2010-11	By Profit & Loss A/c	1,38,000
		1,38,000			1,38,000
2011-12	To ESOP Outstanding A/c	1,23,000	2011-12	By Profit & Loss No	1,23,000
		1,23,000			1,23,000

ESOP Outstanding A/c

Year			Year		
2009-10	To Balance bld	1,44,000	2009-10	By Employees' Compensation Alc	1,44,000
		1,44,000			1,44,000
2010-11	To Balance cld	2,82,000	2010-11	By Balance bid	1,44,000
				By Employees' Compensation A/c	1,38,000
		2,82,000			2,82,000
2011-12	To General Reserve	4,05,000	2011-12	By Balance bid	2,82,000
				By Employees' Compensation A/c	1,23,000
		4,05,000			4,05,000

(c) (i) The following is the Balance Sheet of "Sky" Ltd. as at 31.3.2013:

Liabilities	₹	**Assets**	₹
Share Capital :		Fixed Assets:	
3,000 Equity Shares of ₹ 100, ₹ 75 paid up	2,25,000	Land & Buildings	7,00,000
8,000 Equity Shares of ₹ 100, ₹ 60 paid up	4,80,000	Plant & Machineries	3,80,000
2,500 10% Pref. Share of ₹ 100, fully paid up	2,50,000	Current Assets:	
10% Debentures (floating Charge on all assets)	2,00,000	Stock at Cost	1,20,000
Int. accrued on Deb. (also secured as above)	10,000	Sundry Debtors	2,00,000
Sundry Creditors	5,35,000	Cash at Bank	60,000
		Profit and Loss A/c	2,40,000
Total	**17,00,000**	**Total**	**17,00,000**

On that date, the Company went into Voluntary Liquidation. The dividends on Preference Shares were in arrears for the last two years. Sundry Creditors include a loan of ₹ 90,000 on Mortgage of Land and Buildings. The assets realized were as under: (a) Land & Buildings ₹ 6,40,000; (b) Plant & Machinery ₹ 3,60,000; (c) Stock ₹ 1,30,000;and (d) Sundry Debtors ₹ 1,60,000.

Interest accrued on Loan on Mortgage of Buildings upto the date of payment amounted to ₹ 15,000. The expenses of Liquidation amounted to ₹ 3,600. The Liquidator is entitled to a remuneration of 3% on all the assets realized (except cash at bank) and 2% on the amounts distributed among Equity Shareholders. Preferential Creditors included in Sundry Creditors amount ₹ 40,000. All payments were made on 30.06.2013.

Prepare the Liquidator's Final Statement of Account. **[8]**

Answer:

Liquidator's Final Statement of Account

Receipts	**Amount**	**Amount**	**Receipts**		**Amount**
Assets realized:			Liquidator's Remn.[3% on(6,50,000 + 6,40,000)]		38,700
Cash at Bank		60,000	[2% as computed in WN 4]		5,739
Sundry Debtors	1,60,000		Liquidation Expenses (given)		3,600
Stock	1,30,000		Debenture-holders		
Plant & Machinery	3,60,000	6,50,000	10% Debentures	2,00,000	
Surplus from Securities			Interest accrued as per B/S	10,000	
Land & Buildings	6,40,000		Further Interest **(WN 2)**	5,000	2,15,000
Less: Mortgage Loan	90,000		Preferential Creditors (given)		40,000
Less: Interest upon date of A/c	15,000	5,35,000	Unsecured Creditors **(WN 3)**		4,05,000
			Preference Shareholders		
			Preference Share Capital	2,00,000	
			Dvd Arrears at 10% for 2 yrs	50,000	2,50,000
			Equity Share Holders **(WN 4)**		
			On 8,000 Shares at ₹ 22.00 per share		1,75,976
			On 3,000 Shares at ₹37.00 per share		1,10,985
Total		**12,45,000**	**Total**		**12,45,000**

2. Interest on Debentures: As the Company is solvent, Interest on Debentures should be paid up to the date of final settlement i.e., for the period 01.04.2013 to 30.06.2013 i.e. ₹ 2,00,000 x 10% x 3/12 = 5,000.
3. Balance Unsecured Creditors =Creditors as per B/s – Mortgage Loan – Preferential Creditors = (5,35,000 – 90,000 – 40,000) = 4,05,000
4. Payment to Equity Shareholders and Liquidators' Remuneration:

Particulars	₹
a. Total of Receipts before considering Call Money (from the above account)	12,45,000
b. Total Payments before final payment to Equity Shares & Liquidators' Remn. at 2% thereon (38,700 + 3,600 + 2,15,000 + 40,000 + 4,05,000 + 2,50,000)	9,52,300
c. Surplus from above before Liquidators' Remuneration & Calls made on Equity	

	Shares (a-b)	2,92,700
d.	Liquidators' Remuneration on payment to Equity Share = 2% of amount paid = 2/102 x 2,92,700	5,739
e.	Surplus from above before Calls made on Equity Shares (c-d)	2,86,961
f.	Notional Call on 8,000 Partly Paid Shares at ₹ 15 each (to make all shares ₹ 75 paid up)	1,20,000
g.	Surplus Cash balance after Notional Call (comparing e and f)	4,06,961
h.	Number of Shares deemed paid at ₹ 75 per share (3,000 + 8,000)	11,000
i.	Hence, Refund on every ₹ 75 paid up Share (g ÷ h)	₹ 37.00
j.	Loss per ₹ 75 paid up Equity Share = Paid Up Value ₹ 75 – Refund as above ₹ 37.00	₹ 38.00

The final settlement is made in any of the following ways –

(a) Calling ₹ 15 on 8,000 Shares presently ₹ 60 paid up, so as to make all Shares ₹ 75 paid up, and then refunding ₹ 37.00 per share for all 11,000 Shares.

(b) Refunding ₹ 37.00 per Share (₹ 75 – ₹ 38.00 Loss) for 3,000 Shares; and Refunding ₹ 22.00 per Share (₹ 60 – ₹ 38.00 Loss) for the balance 8,000 Shares, without calling the further money from those Shares.

Alternative (b) is adopted in the above presentation.

(ii) Ms. Lalita Star Ltd. has collected the following information for the preparation of cash flow statement for the year 2000.

	(₹ in lakhs)
Net Profit	**25,000**
Dividend(including dividend tax) paid	**8,535**
Provision for Income tax	**3,000**
Income tax paid during the year	**4,248**
Loss on sale of assets (net)	**40**
Book value of the asset sold	**185**
Depreciation charged to Profit & Loss Account	**22,000**
Amortization of Capital grant	**6**
Profit on sale of Investment	**100**
Carrying amount of Investment sold	**27,765**
Interest income on investments	**2,506**
Interest expenses	**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**
Investment in joint venture	**3,850**
Expenditure on construction work-in-progress	**34,740**
Proceeds from calls in arrear	**2**
Receipt of grant for capital projects	**12**
Proceeds from long term borrowing	**25,980**
Proceeds from short-term borrowing	**20,575**
Opening Cash & Bank balance	**5,003**

Closing Cash & Bank balance	**6,988**

Prepare the Cash Flow Statements for the year 2013 in accordance with AS- 3, Cash Flow Statements. [8]

Answer:

Cash flow Statement for the year……..

Particulars	₹Lakhs	₹Lakhs
A. Cash flow from Operating Activities		
Net Profit before Taxation (25,000 + 3,000)	28,000	
Adjustment for: Depreciation	22,000	
Loss on Sale of Assets (Net)	40	
Amortization of Capital grant	(6)	
Profit on sale of Investment	(100)	
Interest income from investments	(2,506)	
Interest expenses	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 Tax 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 from investments (assuming as received fully during the year)	2,506	
Purchased 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 Activities [B]		(22,634)
C. Cash flow from Financing Activities		
Proceeds from Calles-in-Arrears	2	
Receipt of Grant for Capital Projects	12	
Proceeds from Long term borrowing	25,980	
Proceeds from Short term borrowing	20,575	
Interest paid	(10,520)	
Dividend (including Dividend Tax)	(8,535)	
Net Cash flow from / (used in) Financial Activities [C]		27,514
D. Net Increase/ (Decrease) in Cash and Cash Equivalents (A+B+C)		1,985
E. Cash and Cash Equivalent at the beginning of the period		5,003
F. Cash and Cash Equivalent at the end of the period (D+E)		6,988

Section C

(5) Answer the following (Compulsory) [4x2=8]

(i) Explain the disclosures require under AS 11.

Answer:

Disclosure under AS -11: An enterprise should disclose:

a) The amount of exchange difference included in the net profit or loss for the period.

b) The amount of exchange difference adjusted in the carrying amount of fixed assets during the accounting period.

c) The amount of exchange difference in respect of forward contracts to be recognized in the profit/loss for one or more subsequent accounting period.

d) Foreign currency risk management policy.

(ii) Distinguish between Explanatory Notes and Qualificatory Notes.

Answer:

Distinguish Between Explanatory Notes and Qualificatory Notes

Explanatory Notes	Qualificatory Notes
An Explanatory Note is meant to explain or supplement a matter contained in or related to Financial Statements.	A Qualificatory Note is intended to communicate the Auditor's reservation on the accounts.
The matter on which an Explanatory Note is given is one on which the Auditor has not taken an adverse view.	Qualificatory Notes arc notes on which the Auditor has taken an adverse view e.g. tax provision not made in the accounts.
Explanatory Notes are given by the Directors of the Company.	Qualifications are made by the Auditor in his Report to the Company's shareholders.
These are usually shown under "Notes to Accounts". All Notes, wherever shown, including those required by the Schedule VI constitute an integral part of the accounting statement.	These notes are included in the Auditors' Report before the Opinion Paragraph. The reader's attention is drawn to the Qualification paragraph by use of the word "Subject to".
There is no specific reporting requirement for Notes. The Directors for	Sec.211 requires the Directors to furnish full remark information on contained in every the qualification or adverse Auditors' Report.

(iii) What factors should be considered in the design of a Statistical Sample?

Answer:

When designing an audit sample, the auditor shall consider the purpose of the audit procedure and the characteristics of the population from which the sample will be drawn. The auditor shall determine a sample size sufficient to reduce sampling risk to an acceptably low level.

(iv) Whether an Auditor opinion in a financial statement is persuasive or a conclusive in nature?

Answer:

Auditors opinion in a financial statement is persuasive and not a conclusive in nature. In the financial statement, auditors gives their conclusion but based on that conclusion, user of the financial statement can't conclude the future viability of the Company or firm and took a decision on the basis of that opinion.

(6) Answer any one Question [1x8=8]

(a) Explain the types of Cost Audit? [8]

Answer:

1. On the basis of persons who direct the audit to be performed -

(a) Statutory Cost Audit: Sec.233B of the Companies Act stipulates Cost Audit for certain types of Companies/ Industries. However, it is not a regular or recurring feature on an annual basis. The Government orders the conduct of Cost Audit, from time to time, whenever it feels that such type of audit is necessary for a particular industry.

(b) Cost Audit on behalf of the Management: The principal objective of this audit is to see that the cost data placed before the management are verified and reliable and useful for decision-making. The objectives include-

- Establishing accuracy of the costing data, e.g., cost of materials used, allocation of wages into direct and indirect and on different products, functions and cost centre's.
- Ensuring that the objectives of cost accounting are being achieved through appropriate collection, segregation, analysis and compilation of data.
- Ascertaining abnormal losses and gains along with the relevant causes, expressed in financial terms in a manner that the person responsible for such loss or gain is identified.
- Determining per unit cost of production in a precise but practicable manner.
- Establishing proper overhead rates for absorption by various cost units, so as to ascertain costs properly, and to ensure that there is no significant over or under recovery of expenses.
- Fixing the contracted price and determination of additional or supplementary charge

that can be raised against customers for alterations, etc.

- Improving the quality of the cost accounting system by obtaining audit observations and suggestions of the Cost Auditor.

(c) Cost Audit on behalf of a Customer: In case of cost plus contracts, often the buyer or the Contractee insists on a cost audit to satisfy about the correct ascertainment of cost. Sometimes, such audit is contained in the agreement between the parties that the Supplier or the Contractor will extend all co-operation to the Cost Auditor. The cost of production arrived at for this purpose may differ from the cost of production ascertained for internal control purposes.

(d) Cost Audit on behalf of Government: The Government may order that a Cost Audit may be conducted in the following situations -

- When it is approached with requests for subsidies, protection, etc.- to satisfy itself whether the need is genuine or made up , whether the industry seeking assistance is efficiently run, etc.
- In public interest - to establish the fair price of any product.

(e) Cost Audit by Trade Association: The Trade Association may seek full information on the costing system, level of efficiency, utilisation of capacity, etc. It may also require a cost audit when -

- Its activities include maintenance of price of the products manufactured by its member units, or
- Where there is a pooling or contribution arrangement by all members of the association.

2. On the basis of persons who conduct the audit –

Internal Cost Audit	External Cost Audit
It is conducted by persons who are in the regular employment of the Company.	It is conducted by parties outside the Firm i.e. those who are not Company's employees.
It is oriented towards the objectives of the Management, primarily for system compliance and decision making purposes.	It is oriented towards the objectives of the persons who direct the audit to be performed, e.g. Government, Trade Association etc.
It may be conducted as part of the system of Internal Control and Internal Check.	It is not part of the regular organisational procedure.

(b) Purchase of Raw materials by a business were supported by invoices, challans and receipts of suppliers. Invoices were authorized by the Purchase Manager and payments were made to the suppliers by account payee cheque. After the accounts were audited, it was discovered that the raw materials were purchased at inflated prices resulting in a loss or ₹ 3 lakhs to the business. Will the Auditor be held liable in this connection? [8]

Answer:

(1) CARO Requirements: In the given case, the purchase of materials have been documented by Invoices, Challans acknowledging actual supply, payment by Account Payee Cheques and

valid receipts from Suppliers. It is also observed that the Auditor has verified the purchase transactions. The Auditor's reporting duties in this regard under CARO involve the following -

(a) Internal Control [4(iv)]:

(i) Adequacy: Is there an adequate internal control procedure commensurate with the size of the company and the nature of its business, for the purchase of inventory and Fixed Assets for the sale of its goods and services.

(ii) Correction of Weakness: Whether there is a continuing failure to correct major weaknesses in Internal Control.

(b) Transaction Covered by Sec. 301 [4(v)]:

(i) Records: whether the particulars of contracts or arrangements referred to u/s 301 have been entered in the registered to be maintained under that Section.

(ii) Reasonability: Whether transactions made in pursuance of these contracts or arrangements have been made at prices which are reasonable having regard to the prevailing market price at the relevant time. (This information is required only in case of transaction exceeding the value of ₹5 lakhs in respect of any party and in any one financial year.

(c) Fraud [4(xxi):

(i) Whether any fraud on or by the company has been noticed or reported during the year.

(ii) Where any Fraud is noticed and reported, the nature and the amount involved should be indicated.

(2) Auditors' Duties:

(a) The Auditor had examined the Company's Internal Control System in relation to purchases, e.g. procedures like obtaining quotations from competitive Suppliers, analysis thereof to choose the Supplier, and placing the order on a correct understanding of the terms contained in the quotations.

(b) In case of transactions with parties listed u/s 301 of the Act, the Auditor is required to verify the reasonableness of prices having regard to the prevailing market prices.

(c) The Auditor is also required to examine whether there has been any fraud detected / noticed / reported in relation to purchases.

(3) Conclusion: If the Auditor had properly examined all these and also had satisfied himself about compliance of these in placing orders for purchases of Raw Materials, he will not be liable for the excess price paid. However, if he has not exercised due care and diligence in the performance of his duties, he may be guilty of negligence.

(7) Answer any two Question [2x12=24]

(a) (i) Compare and contrast between Special Audit u/s 233A and Cost Audit u/s 233B. [8]

Answer:

(1) Common Points:

(a) Initiative of Central Government: Both audits are based on the central Government's direction.

(b) Reporting: Both Auditors report directly to the central Government. In case of cost audit, a copy of the cost Audit report shall be given to the company.

(c) Powers & Duties: Auditors u/s 233A and 233B shall have same powers as the company auditors.

(d) Action on report: The central Government may take such action on the report as it considers necessary, in accordance with the companies Act or any other law.

(e) Circulation to members: The central Government may require that a copy of, or relevant extracts from, the reports shall be circulated to members of the company.

(2) Points of difference:

Particulars	Special Audit	Cost audit
Governing Sec.	233A	233B
Circumstances	(a) That the affairs of the company are not being managed in accordance with sound business principles or prudent commercial practices, or (b) That the company is being managed in a manner likely to cause serious injury or damage to the interests of the trade, industry or business to which it pertains, or (c) That the financial position of the company is such as to endanger its solvency.	The company should be one for which maintenance of cost records under sec .209 (1) (d) have been prescribed.
Appointing Authority	By central Government directly	By the Board of Directors with the previous approval of central government.
Auditor	(a) A Chartered account u/s 2(1)(b) of the chartered Accountants Act, 1949, whether or not he is in practice, or (b) The company auditor himself.	A cost Accountant as per the cost and work Accounts act , 1959. It is specifically provided that the company Auditor shall not be appointed as the cost auditor.
Audit report	Directly sent to the central Government. A copy shall be sent to the company, if the Government does not take any action on the report for four months.	To central Government, with a copy to the Company. The company shall submit information on reservations and qualifications in the report.
Auditor's remuneration	Determined by the central Government (which determination shall be final)	It shall be decided by the Board of Directors.

(ii) External confirmations are more reliable evidence than internal confirmations. Comments. [4]

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.

(b) As an auditor, how would you vouch & verify the following items [3x4=12]

(i) Investments,
(ii) Loan against the securities of Land & Buildings
(iii) Sales

Answer:

(i) Investments:

- Insist on a schedule of investments, when number of investments held by the auditee is very large.
- Examine the investment schedule with reference to the relevant ledger accounts.
- See that the investments have been shown properly in the Balance Sheet
- He should verify the existence of investments by inspecting the certificate, deposit receipts etc.,
- Obtain a certificate from bank of certain securities given to the bank for safe custody.
- Examine the transfer deed, broker's contract note if certificate of investments is not received upto the date of audit of the securities purchased during the year under audit.
- Examine the trust deed if securities are held by a trust on behalf of the client.
- Verify the Sales proceeds from pass book of the sale of any securities made after the date of Balance Sheet but before the audit.

- Verify relevant vouchers and certificates whether securities are free from any charge or not.
- See whether investments are properly valued or not giving consideration to the provisions of the Articles of Association in case of trust companies as they are valued at cost but in case of finance companies they are valued, being traded as current assets, at cost price or market price, whichever is less.
- See that regarding the investments in subsidiaries, disclosure requirements of section 212 are complied with.
- Check the balance in the schedule of investments in the name of the client and compare it with the general ledger and Balance Sheet. See that the investments are in the name of the client.
- See that investments made by the company are not contrary to the provisions of section 372 of the Indian Companies Act, 1956.
- In case of application money paid for shares which are still to be allotted, the fact is to be specifically disclosed in Balance Sheet.
- Confirm that uncalled amount on partly paid shares held as investment is shown as contingent liability in Balance sheet.
- The auditor has to report, as per section 227 of the Companies Act, whether any shares, debenture sold at price lower than their cost, in the case of finance company, whether proper records of investments are kept.
- While auditing the investments the auditor should keep in mind the provisions of AS 13.

(ii) Loan against the securities of Land & Buildings

- MOA/AOA: Examine the Memorandum and articles of Association to see whether the company is empowered to lend money against property.
- Minutes and resolutions:
  - Check the Minutes Book and resolution approving the loan.
  - Note the decision taken as to terms and conditions like interest, repayment period, security, etc.
- Statutory compliance:
  - Scrutinise the Loan Account in the Ledger and ensure compliance with Sec.269T of the Income tax Act, 1961.
  - Examine the reporting requirements under CARO, if applicable in the given case, e.g. transactions to be recorded in the Register maintained u/s301 of the companies Act.
- Confirmation: Obtain confirmation from the Borrowers for the amount of loan.
- Loan Documents and Mortgage Documents – for Security of Land:
  - Obtain and scrutinize the loan documents and documents relating to the land & Buildings.
  - Examine the Mortgage Deed and find out whether the mortgage is properly executed.
  - Note the date of mortgage.
  - If it is a second mortgage, check, whether he has the title deeds relating to the property.

- Where required, see whether the charge/ Mortgage has been registered with the ROC, and a copy of the certificate is available with the company in its capacity as Mortgage- Holder.

- Documents for Security of goods:

  Examine the documents relating to loan noting the following points –

  - For advances against Godown- Keeper's receipt – Examine the receipt.
  - For goods in dock or in bonded warehouse – examine the Dock Warrant or the Warehouse Certificate or Delivery Note duly endorsed favour of the Entity.
  - For Goods in Transit – Inspect the railway receipt or Bill of Landing together with Letter of Hypothecation, Insurance policy and Invoices, etc, duly endorsed in favour of the Entity.
  - See that the rent for warehouse or godown has been paid by the Borrower. If it has not been paid, then it should be added to the amount of principal.

(iii) Sales

Cash sales:

- A/cing manual & Internal:
  - Examine the internal control and ascertain whether it operates satisfactorily.
  - Ensure proper co-ordination (and not collusion) between Billing & Despatch Sections.
  - Identify possible loopholes in the system, whereby cash could be misappropriated
- Carbon copies of cash Bills: .
  - Verify actual collections on a given date based on the carbon copies of Cash Bills.
  - Conduct examination in depth, for a few bills, in order to ascertain whether product description, model-wise, prices, discounts, quantities, etc. are properly calculated.
  - Ascertain whether rates of Excise and VAT on Sales have been calculated properly.
  - Trace a few entries / items of Cash Sales into the Stock Register and confirm issue / despatch postings.
  - Examine the Bill Serial Numbers to ensure that "ghost" bills are not included.
  - Confirm whether dates of these bills correspond with the Cash Book entry date.
- Cash Sales Summary Book:
  - Where Cash Sales are numerous, the Firm maintains a Collection Chitta or Cash Sales Summary Book. Trace the collections into the Summary Book.
  - Test Check the Summary Book to ensure that castings, cross-totals, etc. are correct.
- Cash Book:

  Trace the daily total collections to the Cash Book from the following sources –
  - Carbon Copies of Cash Bills.
  - Summary Book or Collection Chitta - in case collections are heavy.
  - Machine Printouts - in case of mechanised collections / cash registers.
- Originals of Cancelled Cash Bills:
  - Where a cash bill has been cancelled, inspect its Original and confirm the cancellation.
  - Trace the entry into the Stock Register, and ensure that there is no despatch against a cancelled invoice / bill.
- Bank Statements:

  In case daily cash collections are banked on the following day, trace the earlier day collection into the Bank Statement along with pay-in-slip counterfoil.

- Sales tax & Excise Duty returns:

  Examine whether the Total Sales (Cash and Credit) as per General Ledger tallies with the amount disclosed in Excise and VAT monthly returns submitted to the Sales Tax and Excise Authorities.

- General Ledger:
  - Trace the total of Cash Sales & Credit Sales, into Sales account in the General Ledger.
  - Confirm the totals of the various heads of account, i.e. Sales, Excise Duty Collection, Sales Tax Collection, etc. tallies with the Subsidiary Register.

Credit sales:

- Accounting Manual & internal Control:
  - Confirm whether the internal control system ensures proper inclusion of miscellaneous income item to be billed, e.g. Freight Charges Collection, Insurance Charges Collection, Service Charges / Installation Charges, if any.
  - Review the control system as regards - (a) Booking of Sales, (b) Intimation to Production / Despatch Section, (c) Despatch of goods, (d) Intimation to Accounts / Billing Section, (e) Actual Billing, and (f) Follow-up for collection.
  - Examine whether the system operates effectively to ensure that all despatches are promptly billed and there is no leakage of revenue.
- Carbon Copies of Sales Bills/ Invoices:
  - Conduct examination in depth, for a few bills, in order to ascertain whether product description, model-wise, prices, discounts, quantities, etc. are properly calculated.
  - Ascertain whether rates of Excise and VAT on Sales have been calculated properly.
  - Examine the Bill Serial Numbers to ensure that "ghost" bills are not included.

- Despatch/ Stock Register:
  - Trace a few entries / items of Sales into the Stock Register and confirm issue / despatch postings.
  - Compare a few entries in Despatch Register with Freight Outward Expenses A/c and confirm whether such despatch has been really made.
- Originals of Cancelled Bills:
  - Where a Bill has been cancelled, inspect its Original and confirm the cancellation.
  - Trace the entry into the Stock Register, and ensure that there is no despatch against a cancelled invoice / bill.
- Sales tax & Excise Duty Returns:
  Examine whether the Total Sales (Cash and Credit) as per General Ledger tallies with the amount disclosed in Excise and VAT monthly returns submitted to the Sales Tax and Excise Authorities.
- Collection register:
  Examine the control system for cash and Cheque collection from debtors, and ascertain if there are any loopholes (for teeming and landing fraud, mis- appropriation of cash, etc) and verify whether the system operates properly.

- General Ledger:
  - Trace the total of Cash Sales & Credit Sales, into Sales account in the General Ledger.
  - Confirm the totals of the various heads of account, i.e. Sales, Excise Duty Collection, Sales Tax Collection, etc. tallies with the Subsidiary Register.
  - Trace a few entries into the Debtors' Ledger, and confirm postings in correct Party a/c.

(c) State the steps for proper Internal Control over stores of a large Textile Mill company. [12]

Answer:

A company's investment in inventory is usually a large one, and it may be comprised of a large number of merchandise items that can be readily stolen and resold. If the inventory contains mostly raw materials, then keeping track of it is essential for ensuring that the production processes using it will not run short of materials. This means that you need to implement an array of controls, either to prevent theft or to ensure that the manufacturing operation does not run short of inputs. We will describe below a number of the key controls you should consider for your inventory investment.

Following steps are considered the most important in case of internal control over stores:

(i) Maintenance of Record: For the strong control over stores it is necessary that record of the goods in the store should be maintained properly. Quality and quantity of the goods should be recorded in detail.

(ii) Checking of Record: There should be proper checking of such record. This record should be kept in those hands who do not handle the stores.

(iii) Continuous Stock Taking: Continuously independent stock taking by actual must be carried out. It should be done by any other person who is not store keeper. It will be very useful in detecting the fraud and errors.

(iv) Use of Separate Bin: Store room should be arranged systematically and each item should be kept in separate bin. It will become very easy for the store keeper to find the particular item.

(v) Quantity Fixation Limit: Each item of the store minimum and maximum quantity limit should be fixed by the management. This limit should be entered in Bin Cards. If the quantity of any item reduces then the fixed limit, store keeper should report to the purchase department.

(vi) Entrance not allowed: No any person should be allowed to enter in the stock room except the store keeper and his assistance.

(vii) Use of Bin Cards: Bin Cards should be attached with each Bin. Store keeper should write to the issuance or receipt of item to the bin card. The record of the store room should consist of only a bin cards.

(viii) Issuance without requisition not allowed: Any item may not be issued by the store keeper upon verbal request. Without presenting the requisition duly signed by the in-charge of the needed department no any material should be issued by the store keeper.

(ix) Entry in Store Cards: After entering the items on the bin card store keeper sends the store issue requisitions to the "Store Record Office". The office will enter the issues in dependently in the store cards. These would contain the record of items quantity and their price.

(x) Tag all inventory: Every scrap of inventory in the warehouse should be identified with a tag, which states the part number, description, unit of measure, and quantity. Otherwise, inventory items are bound to be mis-identified.

(xi) Segregate customer-owned inventory: If there is inventory on-site that customers own, the warehouse staff will likely count it as though it is owned by the company, so have a procedure in place for labeling these items as customer-owned when they arrive, and segregate them in a separate part of the warehouse.
(xii) Standardize record keeping for inventory picking: When an item is picked from the shelf in the warehouse, for use either in the production area or for sale to customers, have a standard procedure for recording the picks as soon as they leave the warehouse (which is easier if there is a warehouse fence, and inventory can only pass through a single controlled gate).
(xiii) Sign for all inventory removed from the warehouse: If inventory items are being removed from the warehouse for reasons outside of the normal picking process, have the person removing the inventory sign for the removal, so that there is a record of who is responsible.
(xiv) Audit the bill of materials: The bill of materials is a record of the parts used to construct a product. The bill of materials is used to pick items from stock, so if the bill is incorrect, pickers will pull incorrect amounts from the warehouse. This calls for a periodic audit of every bill, as well as password-only access to the bill of material records in the computer system.
(xv) Trace extra requisitions and returns: If the production staff asks for extra issuances of parts, or returns excess amounts to the warehouse, then there is an error in the picking records (possibly in the bill of materials, as just noted).
(xvi) Conduct a periodic obsolete inventory review: The warehouse can eventually become choked with obsolete inventory that cannot be used, which requires high storage costs and also interferes with the components that are needed in production. Form a materials review board that periodically combs through the inventory records to determine which items should be sold off or otherwise eliminated.
(xvii) Conduct cycle counts: Have the warehouse staff conduct small, frequent counts of a small portion of the inventory, and investigate and correct any errors they find. This gradually improves the inventory record accuracy.
(xviii) Investigate negative-balance inventory records: If the accounting records show that there is negative inventory on hand, then there is obviously a transactional flaw that caused the negative balance. This is a prime target for a detailed investigation.
(xix) Record scrap transactions: Do not just throw scrap in a scrap bin when it occurs. If you do, the accounting system still thinks the scrapped item is in stock, and so will overstate the amount of inventory. Instead, create a procedure to track scrap on a regular basis.
(xx) Return of any item: Sometimes any item is not used and returned to store. It should be accompanied by "Store Resumed Notes" in duplicates. Its entry in the bin card and stores record cards will be just like the requisition entry.
(xxi) Verification of Items: Inspection department should make a surprised checking of the store time to time. Some items of the stores should be verified by actual count and these should be balanced by bin cards and stores cards.