Paper-12 : COMPANY ACCOUNTS & AUDIT

SECTION — A

Question No. 1

(a) Discuss the fundamental Accounting Assumptions.

Answer:

Accounting Assumption Underlying assumptions for the preparation and presentation of financial statements are accrual , consistency 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. As per consistency the same set of rules are to be followed all the time in a consistent manner while preparing the financial statements. 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.

(b) Discuss the objectives of Financial Statements.

Answer:

The objective of financial statements is to provide information about the financial position, performance and changes in financial position of an entity that is useful to a wide range of users in making economic decisions. This would guide in deciding statements, their contents and disclosures. A set of general purpose financial statements focus on financial position, performance and cash flows of an entity which could be used by any user group to assess investment decision, employment stability or growth, debt servicing, business continuity and ability to make societal contribution. General purpose financial statements are those intended to meet the needs of users who are not in a position to require an entity to prepare reports tailored to their particular information needs. A complete set of financial statements is the outcome of the Framework which in turn is linked to the information need of various user-groups.

It comprises of:

(i) a statement of financial position as at the end of the period;

(ii) a statement of comprehensive income for the period;

(iii) a statement of changes in equity for the period;

(iv) a statement of cash flows for the period;

(v) notes, comprising a summary of significant accounting policies and other explanatory information; and

(vi) a statement of financial position as at the beginning of the earliest comparative period when an entity applies an accounting policy retrospectively or makes a retrospective restatement of items in its financial statements, or when it reclassifies items in its financial statements.

Notes, comprising a summary of significant accounting policies and other explanatory information are important components of financial statements as they explain various elements of financial statements. Disclosure of risks adds to the information content of the financial statements. Earnings per share information contained in the Income Statement are focused information to shareholders as regards entity's performance. Information regarding diluted earning improves the information communique working out the effect of possible equity dilution actions. Similarly, segment reporting is intended to provide disaggregated information based on operating and / or geographic segments, consolidated financial statements focus on providing aggregated financial information for the entity-group as a whole, related party disclosures are intended to highlight non-market oriented transactions, if any. Thus the origination and improvement in disclosure and presentation standards have the purpose of making a set of general purpose financial statements useful to the diverse user-groups.

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

On 31st March, the following ledger balances have been extracted from the books of Washington Branch Office —

Ledger A/c	$	Ledger A/c	$
Building	180	Sales	110
Stock as on 1st April (Beginning)	26	Commission Receipts	28
Cash and Bank Balances	57	Debtors	46
Purchases	96	Creditors	65

You are required to convert above Ledger balances into Indian Rupees. Use the following rates of exchange — Opening Rate 1$ — ₹46; Closing Rate 1$ = ₹50; For Fixed Assets 1$ = ₹42.

Answer:

Trial Balance of Washington Branch in Reporting Currency (Extract)

Particulars	$	Details	Exchange Rate	(₹)
Building	180	Actual Rate	42	7,560
Stock as on 1st April (Beginning)	26	Opening Rate	46	1,196
Cash and Bank Balances	57	Closing Rate	50	2,850
Purchases	96	Average Rate	[(46+50)/2] i.e. 48	4,608
Sales	110	Average Rate	48	5,280

Commission Receipts	28	Average Rate	48	1,344
Debtors	46	Closing Rate	50	2,300
Creditors	65	Closing Rate	50	3,250

(b) Mitra Ltd. imported a machine on 04.01.2009 for Euros 12,000, on deferred payment basis, payment in six equal annual instilments at every financial year end, commencing from 31.03.2009 onwards. Use AS – 11 provisions and determine the exchange differences carrying amounts of the liability as the end of each financial year, if the following exchange rates are given. One Euro equals Indian Rupees on —

04.01.2009	31.03.2009	31.03.2010	31.03.2011	31.03.2012	31.03.2013	31.03.2014
₹50.4872	₹45.5208	₹41.8463	₹41.0175	₹42.6400	₹51.4400	₹53.1000

Answer:

A. Computation of Carrying Amounts of Liability

Financial Year ending	EURO Amount due	Closing Rate	Carrying Amount in ₹
31st March 2009	10,000	45.5208	4,52,208
31st March 2010	8,000	41.8463	3,34,770
31st March 2011	6,000	41.0175	2.46.105
31st March 2012	4,000	42.6400	1,70,560
31st March 2013	2,000	51.4400	1,02,880
31st March 2014	Nil	53.1000	Nil

B. Computation of Exchange Differences

Financial Year ending	Due to settlement	Due to Reporting
31st March 2009	2,000 × (50.4872 – 45.5208) = 9,933 Gain	10,000 × (50.4872 - 45.5208) = 49,664 Gain
31st March 2010	2,000 × (45.5208 – 41.8463) = 7,349 Gain	8,000 × (45.5208 – 41.8463) = 29,396 Gain
31st March 2011	2,000 × (41.8463 – 41.0175) = 1,658 Gain	6,000 × (41.8463 – 41.0175) = 4,973 Gain
31st March 2012	2,000 × (41.0175 – 42.6400) = 3,245 Loss	4,000 × (41.0175 – 42.6400) = 6,490 Loss
31st March 2013	2,000 × (42.6400 – 51.4400) = 17,600 Loss	2,000 × (42.6400 – 51.4400) = 17,600 Loss
31st March 2014	2,000 × (51.4400 – 53.1000) = 3,320 Loss	Nil

3. (a) Pipli University has received the following Grants during a yeas —
(i) From Ministry of Human Resources to be used for AIDS research — ₹45,00,000, which includes ₹3,00,000 to cover Indirect Expenses incurred in administering the Grant.
(ii) From a Reputed Trust to be used to set up a Centre to conduct seminars on AIDS related matters from time to time — ₹35,00,000.

During the year, the University spent ₹32,25,000 of the Government Grant and incurred ₹3,00,000 as Overhead Expenses. ₹28,00,000 were spent from the grant received from the Trust. Show the necessary Journal Entries.

Answer:

	Particulars		Dr. (₹)	Cr. (₹)
1	Bank A/c	Dr.	45,00,000	

	To, Government Grants A/c		45,00,000
	(Being Govt. Grant for AIDS Research including ₹3 Lakhs for indirect expenses thereof)		
2	Bank A/c Dr.	35,00,000	
	To, Grants from Trusts A/c		35,00,000
	(Being Grant received to set up a Centre to conduct seminars on AIDS related matters		
3	AIDS Related Expenses A/c Dr.	35,25,000	
	Seminar/ Centre Related Expenses A/c Dr.	28,00,000	
	To, Bank A/c		63,25,000
	(Being AIDS /Grant related expenditure incurred including OH Expenses)		
4	Government Grant A/c Dr.	35,25,000	
	Grants from Trusts A/c Dr.	28,00,000	
	To, Profit & Loss A/c		63,25,000
	(Being Grants transferred to P&L Account to the extent of expenditure incurred thereto)		

Note: In the P&L A/c , the credit of ₹63,25,000 may be shown generally as other Income or specifically as " Grant Income". Alternatively, the expenses could be netted off against the Grants transferred to P&L A/c.

(b) On 1st April 2011, Vidyut Ltd. received a Government Grant of ₹300 Lakhs for acquisition of a Machinery costing ₹1,500 Lakhs. The Grant was credited to the cost of the Asset. The life of the Machinery is 5 years. The Machinery is depreciated at 20% on WDV basis. The Company had to refund the Grant in May 2014 due to non-fulfillment of certain conditions. How you would deal with the refund of Grant?

Answer:

Particulars	₹ Lakhs
Original Cost of the Machinery	1,500
Less: Government Grant	(300)
Depreciable Cost as on 01.04.2011	1,200
Less: Depreciable for 2011-12 [₹1,200 × 20%]	(240)
W.D.V on 01.04.2012	960
Less: Depreciation for 2012-13 [₹960 × 20%]	(192)
W.D.V on 01.04.2013	768
Less: Depreciation for 2013-14 [₹768 × 20%]	(154)
W.D.V on 01.04.2014	614
Add: Refundable Government Grant	300
Revised Book Value of Machinery	914
Balance useful life	2 Years
Depreciation to be provided for the next 2 years [₹914 ÷ 2 years]	457

4. (a) How will you recognize the liability / asset of a Defined Benefit Plan from the data below?

Particulars	₹ Lakhs
PV of Defined Benefit Obligation	**2,200**
Fair Value of Plan Assets	**2,380**
Unrecognised Past Service Cost	**140**

Answer:

Particulars		₹ Lakhs
PV of Defined Benefit Obligation		2,200
Less: Fair Value of Plan Assets		2,380
Balance PV of Economic Benefits available from the Plan (if negative)		(180)
Less: Unrecognised Past Service Cost		140
Balance Negative Amount as computed under Para 55	[A]	(320)
Limit under Para 59 (b) being PV of Economic Benefits available from the Plan	[B]	(180)
Amount to be recognised as Asset under Para 59	[Least of A or B]	(180)

The enterprise should regognise an asset of ₹180 Lakhs, and disclosed that the limit reduced the Carrying Amount of the Asset by ₹140 Lakhs .

(b) Bihari Ltd. wishes to obtain a Machine Tool costing ₹40 Lakhs by way of lease. The effective life of the machine tool is 12 years years but the Company requires it only for the first five years. It enters into an agreement with Radhika Ltd. for a lease rental of ₹4 Lakhs p.a.

Bihari Ltd is not sure about the treatment of these lease, and hence requests your assistance in proper disclosure of the same. Assume implicit Rate of interest at 15% PV are: 0.87,0.76,0.66,0.57 and 0.50.

Answer:

A. Type of Lease :

(i) PV of Lease Rentals = ₹4,00,000 × (0.87+0.76+0.66+0.57+0.50) = ₹13,44,000, whereas Fair Value of Leased Asset = ₹40,00,000.

(ii) Useful Life of the Machine = 12 years whereas the period of Lease will classified as an Operating Lease.

B. Disclosure Requirements :

Lease Rent for current year expensed off in P&L A/c	**₹4,00,000**
Balance Sheet Disclosures: Future Minimum Lease Payments - Not later than 1 year - Later than 1 year but not later than 5 years	 ₹4,00,000 ₹12,00,000

Note: Assumed that the lease Rent is payable in the middle of the year. Excluding the Current Year Lease Rental Payable, 4 installments are payable in future (1 in the forthcoming year and 3 in the rest of the future).

5. (a) Compute Basic EPS for the financial Year ended 31st March from the following date:

1st April	Equity Shares outstanding - Face Value ₹100 fully paid (Opening Balance)	20,000
1St June	Issue of Shares – Face Value ₹100 Paid Up Amount ₹70	20,000
1st July	Buy- Back of Shares (Fully Paid)	8,000

1st Nov	Issue of Shares - Face Value ₹100 fully paid	12,000
	Net Profit before Tax fo the year (Tax Rate = 35%)	₹24 Lakhs
	Preference Dividend (Dividend Distribution Tax = 12.5%)	₹10 Lakhs

Answer:

Date	No. of Equity Shares	Proportion of Paid-up Value to FV	Period Outstanding (upto 31st Mar)	Time Weighting factor	Weighted Average Number of Shares
(1)	(2)	(3)	(4)	(5)	(6) = (2) × (3) × (5)
1st Apr	20,000	₹100 ÷ ₹100 = 100%	12 months	12/12	20,000
1st Jun	20,000	₹70 ÷ ₹100 = 70%	10 months	10/12	11,667
1st Jul	8,000	₹100 ÷ ₹100 = 100%	9 months	9/12	(6,000)
1st Nov	12,000	₹100 ÷ ₹100 = 100%	5 months	5/12	5,000
Weighted Average Number of Equity Shares Outstanding during the period					30,667

Net Profit attributable to Equity Shareholders

Particulars	₹
Net Profit Before Tax	24,00,000
Less: Tax at 35%	(8,40,000)
Profit After Tax	15,60,000
Less: Preference Dividend + 12.5% Tax thereon	(11,25,000)
Net Profit for the period attributable to equity Shareholders	4,35,000

Basic EPS —

$$\frac{\text{Net Profit or Loss attributable to Equity Shareholders}}{\text{Weighted Average Number of Equity Shares outstanding}} = \frac{₹4,35,000}{30,667 \text{ Shares}} = ₹14.18 \text{ per shares.}$$

(b) Visalyakaranya Ltd. is showing an Intangible Asset at ₹144 Lakhs as on 01.04.2011 and that item was acquired for ₹192 Lakhs on 01.04.2008 and that was available for use from that date. Visalyakarani Ltd. has been following the policy of amortization of the Intangible Asset over a period of 12 years on a straight line basis. Comment on the accounting treatment of the above with reference to the relevant accounting standard.

Answer:

AS – 26 assumes that the useful life of an Intangible Asset will not exceed a period of 10 years, but this presumption is rebuttable.

Amortisation Amount as per Company Policy:

(i) Amortisation Amount ₹192 Lakhs ÷ 12 years =₹16 Lakhs p.a.
(ii) Accumulated Amortisation
upto 31st March 2011 (for three years) = ₹16 Lakhs × 3 =₹48 Lakhs
(iii) Carrying Amount = ₹192 Lakhs - ₹48 Lakhs =₹144 Lakhs
(iv) Carrying Amount as per Books =₹144 Lakhs

The balance Carrying Amount of ₹144 Lakhs should be amortised over the balance Useful Life (9 years) at ₹16 Lakhs per annum.

6. (a) A Public Interest Litigation (PIL) has been filed before the Supreme Court on the environmental influences of air, noise and water pollution , caused by certain manufacturing industries. The matter has been heard by the Court and proceedings show that the Court will direct such industries to install suitable pollution control equipments. However , till the date the accounts have approved by the Board of Directors of a Company, no such order has come from the Court. The Company feels that no Provisioning or disclosure is required as the Court has not been served on the Company, Is this justifiable?

Answer:

As per AS – 29 a Provision should be recognised if the following conditions are satisfied —

Condition (1)	**Condition (2)**	**Condition (3)**
Present obligation as a result of past event.	Outflow of resources to settle the obligation is probable.	Reliable estimate of the amount.
Environmental pollution and filing of PIL thereon is the past event, on which there is a present obligation.	Outflow of resources to settle the obligation, i.e. cost of installation of pollution control equipments, is probable	Provision should be made for the best estimate of the cost of installing pollution control equipments.

Note: Obligating event is the pollution caused, because of the virtual certainty that the Supreme Court will direct such industries to install suitable pollution control equipments.

Since all the conditions for recognition of a provision are satisfied, a provision should be recognised for the financial year. The company's contention not to make any provision or disclosure, violets AS – 29 requirements.

(b) Sadhna Ltd. acquired a Licence Right on 1st April 1990 for ₹90 Lakhs and amortises the same over a fifteen year period AS – 26 is applicable to the Company from 1st April 2003 on which date the Patents appeared in the Balance Sheet at ₹24 Lakhs (net of accumulated amortization till that date). Give the accounting Treatment for the above as per AS – 26.

Answer:

Useful Life of Intangible Asset has expired and the Enterprise amortises the Intangible Asset over a period exceeding 10 year.

Amortisation Period for licence Right = 10 years from 1st April 1990. The amortization period expires in 1999 – 2000 itself, i.e. before AS – 26 becomes applicable to the Enterprise.

So, the Carrying Amount of Licence Right should be eliminated by the following entry —

Profit and Loss A/c or Revenue Reserve A/c	Dr.	₹24 Lakhs	
To, Licence Right A/c			₹24 Lakhs

SECTION - B

7. Following is the Balance Sheet of Tirthankar Ltd. as on 31st March —

Equity and Liabilities	₹	Assets	₹
Equity Shares of ₹10 each Fully Paid	12,50,000	Fixed Assets	46,50,000
Reserve & Surplus		Current Assets	30,00,000
Revenue Reserve	15,00,000		
Securities Premium	2,50,000		
Profit & Loss A/c	1,25,000		
Secured Loans:			
12% Debentures	18,75,000		
Unsecured Loans	10,00,000		
Current Liabilities	16,50,000		
	76,50,000		76,50,000

The Company wants to buy back 25,000 Equity Shares of ₹10 each on 1st April, at ₹20 per Share. Buyback of Shares is duly authorized its Articles and necessary Resolution passed by the Company towards this. Payment for Buyback of Shares will be made by the Company out of sufficient Bank Balance available as a part of Current Assets.

Comment with your calculations, whether Buyback of Shares by Company is within the provisions of the Companies Act. If yes, pass necessary Journal Entries towards Buyback of Shares and prepare Balance Sheet after Buyback of Shares.

Answer:

A. Computation of maximum Permissible Buyback under Companies Act

Rule 1: Percentage of Shares Bought Back: Maximum Permissible Percentage of Buyback Shares = 25% of Total Shares Outstanding, i.e. 25% of 1,25,000 Shares = 31,250 Shares. (Shareholders' approval by Special Resolution)

Rule 2: Amount ≤ 25% of (ESC + Free Reserves): (For Sec. 68, Free Reserves include Securities Premium A/c.)

- 25% of paid up Capital and Reserves = 25% (12,50,000 15,00,000 + 2,50,000 + 1,25,000) = 25% of ₹31,25,000 = ₹7,81,250.
- Offer Price for Buyback = Face Value ₹10 + Premium ₹10 = ₹20 per Share (given).
- Maximum Permissible Buyback = ₹7,81,250 ÷ ₹20 per Share = 39,063 Shares.

Rule 3: Debt Equity Ration to be 2:1

Particulars	₹
(i) Desired Debt Equity Ratio after Buyback u/s	2:1
(ii) Debt (given) (18,75,000 +10,00,000)	₹28,75,000
(iii) Equity to be maintained after Buyback = (ii) ÷ 2	₹14,37,500
(iv) Existing Equity (Share Capital & All Free Reserves) (12,50,000 +15,00,000 +2,50,000 +1,25,000)	₹31,25,000
(v) Permissible Dilution in Equity = (iv) – (iii)	₹16,87,500
(vi) Buyback Price as calculated above	₹20

(vii) Maximum Permissible Buyback in Crores of Shares = (v) ÷ [(vi) + FV]	84,375 Shares

Summary of above determining the maximum number of Shares that can be bought back

Particulars	No. of Shares
Rule 1 : Percentage of Shares Bought Back	31,250
Rule 2 :Cash Availablity	39,063
Rule 3 : Debt Equity Ratio to be 2:1	84,375
Maximum Permissible Buyback = Least of the above	31,250

Note: The buyback offer of 25,000 shares is within the above limit, and is hence permissible.

Journal Entries

	Particulars	Dr. (₹)	Cr. (₹)
1.	Equity Share Capital A/c (25,000 × ₹10) Dr. Premium on Buyback A/c Dr. To, Equity Shareholders A/c (25,000 × ₹20) (Being, Equity Shares bought back vide resolution No. ….. dated ….., Share Capital cencelled and Premium on Buyback payable to Shareholders)	2,50,000 2,50,000	 5,00,000
2.	Securities Premium A/c Dr. To, Premium on Buyback A/c (Being Premium on Equity Shares Buyback provided out of Securities Premium)	2,50,000	 2,50,000
3.	Revenue Reserve A/c Dr. To, Capital Redemption Reserve A/c (Being transfer to Capital Redemption reserve on account of Securities Premium)	2,50,000	 2,50,000
4.	Equity Shareholders A/c Dr. To, Current Assets A/c (Being paid to equity shareholders on Buyback)	5,00,000	 5,00,000

8. (a)Lakshmi Ltd. issued 1,00,000 Equity Shares of ₹10 each at par. The entire issue was underwritten as fallowes:

A – 60,000 Shares (Firm underwriting 8,000 Shares)
B – 30,000 Shares (Firm Underwriting 10,000 Shares)
C – 10,000 Shares (Firm Underwriting 2,000 Shares)

The Total Applications including Firm Underwriting were for 80,000 Shares. The marked Applications were as follows –

A – 20,000 Shares
B – 14,000 Shares and
C – 6,000

The underwriting contract provides that credit for Unmarked Applications to be given to the Underwriters in Proportion to the Shares underwritten. Determine the liability of each Underwriter.

Answer:

Statement of Underwriters' Liability (No. of Shares)

Particulars	A	B	C	Total
Gross Liability (given) (6:3:1)	60,000	30,000	10,000	1,00,000
Less: Marked Applications	(20,000)	(14,000)	(6,000)	(40,000)
Less: Unmarked Application (Note)	(12,000)	(6,000)	(2,000)	(20,000)
Less: Firm Underwriting	(8,000)	(10,000)	(2,000)	(20,000)
Net Liability	20,000	-	-	20,000
Add: Firm Underwriting	8,000	10,000	2,000	20,000
Total Liability = Share to be taken up by Underwriters	28,000	10,000	2,000	40,000

Note: Unmarked Application = Total Applications 80,000 **Less** Marked Applications 40,000 **Less** Firm Underwriting 20,000 = 20,000 Shares.

(b) Lajpat Ltd. issued 10,000 equity Shares of ₹100 each at a premium of ₹ 15 each. 90% of the issue was underwritten by B & Co. at a Commission of 1% on the Nominal Value. Application was received for 8,000 Shares and allotment was fully made. All the money due from allottees was received in one installment. The accounts with B & Co. were settled. Show the journal Entries to Record Transactions.

Answer:

Computation of Net Liability —

Particulars	B & Co.	Lajpat Ltd.	Total
Gross Liability (Number of Shares)	9,000	1,000	10,000
Less: Total Applications received allotted in 9: 1 Ratio	(7,200)	(800)	(8,000)
Balance to be underwritten	1,800	200	2,000

Note: Only 9,800 Shares (8,000 subscribed by public + 1,800 devolved on the Underwriter) will be allotted by the Company. The Balance 200 Shares will be ignored, since the Company cannot allot Shares to itself.

Journal Entries in the Books of Lajpat Ltd.

	Particulars	Dr. (₹)	Cr. (₹)
1.	Bank A/c Dr. To, Equity Share Application and Allotment A/c (Being Application Money received on 8,000 Shares at ₹115 per share)	9,20,000	 9,20,000
2.	Equity Share Application and Allotment A/c Dr. B & Co. A/c (1,800 × 115) Dr. To, Equity Share Capital A/c (9,800 × ₹100) To, Securities Premium A/c (9,800 × ₹15) (being allotment of 9,800 Shares at ₹15 Premium, 8,000 Shares to Public against forms received and 1,800 shares to underwriters as per their liability under the contract vide Board's resolution No.… Dated ….)	9,20,000 2,07,000	 9,80,000 1,47,000

3.	Underwriting Commission A/c Dr. To, B & Co. A/c (Being Underwriting Commission payable to B & Co. at 1% of Face Value of 9,000 Shares of ₹100 each)	9,000	9,000
4.	Bank A/c Dr. To, B & Co. A/c (Being money received from B & co. in settlement of account)	1,98,000	1,98,000

9. Nimni Limited issued 10,000 equity shares of ₹ 100 each at premium of ₹ 25 per share. Under the terms of the issue, the shares were to be paid for as follows:

		₹
2015 January 1,	**on application (including ₹ 25 premium on issue per share)**	**50**
February 1,	**on allotment**	**50**
April 1,	**balance of**	**25**

The issue was oversubscribed. The applications received are summarised below:

	A	B	C
Number of applicants in categories	**40**	**20**	**1**
Applied for by each applicant in the three categories	**200**	**2000**	**8000**
Issued to each applicant	**100**	**200**	**2000**

One of the conditions of the issue was that amounts over-paid on application were to be retained by the company and used in reduction of further sums due on shares allotted. All surplus contributions were refunded on 15th February, 2014.
Ramesh who had subscribed 100 on an application for 200 shares was unable to meet the claim due on April 1. On May 5, the directors forfeited his shares. All other shareholders paid the sums requested on the due dates. On June 10, 2014 the directors re-issued the forfeited shares as fully paid to Mohan, on receiving a payment of ₹ 10,500.

(i) To prepare a statement as on February 1, 2014, showing the over-payment, under-payment to in respect of category of applicants: and
(ii) To show how the above transactions would appear in the journal of the company.

Answer:

Nimni Ltd.
Statement of Shares Applied, Allotted and Amounts Adjusted

Particulars	Categories		
	A	B	C
(a) Applied (Nos.)	8,000	40,000	8,000
(b) Allotted (Nos.)	4,000	4,000	2,000
	₹	₹	₹
(c) Application money Received (Applied (Application per share)	4,00,000	20,00,000	4,00,000
(d) Application Money required (Allotted × Application per share)	2,00,000	2,00,000	1,00,000
(e) Excess Application Money to be Adjusted with	2,00,000	18,00,000	3,00,000

Allotment [c-d]			
(f) Allotment Money Due (Allotted × Allotment per share)	2,00,000	2,00,000	1,00,000
(g) Balance of Excess Application Money for Adjustment with calls [e-f]	Nil	16,00,000	2,00,000
(h) Call Money Due (Allotment × Call per share)	1,00,000	1,00,000	50,000
(i) Excess/(Shortage) In case of shortage, the shareholders will deposit the dues.	(1,00,000)	15,00,000	1,50,000

Journals

Date	Particulars	Dr. (₹)	Cr. (₹)
2015 Jan,0 1	Bank A/c Dr. To Equity Share Application A/c (Application money received on 56,000 shares @ ₹ 50 per share)	28,00,000	 28,00,000
Feb, 01	Equity Share Application A/c Dr. To Equity Share Capital A/c To Securities Premium A/c (Being application money on 10,000 shares transferred to share Capital and Securities Premium vide Board's resolution no........ dated........)	2,50,000	 2,50,000
	Equity Share Application A/c Dr. To Bank A/c (Being excess application money refunded of vide Board's resolution no........ dated........)	16,50,000	 16,50,000
	Equity Share Allotment A/c Dr. To Equity Share Capital A/c (Being allotment money due on 10,000 shares @ ₹ 50 per share vide Board's resolution no........ dated........)	5,00,000	 5,00,000
	Equity Share Application A/c Dr. To Equity Share Allotment A/c (Being excess of Equity share application money adjusted with allotment)	5,00,000	 5,00,000
	Equity Share First & Final Call A/c Dr. To Equity Share Capital A/c (Being first & final call money due on 10,000 shares @ ₹ 25 per share vide Board's resolution no........ dated........)	2,50,000	 2,50,000
Apr,01	Bank A/c Dr. Calls in Arrear A/c Dr. Equity Share Application A/c Dr. To Equity Share First & Final Call A/c (Being amount received and adjusted, except a holder of 100 share who failed to pay the call)	97,500 2,500 1,50,000	 2,50,000
May,05	Equity Share Capital A/c Dr. To Shares Forfeited A/c To Calls in Arrear A/c (Being 100 shares held by Ramesh forfeited for nonpayment of call @ ₹ 25 per share vide Board's resolution no........ dated........	10,000	 7,500 2,500
Jun,10	Bank A/c Dr. To Equity Share Capital A/c To Securities Premium A/c (Being 100 forfeited shares reissued at ₹ 10,500)	10,500	 10,000 500

	Share Forfeited A/c Dr. To Capital Reserve A/c (Being balance of shares forfeited transferred to captial reserve)	7,500	 7,500

10. Himgiri Ltd. had ₹10,00,000 , 8% Debentures of ₹100 each as on 31st March 2013. The Company purchased in the Open Market following Debentures for immediate cancellation:

On 01.07.2013: 1,000 Debentures at ₹97 (cum-interest).
On 29.02.2013: 1,800 Debentures at ₹99 (ex-interest)
Debentures Interest due dates are 30th September and 31st March.

Give Journal Entries in the books of Company for the year ended 31st March, 2014.

Answer:

	Particulars	Dr. (₹)	Cr. (₹)
01.07.2013	Investment in Own 8% Debentures A/c Dr. Interest on Own 8% Debentures A/c Dr. To, Bank A/c (WN) (Being 1,000 Debentures purchased at ₹97 cum interest. Payment = 97,000, Interest from 1st July to 30th Sept = 1,00,000 x 8 % ×⅓ = 2,000, hence, balance = Cost)	95,000 2,000	 97,000
01.07.2013	8% Debentures A/c Dr. To, Investment in Own 8% Debentures A/c To, Profit on cancellation of Own Debentures A/c (Being cancellation of Own Debentures)	1,00,000	 95,000 5,000
30.09.2013	Interest Expense A/c Dr. To, Bank A/c ($9{,}00{,}000 \times 8\% \times \frac{6}{12}$) (Being half yearly Debenture Interest paid on ₹9,00,000 for 6 months)	36,000	 36,000
29.02.2014	Investment in Own Debentures A/c (1,800 × ₹99) Dr. Investment on Own 8% Debentures A/c Dr. To, Bank A/c (Being 1,800 Debentures purchased at ₹99 ex-interest, Interest from 1st Oct to 29th Feb i.e. for 5 months = 1,800 × 100 × 8% ×(5/12) = ₹6,000)	1,78,200 6,000	 1,84,200
29.02.2014	8% Debentures A/c Dr. To, Interest on Own 8% Debentures A/c To, Profit on Cancellation of Own Debentures A/c (Being cancellation of Own Debentures)	1,80,000	 1,78,200 1,800
31.03.2014	Interest Expense A/c Dr. To, Bank A/c (7,20,000 × 8% × ½) (Being Half-yearly Interest paid on Debentures ₹7,20,000 for 6 months)	28,800	 28,800
31.03.2014	Profit & Loss A/c Dr. To, Interest on Own 8% debentures A/c To, Interest Expense A/c (Being Interest Expense transferred to Profit & Loss A/c)	72,800	 8,000 64,800
31.03.2014	Profit on Cancellation of Own debentures A/c Dr. To, Profit & Loss A/c	6,800	 6,800

	(Being Profit on cancellation transferred to Profit & Loss A/c)		

- In the above case the Profit on Cancellation of Owned Debenture is routed through the **"Profit on Cancellation of Owned Debentures A/c" .**

11. Following is the Balance Sheet of Ms Nataraja Ltd as on 31st March

Equity and Liabilities	₹	Assets	₹
80,000,6% Red. Pref. Shares of₹ 10 each ₹ 9	**7,20,000**	**Sundry Assets**	**16,80,000**
40,000 Equity Shares of ₹10 each Fully Paid	**4,00,000**	**Cash**	**5,22,000**
Securities Premium	**1,00,000**		
Profit and Loss Account	**5,00,000**		
General Reserve	**60,000**		
Sundry Creditors	**4,22,000**		
Total	**22,20,00**	**Total**	**22,20,000**

By the terms of their issue, the Preference Shares were redeemable at a Premium of ₹50 per Share on 1st April, and it was decided to arrange for this, as far as possible, out of the Company's resources subject to leaving a credit balance of ₹24,000 in the P&L A/c. It was also decided to raise the balance of funds required by the issue of sufficient number of Equity Shares at a Premium of 10%. Assume that Securities Premium A/c is usable for providing the Premium on redemption of Preference Shares. Show the Journal Entries giving effect to the above transactions and the Balance Sheet thereafter.

Answer:

1. Computation of Minimum Number of Equity Shares to be issued

Particulars		₹
Face Value of Redeemable Preference Shares		8,00,000
Less: General Reserve	60,000	
Profit and Loss Account (5,00,000 - 24,000 to be retained)	4,76,000	(5,36,000)
Face Value of Equity Shares to be issued		**2,64,000**
Number of Equity Shares to be issued (Face Value = ₹10 per Share)		26,400

2. Journal Entries in the books of Nataraja Ltd

	Particulars	Dr. (₹)	**Cr. (₹)**
1.	Redeemable Preference Share Final Call A/c Dr. To 6% Redeemable Preference Share Capital A/c (Being Final Call due on 80,000 Shares at ₹1 each, so that Preference Shares can be made fully paid and eligible for redemption)	80,000	80,000
2.	Bank A/c Dr. To 6% Redeemable Preference Share Final Call A/c (Being Call Money received from all Preference Shareholders)	80,000	80,000
3.	Bank A/c Dr. To Equity Share Application and Allotment A/c (Being amount received on issue of 26,400 Shares x ₹10 + 10% Premium)	2,90,400	2,90,400

4.	Equity Share Application & Allotment A/c Dr. To Equity Share Capital A/c (WN) To Securities Premium A/c (Being 26,400 Equity Shares of ₹10 each issued at a Premium of 10%)	2,90,400	 2,64,000 26,400
5.	6% Redeemable Preference Capital A/c Dr. Premium on Redemption of Preference Shares A/c Dr. To Preference Shareholders A/c (Being amount due to Pref. Shareholders on redemption incl. 5% Premium)	8,00,000 40,000	 8,40,000
6.	Securities Premium A/c Dr. To Premium on Redemption of Preference Shares A/c (Being Premium on PSC Redemption at 5% provided out of Securities Premium A/c)	40,000	 40,000
7.	Preference Shareholders A/c Dr. To Bank A/c (Being payment made to Preference Shareholders)	8,40,000	 8,40,000
8.	Profit & Loss A/c Dr. General Reserve A/c Dr. To Capital Redemption Reserve A/c (Being Revenue Profits transferred to Capital Redemption Reserve)	4,76,000 60,000	 5,36,000

3. Cash Account

Receipts	₹	Payments	₹
To balance b/d	5,22,000	By Preference Shareholders A/c	8,40,000
To 6% Red. Pref. Shares Final Call A/c	80,000	By balance c/d	52,400
To Equity Share Appl. & Allot. A/c (Fresh issue)	2,90,400		
Total	**8,92,400**	**Total**	**8,92,400**

4. Balance Sheet of Nataraja Ltd as at 1st April (After Redemption)

	Particulars	Note	This Year	Prev. Yr
I	**EQUITY AND LIABILITIES:**			
(1)	**Shareholder's Funds:**			
(2)	(a) Share Capital	**1**	6,64,000	
	(b) Reserves and Surplus	**2**	6,46,400	
	Current Liabilities: - Trade Payables (Sundry Creditors)		4,22,000	
	Total		**17,32,400**	
II	**ASSETS**			
(1)	**Non-Current Assets:** - Sundry Assets		16,80,000	
(2)	**Current Assets:** - Cash and Cash Equivalents		52,400	
	Total		**17,32,400**	

Note 1: Share Capital

Particulars	This Year	Prev. Yr
Authorised: ....Equity Shares of...each & .... Preference Shares of each		
Issued, Subscribed & Paid up: 66,400 Equity Shares of ₹ 10 each Fully Paid	6,64,000	
Total	**6,64,000**	

Reconciliation of Number and Amount of Shares (all figures for this year)

Particulars	**Equity Shares of ₹ 10 each**		**Pref .Shares of ₹ 10 each**	
	Number	**Amt₹**	**Number**	**Amt₹**
Opening Balance (assumed) **Add:** Fresh Issue **Less:** Redemption/Buyback	40,000 26,400	4,00, 000 2,64,0	80,000 Final Call 80,000	@ ₹9= 7,20,000 @ ₹1= 80,000 (8,00,000)
Closing Balance	**66,400**	**6,64,000**	-	-

Note 2: Reserves and Surplus (showing Appropriations and Transfers) (all figures for this year)

Particulars	**Opg Bal.**	**Additions**	**Deductions**	**Clg.Bal**
Capital Redemption Reserve		From P&L = 4,76,000 From Gen Res =	—	5,36,000
Securities Premium	1,00,000	Fresh Issue = 26,400	Prem. on PSC Redemp.= 40,000	86,400
Other Reserves (Gen.	60,000	-	Tfr to CRR = 60,000	Nil
Surplus (P&L A/c)	5,00,000	-	Tfr to CRR = 4,76,000	24,000
Total	**6,60,000**	**5,62,400**	**5,76,000**	**6,46,400**

12. A company grants 1,000 Employees Stock Options on 01.04.2011 at ₹40 , when the Market Price is ₹160. The Vesting Period is 2½ years and the Maximum Exercise Period is 1 year. 300 Unvested Options lapse on 31.03.2013. 600 Options are excerxised on 30.06.2014. 100 Vested Options lapse at the end of the Exercise Period. Pass Journal Entries giving suitable narrations.

Answer:

Computation of Expense to be recognised (vesting Period = 2½ years)

Particulars	**₹**
(a) Fair Value of Option per Share = MPS on Grant Date ₹160 Less Exercise Price ₹40	120
(b) No. of Shares vesting under the Scheme	1,000 Shares
(c) Total fair Value of Options (a × b) to be recognised as Expense in 2½ years on Straight –Line Basis	₹1,20,000
(d) Expense to be recognised for Year 1 (2010 – 2012) (Full Year) ₹48,000 for Year 1 (2012 – 2013) (Full Year) ₹48,000 for Year 1 (2013 – 2014) (Half Year) ₹24,000	
(e) Value of Active Options (after lapse of 300 Options) as on 31.3.2011 = 700 × ₹120	₹84,000
(f) Cumulative Balance in Employee Stock Option O/s A/c at the end of Yr 2 = ₹48,000 +₹48,000	₹96,000
(g) Hence, Excess Expenses to be reversed by transfer to General Reserve at the end of year 2 (f – e)	₹12,000

Value of Option: Intrinsic Value = MPS on Grant Date Less Exercise Price = ₹160 -₹40 =₹120.

Options will vest finally on 30.09.2013 at the end of 2½ years. This can be exercised within one year from that date, i.e. before 30.09.2014. The Employee has exercised their vested Options on 30.06.2014, and the balance will lapse on 30.092014.

Answer:

	Particulars	Dr. (₹)	Cr. (₹)
Year 1			
31.03.2012 Yr end.	Employee Compensation Expense A/c Dr. To, Employee Stock Option Outstanding A/c (Being Compensation Expense recognised in respect of the Employee Stock Option Plan, i.e. 1,000 Option granted to Employees at a discount of ₹ 120 each, amortised on Straight Line Basis over 2½ Years = 1,000 × ₹48 [120 ÷ 2.5= ₹48])	48,000	 48,000
31.03.2012 Yr end.	Profit and Loss A/c Dr. To, Employee Compensation Expense A/c (Being transfer of Employee Compensation Expense to P& L A/c at year – end)	48,000	 48,000
Year 2			
31.03.2013 Yr end.	Employee Compensation Expense A/c Dr. To, Employee Stock Option Outstanding A/c (Being Compensation Expense recognised in respect of the Employee Stock Option Plan, i.e. 1,000 Option granted to Employees at a discount of ₹ 120 each, amortised on Straight Line Basis over 2½ Years = 1,000 × ₹48)	48,000	 48,000
31.03.2013 Yr end.	Profit and Loss A/c Dr. To, Employee Compensation Expense A/c (Being transfer of Employee Compensation Expense to P& L A/c at year – end)	48,000	 48,000
31.03.2013	Employee Stock Option Outstanding A/v (WN) Dr. To, General Reserve A/c (Being excess of Employee Compensation Expenses transferred to General Reserve A/c)	12,000	 12,000
Year 3 31.03.2014	No Expense Entry is required, since the Value of 700 Option Outstanding is already accumulated in the ESOP A/c (Cr.), over the first two years itself.		
Year 4			
30.06.2014 (date of exercise of Option)	Bank A/c (600 Option × ₹40) Dr. Employee Stock Option Outstanding A/c (600 Option × ₹120) Dr. To, Equity Share Capital A/c (600 Options × ₹10) To, Securities Premium A/c (600 Options × ₹150) (Being 600 Employee Stock Option exercised at an Exercise Price of ₹40 each)	24,000 72,000	 6,000 90,000
30.09.2014 9End of Exercise Period)	Employee Stock Option Outstanding A/v (100 Options × ₹120) Dr. To, General Reserve A/c (Being ESOS Outstanding A/c on the lapse of 100 Options at the end of exercise of Option period, transferred to General Reserve A/c)	12,000	 12,000

13. (a) From the following particulars, calculate Commission to the managing Director: Profit as per Profit and Loss A/c is ₹1,45,08,000, after deducting the depreciation of ₹1,24,24,000, Salary and remuneration to the managing director of ₹72,000 and director fees of ₹4,000. The depreciation as per U/S 198 of the Companies Act, 2013 is of ₹1,04,24,000.

Answer:

Computation of Commission to the Managing Director

Particulars	₹ 000's	₹ 000's
Profit as per Profit and Loss A/c		14,508
Add: Depreciation charged in the Profit and Loss A/c	12,424	
Salary and remuneration to the managing director	72	
Director fees	4	12,500
		27,008
Less: Depreciation u/s 198 of the Companies Act		(10,424)
Profit u/s 198 for the purpose of Managerial Remuneration		16,584
Maximum remuneration (5%)		829
Less: Salaries and remuneration paid (director's fees is excluded here)		(72)
Maximum commission payable to Managing Director		757
Commission to be provided for at 1% of Net Profits (1% of ₹16,584)		166

(b) The following is the Profit and Loss Account of the Lakhpati Paper Ltd. for the year ending 31st March:

Particulars	₹	Particulars	₹
To, Admn, Selling & Finance Expenses	**5,75,400**	**By, Balance b/d**	**4,53,000**
To, National Defence Fund	**29,000**	**By, Balance from Trading Account**	**38,60,800**
To, Directors Fees	**55,000**	**By, Interest on Investment**	**10,000**
To, Interest on Debentures	**20,750**	**By, Transfer Fee**	**1,050**
To, Managing Director's Remuneration	**3,80,000**	**By, Profit on Sale of Plant Amount realized 40,000**	
To, Depreciation of Fixed Assets	**4,64,700**	**Less: Book Value (31,000)**	**9,000**
To, Provision for Taxation	**11,45,000**		
To, General Reserve	**5,49,000**		
To, Debenture Sinking Fund	**14,000**		
To, Investment Revaluation Reserve	**9,000**		
To, Net Profit	**10,92,000**		
	43,33,850		**43,33,850**

As an Auditor you are required to compute the Profit as per Section 198.

Answer:

Statement showing computation of Profit as per Section 198

Particulars	Amount (₹)	Amount (₹)
Balance from Trading Account		38,60,800
Add: Interest on Investment		10,000
Transfer Fee received		1,050
Profit on Sale of Plant		9,000
Total		38,80,850
Less: Admn, Selling & Finance Expenses	5,75,400	
Contribution to National Defence Fund	29,000	
Directors Fees	55,000	
Interest on Debentures	20,750	

Depreciation of Fixed Assets	4,64,700	11,44,850
		27,36,000

14. Prepare Cash Flow Statement for the year ended 31st March 20X2 by using Indirect Method as per AS-3.
Additional Information:

(i) Net Profit for the year ended 31st March 20X2, after charging Depreciation ₹1,80,000 is ₹22,40,000.

(ii) Debtors of ₹2,30,000 were determined to be worthless and were written off against the Provision for Doubtful Debts Account the year.

(iii) The Company declared dividend of ₹12,00,000 for the year 20X1-20X2.

Balance Sheets **(information in ₹000)**

Equity and Liabilities	31.03.20X1	31.03.20X2	Assets	31.03.20X1	31.03.20X2
(1) Shareholders' Funds:			(1) Non-Current Assets:		
(a) Share Capital			(a) Fixed Assets – (i) Tangible		
(i) Equity Shares of	5,000	5,000	Plant and Machinery	2,730	4,070
			Less : Depreciation	610	790
(b) Reserves & Surplus			Net Block	2,120	3,280
Retained Earning	2,650	3,690	(b) Non-Current Invt -		
(2) Non- Current Liabilities			Marketable Security	1,180	1,500
- Debentures		900	(2) Current Assets:		
(3) Current Liabilities:			(a) Inventories	2,010	1,920
(a) Short Term Borrowings			(b) Trade Receivables		
Bank Loan	150	300	Debtors	2,480	2,950
(b) Trade Payables (i) Sundry Crs	880	820	Less: Provision	150	190
			Net Debtors	2,330	2,760
(c) Other Current Liabilities – liability for Expenses	330	270	(c) Cash & Cash Equivalents	1,520	1,820
- Dividend Payable	150	300			
Total	9,160	11,280	Total	9,160	11,280

Answer:

Particulars	₹	₹
A. CASH FLOW FROM OPERATING ACTIVITIES	22,40,000	
Profit before Taxation (given) **Add**	1,80,000	

Operating Profit before Working Capital changes	24,20,000	
Adjustment for Working Capital Changes:		
Increase in Debtors [₹ 23,30,000 - ₹ 27,60,000	(4,30,000)	
] Increase in Marketable Securities [₹ 11,80,000 - ₹ 15,00,000	(3,20,000)	
] Decrease in Stock [₹ 20,10,000 - ₹ 19,20,000	90,000	
] Decrease in Creditors [₹ 8,80,000 - ₹ 8,20,000]	(60,000)	
Increase in Bank Loan [₹ 1,50,000 - ₹ 3,00,000]	1,50,000	
Decrease in Liability for Expenses [₹3,30,000 - ₹ 2,70,000]	(60,000)	
Cash Generated from Operations	17,90,000	
Less: Income Taxes Paid	Nil	
Net Cash Flow from / (used in) Operating Activities [A]		**17,90,000**
B. CASH FLOW FROM INVESTING ACTIVITIES		
Purchase of Plant and Machinery [₹ 40,70,000 - ₹ 27,30,000]	(13,40,000)	
Net Cash Flow from / (used in) Investing Activities [B]		**(13,40,000)**
C. CASH FLOW FROM FINANCING ACTIVITIES		
D. Proceeds from issuance of Debentures (assumed issued on last date of fin.year)	9,00,000	
Dividends paid	(10,50,000)	
Net Cash Flow from / (used in) Financing Activities [C]		**(1,50,000)**
E. Net Increase / (Decrease) in Cash and Cash Equivalents (A + B + C)		3,00,000
		15,20,000
F. Cash and Cash Equivalents at the end of the year (given)		**18,20,000**

Note:

A. Dividend Paid during the year = Opening Balance + Dividend declared during the year - Closing Balance = 1,50,000 + 12,00,000 - 3,00,000 = **10,50,000.**

B. Alternative treatments are available in respect of Marketable Securities and Bank Loan, i.e. as Cash & Cash Equivalents.

15. Mayukh Ltd gives you the following information for the year ended 31st March 20X2:

Particulars	Amount (₹)
Sales for the year ₹48,00,000 (The Company sold goods for Cash only)	**48,00,000**
Cost of Goods Sold	**75% of Sales**
Closing Inventory was higher than Opening Inventory by	**50,000**
Trade Creditors on 31.03.20X2 exceed the outstanding on 31.03.20X1 by	**1,00,000**
Tax paid during the year	**1,50,000**
Amounts paid to Trade Creditors during the year	**35,50,000**
Administrative and Selling Expenses Paid	**3,50,000**
Cost of new Machinery acquired in December 20X1	**6,00,000**
Dividend paid during the year	**1,20,000**
Cash in hand and at Bank on 31.03.20X2	**80,000**

Cash in hand and at Bank on 01.04.20X1	**50,000**

Prepare Cash Flow Statement for the year ended 31.03.20X2.

Answer:

Cash Flow Statement for the year ended 31st March 20X2 (Direct Method)

Particulars	Amount (₹)	Amount (₹)
A. CASH FLOW FROM OPERATING ACTIVITIES		
Cash received from Sale of Goods	48,00,000	
Less: Cash Payment to Suppliers	(35,50,000)	
Selling & Administrative Expenses	(3,50,000)	
Cash Generated from Operations before Taxes and Extraordinary items	**9,00,000**	
Less: Taxes paid	(1,50,000)	
Net Cash Flow from / (used in) Operating Activities [A]		**7,50,000**
B. CASH FLOW FROM INVESTING ACTIVITIES - Fixed Asset Purchased **[B]**		**(6,00,000)**
C. CASH FLOW FROM FINANCING ACTIVITIES = Payment of Dividend **[C]**		**(1,20,000)**
D. Net Increase / (Decrease) in Cash and Cash Equivalents [A + B + C]		**30,000**
E. Opening Balance of Cash and Cash Equivalents		**50,000**
F. Closing Balance of Cash and Cash Equivalents		**80,000**

16. (a) Discuss — (a) Business Segment, (b) Geographical Segment, and (c) Reportable Segment.

Answer:

Point	Business Segment	Geographical Segment
Meaning	A Business Segment is a distinguishable component of an Enterprise • that is engaged in providing an individual product or service or a group of related products or services, and • that is subject to risks & returns that are different from those of other Business Segments.	A Geographical Segment is a distinguishable component of an enterprise – i. that is engaged in providing products or services within a particular economic environment, and ii. that is subject to risks and returns that are different from those of components operating in other economic environments.

Factors	Factors that determine whether products or services are related, include – • nature of products or services, • nature of production processes, • type / class of customers for products or services, • methods used to distribute products or provide services, e.g. Sole Selling Agency, Direct Marketing, etc. and • if applicable, nature of the regulatory environment, e.g. Banking, Insurance, or Public Utilities.	Factors considered to identify Geographical Segments include – • similarity of economic and political conditions, • relationships between operations in different geographical areas, • proximity of operations, • special risks associated with operations in a particular are • exchange control regulations, and • the underlying currency risks.
Exclusion	• A single Business Segment does not include products and services with significantly differing risks and returns. • The products and services included in a single Business Segment should be similar with respect to a majority of the factors.	A single Geographical Segment does not include operations in economic environments with signifies differing risks and returns. A Geographical Segment may be a single country group of two or more countries, or a region with country.

A **Reportable Segment** is a business segment or a geographical segment, identified on the basis of the above definitions for which disclosure of segment information is required.

(b) Discuss - (i) Segment Result, (ii) Segment Revenue, and (iii) Segment Expense.

Answer:

Segment Result = Segment Revenue Less Segment Expense.

Item	Segment Revenue	Segment Expense
Included Items	**Segment Revenue =1 + 2 + 3, where** – 1. Portion of Enterprise Revenue **directly attributable** to a segment, and 2. Relevant portion of Enterprise Revenue, that can be **allocated** on a reasonable basis to a segment, and 3. Revenue from **transactions with other segments** of the enterprise.	**Segment Expense = 1 + 2 + 3, where** – 1. Expense resulting from operating activities **directly attributable** to the segment, and 2. Relevant portion of Enterprise Expense that can be **allocated** on a reasonable basis to the segment, and 3. Expense relating to **transactions with other segments** of the Enterprise.
Excluded Items	1. Extraordinary Items as per AS -5, 2. Interest or Dividend Income, including Interest earned on Advances or Loans	1. Extraordinary Items as per AS -5, 2. Interest Expense, including Interest Incurred on Advances or Loans from other segments, Losses on Sale of

	to other segments, & 3. Gains on Sale of Investments or on extinguishment of debt. **Note:** Items in 2 and 3 above become includible in Segment Revenue, when the operations of the Segment are primarily of a **financial nature.**	Investments or losses on extinguishment of debt, 3. Income Tax Expense, and 4. General Admin. Exp., Head-Office Exp., & other expenses that arise and relate to the Enterprise as a whole. **Note:** Items in 2 and 3 above become includible when the segment's operations are primarily of a **financial nature.**
Note: • When Segment Assets contains Goodwill, Segment Expense includes related amortisation. • Costs incurred at Enterprise level on behalf of a segment are part of Segment Expense, if they relate to Operating Activities of the Segment, and can be **directly attributed or allocated** to the Segment on a reasonable basis.		

17. The financial position of two Companies A Ltd and B Ltd as on 31st March was as under: (₹)

Liabilities	A	B	Assets	A	B
Share Capital:			**Goodwill**	**50,000**	**25,000**
Equity Shares of ₹ 10 each	**10,00,000**	**3,00,000**	**Building**	**3,00,000**	**1,00,000**
9% Pref. Shares of ₹100 each	**1,00,000**	**-**	**Machinery**	**5,00,000**	**1,50,000**
10% Pref. Shares of ₹100 each	**-**	**1,00,000**	**Stock**	**2,50,000**	**1,75,000**
General Reserve	**1,00,000**	**80,000**	**Debtors**	**2,00,000**	**1,00,000**
Retirement Gratuity Fund	**50,000**	**20,000**	**Cash at Bank**	**50,000**	**20,000**
Sundry Creditors	**1,30,000**	**80,000**	**Preliminary Expenses**	**30,000**	**10,000**
Total	**13,80,000**	**5,80,000**	**Total**	**13,80,000**	**5,80,000**

A absorbs B on the following terms:

(i) 10% Preference Shareholders are to be paid at 10% Premium by issue of 9% Preference Shares of A Ltd.

(ii) Goodwill of B is valued at ₹50,000, Buildings are valued at ₹1,50,000 and Machinery at ₹1,60,000.

(iii) Stock to be taken over at 10% less Book Value and Reserve for Bad and Doubtful Debts to be created at 7.5%

(iv) Equity Shareholders of B Ltd will be issued Equity Shares of A Ltd at 5% Premium.

Prepare necessary Ledger Accounts to close the books of B Ltd, and show the acquisition entries in the books of A Ltd.

Answer:

Purchase Consideration

Particulars	₹	₹
Total Assets taken over		
Goodwill (agreed Value)	50,000	
Building (agreed Value)	1,50,000	
Machinery (agreed value)	1,60,000	
Stock (1,75,000 – 10% Reduction)	1,57,000	
Debtors	1,00,000	
Cash at Bank	20,000	6,37,500
Less: Liabilities taken over		
Gratuity Fund	20,000	
Sundry Creditors	80,000	
Reserve for Bad and Doubtful Debts at 7.5% of Debtors	7,500	(1,07,500)
Net Assets = Purchase Consideration		5,30,000
(a) To Pref. Shareholders of B Ltd. Settlement at 10% premium , by issue of 9% Pref. Shares of A Ltd. i.e. 1,100 9% Pref. Shares of ₹100		1,10,000
(b) Balance to be issued as Equity Shares at 5% Premium (no. of Shares = 4,20,000/10.50=40,000 Shares)		4,20,000

Ledger Accounts in the books of B Ltd

(a) Realisation Account

Dr. Cr

Particulars	₹	Particulars	₹
To Goodwill (Transfer)	25,000	By Gratuity Fund (Transfer)	20,000
To Building (Transfer)	1,00,000	By Sundry Creditors (Transfer)	80,000
To Machinery (Transfer)	1,50,000	By A Ltd (Purchase Consideration	5,30,000
To Stock (Transfer)	1,75,000		
To Debtors (Transfer)	1,00,000		
To Cash at Bank (Transfer)	20,000		
To Preference Shareholders A/c (Premium)	10,000		
To Equity Shareholders A/c (Profit on **(balancing figure)**	**50,000**		
Total	**6,30,000**	**Total**	**6,30,000**

(c) Equity Shareholders Account

Dr. Cr.

Particulars	₹	Particulars	₹
To Preliminary Expenses (Transfer)	10,000	By Equity Share Capital (Transfer)	3,00,000
To Equity Shares of A Ltd (Settlement)	4,20,000	By General Reserve (Transfer)	80,000
		By Realisation A/c (Profit on Realisation)	50,000

Total	**4,30,000**	**Total**	**4,30,000**

(d) Preference Shareholders Account

Dr. Cr.

Particulars	₹	Particulars	₹
To 9% Preference Shares of A Ltd (Settlement)	1,10,000	By Preference Share Capital (Transfer) By Realisation A/c (Premium on Redemption of Pref. Shares)	1,00,000 10,000
Total	**1,10,000**	**Total**	**1,10,000**

A Ltd Account

Particulars	₹	Particulars	₹
To Realisation A/c (Purchase Consideration Due)	5,30,000	By 9% Pref. Shares of A Ltd (recd) By Equity Shares of A Ltd	1,10,000 4,20,000
Total	**5,30,000**	**Total**	**5,30,000**

Journal Entries in the books of A Ltd

S.No.	Particulars		Dr. (₹)	Cr. (₹)
1.	Business Purchase A/c	Dr.	5,30,000	
	To Liquidator of B Ltd A/c			5,30,000
	(Being Purchase Consideration payable under the scheme of absorption)			
2.	Goodwill A/c	Dr.	50,000	
	Building A/c	Dr.	1,50,000	
	Machinery A/c	Dr.	1,60,000	
	Stock A/c	Dr.	1,57,500	
	Debtors A/c	Dr.	1,00,000	
	Bank A/c	Dr.	20,000	
	To Gratuity Fund A/c			20,000
	To Sundry Creditors A/c			80,000
	To Provision for Doubtful Debts A/c			7,500
	To Business Purchase A/c			5,30,000
	(Being Assets and Liabilities taken over as per agreed valuation)			
3.	Liquidator of B Ltd A/c	Dr.	5,30,000	
	To 9% Preference Share Capital A/c			1,10,000
	To Equity Share Capital A/c			4,00,000
	To Securities Premium A/c			20,000
	(Being Purchase Consideration discharged as above).			

18. The position of a Company on its Liquidation is as under:

(i) Issued and Paid Up Capital:
2,000 11% Preference Shares of ₹100 each fully paid.
2,000 Equity Shares of ₹100 each fully paid.
1,500 Equity Shares of ₹50 each, ₹30 per Share paid.
(ii) Calls in Arrears are ₹5,000 whereas Calls received in advance is ₹4,000.
(iii) Preference Dividends are in arrears for one year.
(iv) Amount left with the liquidator after discharging all liabilities is ₹3,01,000.
(v) The Company's Articles provide for payment of arrear Preference Dividends in priority to return of Equity Capital.

You are required to prepare the Liquidator's Final Statement of Accounts, with the above information.

Answer:

Liquidator's final Statement of Account

Receipt	₹	Payments	₹
Cash in Hand (given)	3,01,000	Calls in Advance Refund (given)	4,000
Calls in Arrears (given)	5,000	Arrears of Preference Dividend at 11% on 2,00,000	22,000
		Preference Share Capital	2,00,000
		Equity Share Capital – on 2,000 Fully Paid up Shares at ₹40 (WN) (Balancing figure)	80,000
	3,06,000		**3,06,000**

Computation of Deficiency Percentage for final payment purposes

Particulars	₹
(a) Total of Receipt before considering Call Money (3,01,000 + 5,000)	3,06,000
(b) Total Payments before final payment to Equity Shares (4,000 + 22,000 +2,00,000)	2,26,000
(c) Surplus/ (Deficit) from above before Calls made on Equity Shares (a – b)	80,000
(d) Notional Call on 1,500 Partly Paid Shares at ₹20 each (₹50 face Value - ₹30 paid up)	30,000
(e) Surplus Cash Balance after Notional Call (c + d)	1,10,000
(f) Total Amount of Equity Share Capital, after Notional Call [(2,000 × 100) + (1,500 × 50)]	2,75,000
(g) Percentage of Payment possible to Equity Shareholders (e ÷ f)	40%
(h) Hence, Deficiency Percentage (100% - 40%)	60%
(i) Deficiency per ₹100 Paid Up Share = ₹60, deficiency per ₹50 Paid Up Share = ₹30	₹60 & ₹30
(j) Amount refundable for ₹100 paid up share = Paid up value - ₹Deficiency ₹60	₹40

Call Adjustments:

- Calls in Advance is to be refunded since the loss on Partly Paid Up Share is just ₹30, the amount paid up.
- Calls in Arrears ₹5,000 is to be collected.
- Notional Call is applied only on partly paid Shares and not on already fully paid up shares of different Nominal Value.

SECTION – C AUDITING

19. (a) List the essential features of Auditing.

Answer:

The Essential Features of Auditing can be listed as —

(i) It involves evaluation of the relevance, reliability and adequacy of evidence in support of verifiable information.
(ii) It is analytical, critical and investigative.
(iii) The information audited may be financial or non-financial.
(iv) There should be standards or criteria for evaluation of the information.
(v) The auditor should be competent and independent.
(vi) It ensures reliability of information and authenticity of assertions made in the financial statements relating to enterprises, whether profit-oriented or not and whether it is required by law or not, to enable the auditor to form his opinion on these statements with regard to true and fair view disclosed there in.

(b) Distinguish between auditing and investigation.

Answer:

It is to be noted that both auditing and investigation have a fact finding character. Both involve a systematic and critical examination of the available evidence, yet these are quiet distinct from each other as follows:

- Meaning - Auditing is an independent and systematic examination of the evidence underlying the accounting or other data in accordance with the generally accepted auditing practices to ascertain the true and fair view of the financial statements of an enterprise. An investigation may be defined as an examination of accounts and records with a view to ascertain any fact for some special purpose which varies from assignment to assignment.
- Scope - The audit has a wide scope. In statutory audit, the scope is determined by the relevant law and in case of a private audit (e.g. management audit) by a client. The scope of investigations, on the other hand, is limited as regards the period or areas to be covered.
- Objective - In audit, the accounts and records are verified as to their truth and fairness, whereas, investigation is for special purpose (e.g. investigation on the behalf of incoming partner

- Audit Procedure - The audit is conducted in accordance with the generally accepted auditing procedure but investigations involve an extended auditing procedure.
- Evidence - An investigator can draw his conclusions only on the basis of substantial or sometimes conclusive evidence while an auditor will evaluate the accounting records predominantly based on persuasive evidence.
- Approach - Auditor is skeptical and not suspicious whereas an investigator starts with suspicion and collects evidence to either confirm or dispel that suspicion.
- Periodicity - Auditing is a routine exercise (normally conducted annually) but the investigations may spread over a period longer than one year.

(c) "Functionally, an audit can be classified into external audit and internal audit." — Discuss.

Answer:

The major points of distinction between the two are as follows:

(i) The external auditors are appointed by the owners of the organisation, e.g., shareholders in case of a company. When external auditors are appointed under a particular statue, they are called as statutory auditors. But internal auditors are appointed by the management of the organisation. The internal auditors may be appointed on contractual basis or they may be appointed as employees of the organisation.

(ii) The scope of work of an external auditor is determined by the particular statue under which they are appointed but the internal auditors have to work within the scope defined the management which generally includes review and appraisal of accounting, financial and administrative controls.

(iii) The main concern for an external auditor is to collect the adequate and reliable evidence to support his opinion as to the truth and fairness of the representations made in the financial statements. The internal auditors, on the other hand, are concerned with the compliance of various policies, rules and procedures of the enterprise, compliance with applicable laws and generally accepted accounting principles.

(iv) The external auditors are directly responsible to the owners and in some cases to the third parties but the internal auditors do not have any freedom to report to the outsiders. It may be noted that unlike external auditors, internal auditors are generally not considered as independent of the management. But one of the basic philosophies of audit is that the auditor must be independent. Thus, in order to derive benefit from audit in its right earnest even internal auditor must be independent to the extent practicable.

20. (a) State what is independent financial audit.

Answer:

An independent financial audit may be conducted by a qualified auditor at the request of a client, which may be a sole-proprietorship, partnership, non-profit organization or any other entity. Its objective is to comment on the truthfulness and fairness of the Financial Statements, and it may be compulsory under some Acts which govern the entity.

(b)(i) State what interim audit is?

Answer:

Interim audit is an audit conducted between two annual audits. It may be conducted for a specific period, such as a quarter or half year, with an objective of declaration of interim dividend or valuation of shares on a certain date, in case of mergers. It is carried out by professionals, but has no legal status as the figures may be altered subsequently.

(ii) Discuss the steps of Environment Audit.

Answer:

Following are the steps of an Environment Audit —

The International Chamber of Commerce presents the different steps of an environmental audit as follows:

A. Pre-audit activities:
   i. Selection and scheduling of facility to audit.
   ii. Selection of audit team.
   iii. Contact with facility.
   iv. Planning of the audit.

B. Site activities:
   i. Understanding of internal controls.
   ii. Assessment of internal controls.
   iii. Gathering of audit evidence.
   iv. Evaluation of audit findings.
   v. Report of findings to facility.

C. Post audit activities:
   i. Production of a draft report.
   ii. Production of a final report.
   iii. Preparation and implementation of an action plan.
   iv. Monitoring of action plan.

(c) List the objectives and advantages 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.

Advantages of Social Audit

(i) Encourages community participation among different business entities.
(ii) Ensures continuous efforts towards environmental protection and use of environment friendly production processes.
(iii) Builds customer satisfaction and trust through ethical business practices.
(iv) Promotes collective decision making and sharing responsibilities.
(v) Develops human resources by working towards improvement of workers' and the underprivileged persons' working/ living conditions.

21. (a) "The auditor must take some precautions before he applies test checking for auditing." — Discuss.

Answer:

The auditor must take the following precautions before he applies test checking for auditing:

i) The auditor must review the system of internal controls existing in the enterprise. Test checking should be avoided in case the internal control system is weak or ineffective.
ii) The sample selected for test checking should be representative in character and the transactions should be of homogeneous nature.
iii) The number of transactions to be selected for test checking should be predetermined depending upon the extent to which the reliance can be placed on the results of test checking.
iv) The auditor should identify those areas where test checking is not suitable, for example, opening and closing entries, bank reconciliation statement, non-recurring items, transactions of a seasonal industry, other areas where the compliance with the applicable law is required such as managerial remuneration under Companies Act, etc.
v) No element of bias should be present in selecting a sample.
vi) The system of test checking should be reviewed from time to time so that necessary improvements, if any, can be made.

(b) Discuss the methods of determining the size of a sample.

Answer:

There are two main methods for determining the size of sample viz. Judgmental Sampling and Statistical Sampling.

Judgmental Sampling - In this method, the sample size is determined on the basis of the personal experience and the knowledge of the auditor. It is one of the simple methods of sampling. It may be noted that this method, though simple in its applicability, is neither scientific nor objective. The risk of personal bias in selection of sample is always present. Thus, an element of subjectivity does prevail in this method.

Statistical Sampling - This method is more scientific in its approach than the method of judgmental sampling. It involves application of mathematical techniques like theory of probability, use of random number tables etc. But it may also be noted that the auditor need not require having an in depth understanding of the statistical techniques because published statistical tables are available which indicate the sample size based on predetermined criteria.

(c) "Audit risk" is the risk that the auditor gives an inappropriate audit opinion when the financial statements are materially misstated. — Discuss.

Answer:

In very broad terms, audit risk is the risk of a material misstatement of a financial statement item that is or should be included in the audited financial statements of an entity. In theory, audit risk ranges anywhere from zero, where there is complete certainty of no material misstatement, to one, where there is complete certainty of a material misstatement. In practice, however, audit risk is always greater than zero. There is always some risk of material misstatement as it is not possible, (except for the audit of the simplest of financial statements), due to the limitations inherent in both accounting and auditing, to be absolutely certain that a material misstatement will not exist.

i. "Audit risk" is the risk that the auditor gives an inappropriate audit opinion when the financial statements are materially misstated. Such misstatements can result from either fraud or error. SA 400 on "Risk Assessments and Internal Controls" identifies the following three components of audit risk:
ii. ii. Inherent risk. – it is the susceptibility of a account balance or class of transaction to misstatements that could be material, either individually or when taken together with misstatements in other balance or classes, assuming that there were no internal controls.
iii. iii. Control risk.-it is the risk that misstatement, that could occur in an account balance or class of transactions and that could be material, either individually or when taken together with misstatements in other balances or classes, will not be prevented/detected/corrected on timely basis by the accounting and internal control systems.

Detection risk.-it is the risk that an auditor's substantive procedures (the procedures designed to obtain evidence as to the completeness, accuracy and validity of the data produced by the accounting system) will not detect a misstatement that exists in account balance or class of transactions that could be material, either individually or when taken together with misstatements in other balances or classes

22. (a) Discuss the types of Internal Control Systems .

Answer:

The type of internal control system to be employed in an organization depends upon the requirements and nature of the business.

Generally, there are two types of Internal Control in an Organisation — preventive and detective controls.

Both types of controls are essential to an effective internal control system.

From a quality standpoint, preventive controls are essential because they are proactive and emphasize quality. However, detective controls play a critical role by providing evidence that the preventive controls are functioning as intended.

(i) Preventive Controls are designed to discourage errors or irregularities from occurring. They are proactive controls that help to ensure departmental objectives are being met.

Examples of preventive controls are:

• Segregation of Duties:

Duties are segregated among different people to reduce the risk of error or inappropriate action. Normally, responsibilities for authorizing transactions (approval), recording transactions (accounting) and handling the related asset (custody) are divided.

• Approvals, Authorizations, and Verifications:

Management authorizes employees to perform certain activities and to execute certain transactions within limited parameters. In addition, management specifies those activities or transactions that need supervisory approval before they are performed or executed by employees. A supervisor's approval (manual or electronic) implies that he or she has verified and validated that the activity or transaction conforms to established policies and procedures.

(ii) Detective Controls are designed to find errors or irregularities after they have occurred.

Examples of detective controls are:

• Reviews of Performance: Management compares information about current performance to budgets, forecasts, prior periods, or other benchmarks to measure the extent to which goals and objectives are being achieved and to identify unexpected results or unusual conditions that require follow-up.

• Reconciliations: An employee relates different sets of data to one another, identifies and investigates differences, and takes corrective action, when necessary.

(iii) Corrective Controls target at the correction of errors and irregularities as soon as they are detected.

(b) List the limitations of Internal Control System.

Answer:

Limitations of Internal Control are

i. Organizational Structure: Deficiencies in organizational structure make internal control ineffective.

ii. Size of the Organization: Small organizations have very low levels of internal control, which are almost negligible due to more interference by owners and management.
iii. Unusual Transactions: The internal control procedures normally fail to keep a check on unusual transactions.
iv. Costly: The implementation of internal control procedures and processes involves incurring costs in terms of time, effort and resources.
v. Abuse of Power: Members at the top-level management may override/interfere with control.
vi. Collusion of two or more People: It may lead to internal controls being over- ridden.
vii. Obsolescence: Control system may become redundant with passage of time if not updated with change in the size and nature of business.
viii. Potential for human error.
ix. Frequent follow-up measures: Follow-up procedures need to be frequent to ensure its effectiveness, which is extremely time-consuming.

23. (a) State the differences between Check List and Internal Control Questionnaire.

Answer:

Basis	Check List	Internal Control Questionnaire
Point of Time	It is issued at the commencement of audit and reported back after completion of audit.	It can be issued at any point of time and reported back immediately.
Issued To	It is issued to the audit staff to be followed by them during audit and reported back at completion.	It is issued to various people at different levels in the organization.
Contents	It contains instructions to be followed by audit assistants.	It contains questions to be answered by the employees of the organization.
Objective	It works as a guideline for audit staff so that no area remains unchecked.	This is used to collect the information to know about the internal control system and evaluate the weaknesses therein.

(b) List the functions of Internal Audit.

Answer:

The internal auditor, depending on the size and structure of the enterprise and as per the requirements of its management, performs the following functions:

i. Reviews the accounting systems and internal controls prevailing in the organization.
ii. Examination of management information system reports on financial and operational performance of the organization, to check the efficiency and effectiveness of the operations and the management policies laid down for the purpose.
iii. Collection of third party evidences and physical verification of stocks and other assets at the year end.
iv. Collection of evidence and estimation of contingent liabilities.

(c) Discuss the criteria for placing reliance on the work of Internal Auditor.

Answer:

Following are the criteria for placing reliance on the work of Internal Auditor:

Independence

- Who is responsible for reporting and to whom?
- Is there interference by other managers in the internal audit department?
- What is the position of an internal auditor in the organization?

Skill and Competence

- What are the qualifications and experience of the internal auditor?
- Is a trained team from the staff conducting the internal audit?
- Is the internal audit staff updated with changes in law?

Audit Planning

- What is the composition of qualified and unqualified staff in the internal audit team?
- How long has the experience of the internal audit staff been in the same organization?
- How is the internal audit staff trained?
- Use of Documentation
- Is the internal control system evaluated by the use of questionnaires, flow charts and checklists?
- Are such questionnaires and checklists considered?

Audit Procedure

- Is there an internal audit manual in existence?
- Is the internal audit work done as per an audit programme and whether the audit programme is frequently amended?
- Is there a consultation with the statutory auditor regarding the audit programme?
- Is there a system of rotating the functions among internal audit staff?
- Is there a system of maintaining working papers by internal audit staff?
- Is the work of internal auditor subjected to supervision by managers?

Audit Scope & purview

- Does the internal auditor cover only financial areas or also operational areas?
- Does the defined scope of internal audit cover investigations, statutory compliance and year end stock taking procedures?

Audit Report

- To whom is the internal audit report submitted?
- Does it contain recommendations in addition to observations?

- Is there a follow up of earlier recommendations?
- What is the management's attitude towards internal audit recommendations?
- What is the periodicity of audit report?

24. (a) List the importance of verification.

Answer:

Verification is very important function from view point of both, the auditor and the client as it gives clear idea as to true and fair view of balance sheet.

The importance of verification may be described as under –

(i) True and fair view of Balance Sheet – verification of assets and liabilities enables the auditor to comment on true and fair state of affairs of the business.
(ii) Valuation – verification enables the auditor to determine whether the assets or liabilities are overstated or under stated.
(iii) Omissions – verification facilitates the act of confirming the omission of any asset or liability in the balance sheet.

(b) List the areas to be considered while conducting audit of Live Stock.

Answer:

Following are the areas to be considered while conducting of Live Stock:

i. See the live Stock Register and note down carefully the particulars like breed, year of purchases, purchase price, depreciation etc., for various categories of animals.
ii. See that some identification number is given to identify the animals.
iii. Examine the basic of valuation of animals. In case the animals are purchased at the age of maturity the cost will include Purchase Price plus freight. If the animal is reared from its conception and then brought to Maturity the cost includes cost of calving, cost of fodder etc., consumed till maturity and the suitable share of overheads.
iv. See that the cost up to the maturity stage of animal has been written off once the earning capacity of the animals starts declining over the remaining life.
v. Ensure that disposal value at the end of the life of the assets has been adjusted properly.

(c) List the areas to be considered at the time of conducting of a trade mark and copy right.

Answer:

Following are the areas to be considered at the time of conducting audit of a Trade Mark and Copy Right —

Trademark

i. See that the trade Marks are registered in the name of the auditee.

ii. See whether it is shown distinctively in the Balance Sheet.
iii. Check the Assignment Deed to ascertain the Terms and Conditions of the acquisition of Trade Marks to see whether the terms are followed properly.
iv. Obtain a schedule of Trade Marks if those are in large numbers.
v. See that the renewal fee is regularly paid.
vi. Verify the valuation of Trade Marks to see whether it is properly done or not.

Copy Rights

i. Verify copyrights with agreements.
ii. See whether revaluation of copyrights is made properly and profit or loss is properly accounted.
iii. Obtain the certificate of approved valuer to that effect.
iv. See that the balance exhibited on balance sheet can be traced from ledger account.
v. Verify the opening balance from last year's audited balance sheet.

25. (a) Describe the steps to be followed while conducting audit of a recreation club.

Answer:

Steps to be followed while conducting audit of a recreation club —

(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.

(b) List the steps to Sales of a manufacturing unit.

Answer:

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

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

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

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

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

(c) List the areas to be covered while conducting the audit of an NGO incorporated as a company under Section 8 of the Companies Act, 2013.

Answer:

While planning the audit of a Non- Governmental Organisation (NGO), the auditor may concentrate on the following:

- Knowledge of the NGO's work, its mission and vision, areas of operations and environment in which it operates; and
- Reviewing the legal form of the organisation and its Memorandum of Association, Articles of Association, rules and Regulations.
- Reviewing the NGO's Organisation chart, Financial and Administrative Manuals, Project and Programme Guidelines, Funding Agencies Requirements and Formats, budgetary policies, if any.
- Examination of minutes of the Board/Managing Committee/Governing Body/Management and Committees thereof to ascertain the impact of any decisions on the financial records.

- Study the accounting system, procedures, internal controls and internal checks existing for the NGO and verify their applicability.

The audit programme should include in a sequential order all assets, liabilities, income and expenditure ensuring that no material is omitted:

- Corpus Fund: The contributions/grants received towards corpus be vouched with reference to the letters from the donor(s). The interest income be checked with investment Register and physical investments in hand.
- Reserves: Vouch transfers from projects/programmes with donors letters and board resolutions of NGO. Also check transfers and adjustments made during the year.
- Ear-marked Funds: Check requirements of donors' institutions, board resolution of NGO, rules and regulations of the schemes of the ear-marked funds.
- Project/Agency Balances: Vouch disbursements and expenditures as per agreements.
- Loans: Vouch loans with loan agreements receipt counter –foil issued.
- Fixed Assets: Vouch all acquisitions/sale or disposal of assets including depreciation and the authorisations for the same. Also check donor's letters/agreements for the grants. For immovable property, check title, etc.
- Investments: Check Investment Register and the investments physically ensuring that investments are in the name of the NGO. Verify further investments and disinvestments for approval by the appropriate authority and reference in the bank accounts for the principal amount and interest.
- Cash in Hand and Bank Balance: Physically verify the cash in hand and imprest balance, at the close of the year. Check the bank reconciliation statements and ascertain details for old outstanding and unadjusted amounts.
- Stock in Hand: Verify stock in hand and obtain certificate from the management for the quantities and valuation of the same.
- Programme and Project Expenses : Verify agreement with donor/contributor (s) supporting the particular programme or project to ascertain the conditions with respect to undertaking the programme/project and accordingly, in the case of programmes/projects involving contracts, ensure that income tax is deducted, deposited and returns filed and verify the terms of the contract.
- Establishment Expenses: Verify that provident fund, life insurance and their administrative charges are deducted, contributed and deposited within the prescribed time. Also check other office and administrative expenses such as postage, stationery, travelling, etc.
- Check in details the contribution and grants for projects and programs, receipts from Fund arising programmes, Membership Fee and any Subscription related matters and any other matters that are related to Interest and Dividends.

26. (a) "Auditor not to render certain Services" — Discuss [SECTION 144]

Answer:

An auditor appointed under this Act shall provide to the company only such other services as are approved by the Board of Directors or the audit committee, as the case maybe, but which shall not include any of the following services (whether such services are rendered directly or indirectly to the company or its holding company or subsidiary company, namely:

- accounting and book keeping services;
- internal audit;
- design and implementation of any financial information system;

- actuarial services;
- investment advisory services;
- investment banking services;
- rendering of outsourced financial services;
- management services; and
- any other kind of services as may be prescribed.

Provided that an auditor or audit firm who or which has been performing any non-audit services on or before the commencement of this Act shall comply with the provisions of this section before the closure of the first financial year after the date of such commencement.

(b) Discuss the provisions of Companies Act,2013 in relation with maintenance of Cost Records.

Answer:

Realising the importance of proper cost records and control, section 148(1) of the 2013 Act provides that Central Government can direct that particulars relating to the utilisation of material or labour or to other items of cost as may be prescribed shall also be included in the books of account kept by that class of companies.

The direction can be issued to such class of companies engaged in the production of such goods or providing such services as may be prescribed by a notification. In respect of companies regulated by special Act (like insurance, banking, electricity), the Central Government shall, consult the regulatory body constituted or established under such special Act before issuing such order in respect of any class of companies - provision to section 148(1) of the Companies Act, 2013 Act.

(c) Discuss the duties of an auditor relating to reporting of fraud as per the Companies Act,2013.

Answer:

For the purpose of sub-section (12) of section 143, in case the auditor has sufficient reason to believe that an offence involving fraud, is being or has been committed against the company by officers or employees of the company, he shall report the matter to the Central Government immediately but not later than sixty days of his knowledge and after following the procedure indicated herein below:

- auditor shall forward his report to the Board or the Audit Committee, as the case may be, immediately after he comes to knowledge of the fraud, seeking their reply or observations within forty-five days;
- on receipt of such reply or observations the auditor shall forward his report and the reply or observations of the Board or the Audit Committee along with his comments (on such reply or observations of the Board or the Audit Committee) to the Central Government within fifteen days of receipt of such reply or observations;
- in case the auditor fails to get any reply or observations from the Board or the Audit Committee within the stipulated period of forty-five days, he shall forward his report to the

Central Government along with a note containing the details of his report that was earlier forwarded to the Board or the Audit Committee for which he failed to receive any reply or observations within the stipulated time.

The report shall be sent to the Secretary, Ministry of Corporate Affairs in a sealed cover by Registered Post with Acknowledgement Due or by Speed post followed by an e-mail in confirmation of the same.

The report shall be on the letter-head of the auditor containing postal address, e-mail address and contact number and be signed by the auditor with his seal and shall indicate his Membership Number.

The report shall be in the form of a statement as specified in Form ADT-4.

The provision of this rule shall also, mutatis mutandis, to a cost auditor and a secretarial auditor during the performance of his duties under section 148 and section 204 respectively.

27. (a) Discuss the duties of an auditor regarding audit of Interest on Debentures.

Answer:

Following are the duties of an auditor regarding audit of Interest on Debentures:

Interest on Debentures: A predetermined fixed rate of interest is payable on debentures irrespective of the fact that company has earned the profit or not. Debenture holders are creditors of the company, they are not the owners. They have no voting powers and cannot influence the management but their claim of interest rank ahead of the claims of the shareholders.

Auditor's Duty:

• The payment of interest should be vouched by the auditor with the acknowledgement of the debenture-holders, endorsed warrants and in case of bearer debentures with the coupons surrendered.
• The auditor should reconcile the total amount paid with the total amount due and payable with the amount of interest outstanding for payment.
• He should ensure that the interest paid on debenture like that on other fixed loans, must be disclosed as a separate item in the profit & loss account.

(b) List the duties of an auditor regarding audit of Issue of Bonus Shares.

Answer:

• Confirm that issue of Bonus Share was authorized by articles.
• Verify the minutes of the Board meeting and ordinary resolution passed in the general meeting in which the approval of members is obtained.
• Check that the company has issue fully paid-up bonus shares to its members only.
• Confirm that the issue of bonus shares shall not be made by capitalising reserves created by the revaluation of assets.
• Check whether the company has made any default in payment of interest or principal in respect of fixed deposits or debt securities issued by it.

• Check whether the company has made any default in payment of statutory dues of the employees, such as, contribution to provident fund, gratuity and bonus.
• Whether the partly paid-up shares are made fully paid-up.
• Check whether the bonus shares shall not be issued in lieu of dividend.

28. (a) Distinguish between 'Qualified Report' and 'Adverse Report' of an Auditor.

Answer:

Distinctions between Qualified Report and Adverse Report

Qualified Report	Adverse Report
i. In case of Qualified Audit Report an auditor gives an opinion subject to certain reservations.	i. An Adverse 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.
ii. The Auditor's reservation is generally stated as: "Subject to the above, we report that the Balance Sheet shows a true and fair view."	ii. The Auditor states that the Financial Statements do not present a true and fair view of the state of affairs and working results of the organisation.
iii. The accounts present a true and fair view subject to certain reservations.	iii. The accounts do not present a true and fair view on the whole.
iv. A Qualification is made In the Audit Report when the Auditor has reservation on specific item(s) of material nature	iv. An Adverse Report is given when the Auditor has his reservations on the true and fair view presented by the Financial Statements

(b) State what Piecemeal Opinion by an auditor is.

Answer:

The Auditor, may in some cases, find that the Financial Statements he has examined present only a partial true and fair view. In such cases, he may report that he is unable to express an opinion, limited to certain items in the statement, with which he is satisfied. Such a situation would warrant a Piecemeal Opinion.

As the name suggests, the Auditor gives a divided opinion on matters with which he is satisfied and with which he is not. The Auditor should state the reasons for having given a Piecemeal Opinion.

29. (a) Discuss the procedure if the branch audit report is prepared by a person other than the Statutory Auditor and the situations when qualifications are to be made in the branch audit report.

Answer:

i. Forwarding of Branch Audit Reports: Where the branch audit carried out by a person other than the Statutory Auditor, the Branch Auditor shall prepare a report on the accounts of the branch office examined by him and forward the same to be Company's Auditor who shall deal with the same in such manner as he considers necessary. [Section 143]

ii. Qualifications in Branch Audit Reports: If the Branch Auditor's Report contains any qualification, the Statutory Auditors should normally include it in their own report unless they are satisfied that either –

(a) Objections raised by the Branch Auditor have been met while preparing the Company's accounts or during the conduct of the Company's audit, or

(b) The matter on which the qualification is made is not material in the context of the Company's Accounts as a whole, or

(c) In the light of information and explanations given to them, which were not available to the Branch Auditor, they are satisfied that the qualification is not called for.

(b) Audit of abridge Financial Statement — Discuss.

Answer:

Audit of abridge Financial Statement —

iii. Legal Requirements: The Auditor should examine whether the requirements relating to Abridged Balance Sheet and Abridged Profit & Loss Account as laid down in Section 136 have been duly complied with.

iv. Subsequent Events: If the Audit Report on Abridged Financial Statements is issued on a date subsequent to the issuance of the Audit Report on Annual Accounts as per Schedule III, the Auditor's responsibility in relation to events occurring after the Balance Sheet date is limited to the events occurring up to the date of his report on the annual accounts.

v. Unqualified Report: If the Auditor is satisfied that the Abridged Financial Statements are proper in all respects, he should issue an Unqualified Audit Report.

vi. Qualified Report: The Auditor should express a Qualified Opinion or an Adverse Opinion, as appropriate, if he has certain reservations about the Abridged Financial Statements, e.g. if a material piece of information has not been disclosed in the Abridged Financial Statements or has been disclosed in an inappropriate manner.

30. (a) List the objectives and functions of the Auditing and Assurance Standard Board (AASB) .

Answer:

Following are the objectives and functions of Auditing and Assurance Standard Board (AASB):

vii. To review the existing and emerging auditing practices worldwide.
viii. To formulate Engagement Standards, Standards on Quality Control and Statement on Auditing.
ix. To review and revise the existing standards and statements on auditing.
x. To develop guidance notes on issues arising out of any standard, auditing issues pertaining to any specific industry and revise.
xi. To review and revise the existing guidance notes.

xii. To formulate general clarifications, where necessary, on issues arising from standards.
xiii. To formulate and issue Technical Guides, Practice Manuals, Studies and other papers.

(b) Audit Opinion is not an assurance as to the future viability of the enterprise or the efficiency or effectiveness with which management has conducted the affairs of the enterprise — Comment.

Answer:

The auditor's opinion does not assure, the future viability of the entity nor the efficiency or effectiveness with which management has conducted the affairs of the entity.

The reason for this statement is that the auditor's opinion on the financial statements deals with whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework. Such an opinion is common to all audits of financial statements. In some cases, however, the applicable laws and regulations may require auditors to provide opinions on other specific matters, such as the effectiveness of internal control, or the consistency of a separate management report with the financial statements. While the SAs include requirements and guidance in relation to such matters to the extent that they are relevant to forming an opinion on the financial statements, the auditor would be required to undertake further work if the auditor had additional responsibilities to provide such opinions.

(c) 'The responsibilities of joint auditors are joint and several' — Discuss.

Answer:

In respect of audit work divided among the joint auditors, each joint auditor is responsible only for the work allocated to him, whether or not he has prepared a separate report on the work performed by him. On the other hand, all the joint auditors are jointly and severally responsible –

(i) in respect of the audit work which is not divided among the joint auditors and is carried out by all of them;
(ii) in respect of decisions taken by all the joint auditors concerning the nature, timing or extent of the audit procedures to be performed by any of the joint auditors. It may, however, be clarified that all the joint auditors are responsible only in respect of the appropriateness of the decisions concerning the nature, timing or extent of the audit procedures agreed upon among them; proper execution of these audit procedures is the separate and specific responsibility of the joint auditor concerned;
(iii) in respect of matters which are brought to the notice of the joint auditors by any one of them and on which there is an agreement among the joint auditors;
(iv) for examining that the financial statements of the entity comply with the disclosure requirements of the relevant statute; and
(v) for ensuring that the audit report complies with the requirements of the relevant statute.

(d) An assistant of VK& Co, Chartered Accounts, detected an error of ₹ 6 per interest payment, which recurred a number of times. The General Manager (Finance) of Nothing Ltd advised him not to request for passing any adjustment entry as individually the errors were of very small amounts. The Company had 3,000 deposit accounts and interest was paid quarterly. State your views in this issue, with reasons.

Answer:

Mis-statements including omissions are considered to be material, if they either individually or in aggregate, could reasonably be expected to influence the economic decisions of the users, using the Financial Statements.

In the above case, an error of ₹ 6 per interest payment, even if small individually, will have a material effect due to the large number of transactions (3,000 deposit accounts).

Hence, VK & Co, need not to pay any attention to the advise given by the General Manager (Finance) of Nothing Ltd. The necessary adjustment should therefore be carried out in the accounts of the company.