INTERMEDIATE EXAMINATION
GROUP - II
(SYLLABUS 2016)

SUGGESTED ANSWERS TO QUESTIONS
DECEMBER - 2017

Paper-12 : COMPANY ACCOUNTS AND AUDIT

Time Allowed : 3 Hours **Full Marks : 100**

The figures in the margin on the right side indicate full marks.

Where considered necessary, suitable assumptions may be made and clearly indicated in the answer.
The Question paper has two Sections, A and B. Both sections are to be answered as per instruction given against each.

Section – A (Company Accounts)

Answer Question No. 1 and any three from Question No. 2, 3, 4 and 5.

1. (a) Choose the correct alternative: **1×6=6**

(i) While preparing Cash Flow Statement of XY Ltd., a finance company, interest received on loans should be shown as
(A) Cash Flow from Operating Activities
(B) Cash Flow from Investing Activities
(C) Cash Flow from Financing Activities
(D) Cash and Cash Equivalent

(ii) As per Schedule III Current Maturities of Long Term Borrowings should be shown under
(A) Current Assets in Balance Sheet
(B) Non-current Liability in Balance Sheet
(C) Current Liabilities in Balance Sheet
(D) Other Expenses in Statement of Profit and Loss

(iii) Which of the following is not a criterion for selecting a reportable segment under AS 17?
(A) 10% or more of aggregate revenue of all segment
(B) 10% or more of aggregate assets of all segment
(C) 10% or more of aggregate liabilities of all segment
(D) 10% or more of aggregate profit or loss of all segment (higher of the two)

(iv) Which of the following is not a mandatory financial statement of a General Insurance Company as per IRDA regulations?
(A) Revenue Account
(B) Profit and Loss Account
(C) Balance Sheet
(D) Cash Flow Statement

(v) A Banking Company needs to transfer a minimum of ______ its profit to reserve fund.
(A) 10%
(B) 15%
(C) 20%

(D) 25%

(vi) In case of an electricity company, depreciation on assets is calculated based on the rates notified by
(A) Companies Act 2013
(B) State Electricity Commission
(C) Central Electricity Regulatory Commission
(D) Income Tax Act 1961

(b) Match the following items in Column 'A' with items shown in Column 'B': 1×4=4

	Column 'A'		Column 'B'
1.	Guaranteed Residual Value (GRV)	A.	Capital Reserve
2.	Premium on Redemption of Preference shares	B.	AS 11
3.	Exchange Difference	C.	Securities Premium A/C
4.	Profit on reissue of forfeited shares	D.	AS 19

(c) State whether the following statements are True or False: 1x4=4

(i) In case of an underwriting arrangement, marked applications are those applications that bear the stamp of the issuing company.
(ii) In case the leaseback is a finance lease, the sale proceeds in excess of the carrying amount should be immediately recognized in the Income Statement.
(iii) Issue of fully paid up bonus shares increases the total shareholders fund.
(iv) Interest and dividend received form a part of financing cash flow.

Answer:

1. (a)

(i)	A
(ii)	C
(iii)	C
(iv)	D
(v)	D
(vi)	C

(b)

1	D
2	C
3	B
4	A

(c)

(i)	F
(ii)	F
(iii)	F
(iv)	F

2. (a) R Ltd. wants to buy-back 100000 equity shares of ₹ 10 each at a price of ₹ 20 each on 01.04.2017. The buy-back is allowed in its articles of association and the company has obtained necessary approval from the shareholders. The company has sufficient bank balance to make the payment for buy-back of shares.

The following information is available as on 31.03.2017: ₹

Equity Share Capital (₹ 10 each fully paid)	**50,00,000**
General Reserve	**60,00,000**
Dividend Equalization Reserve	**10,00,000**
Balance of Profit and Loss (Cr.)	**5,00,000**
10% Debentures (₹ 100 each)	**75,00,000**
Bank Loan	**40,00,000**
Current Liabilities	**66,00,000**

Verify whether the buy-back plan of the company meets the conditions specified by the Companies Act 2013 as regards to the maximum amount of buy-back. Also pass necessary journal entries in the books of the company to give effect of the process, if the plan is found to be in place. 9

(b) Z Ltd. sold goods to a US Company for US $ 50000 on 10.02.2017 and realized the due on 30.06.2017. Z Ltd. closes the books of accounts on 31st March. Exchange rates were as follows:

Date	**Rate**
10.02.2017	**65.40**
31.03.2017	**66.00**
30.06.2017	**65.80**

Calculate the exchange loss/gain the reporting date and on the settlement date and comment on their treatment as per AS 11. 3

Answer:

2. (a) Determination of maximum buyback permissible as per Companies Act 2013:

1. Shares Outstanding Test: Max. Permissible Limit = 25% of Outstanding Shares

Particulars	
Total number of shares outstanding	500000
25% of the shares outstanding	125000

2. Resource Test: Max. Permissible Limit = 25% of Paid up Capital plus Free Reserves

Particulars	
Equity share capital (₹)	50,00,000
Free Reserve (₹) (General Reserve + DER +P/L)	75,00,000
Paid up Capital plus Free Reserves (₹)	125,00,000
25% of Paid up Capital plus Free Reserves (₹)	31,25,000
Buy back price per share (₹)	20
No. of shares that can be bought back (31,25,000/20)	1,56,250

3. Debt Equity Ratio Test: Debt after buyback cannot exceed twice the paid up capital plus free reserves.

Particulars	
Total Debt (₹) (7500000+4000000+6600000)	181,00,000
Minimum Equity to be maintained after buyback in the ratio 2:1 (₹)	90,50,000
Paid up capital plus free reserves before buyback (₹)	125,00,000
Future Paid up capital plus free reserves (₹) (see working note: 1) (125,00,000 - 11,50,000)	113,50,000
Maximum permissible buyback (₹) (113,50,000-90,50,000)	23,00,000
Buy back price per share (₹)	20
No. of shares that can be bought back	1,15,000

Summary of three test results:

	No. of Shares
Permissible Buyback as per -	
Share Outstanding Test	125000
Resource Test	156250
Debt-Equity Ratio Test	115000
Maximum permissible buyback (least of the three)	115000
Actual buyback plan	100000

Since actual buyback proposed is below the permissible limit, the company can buy back 100000 shares at ₹ 20 each.

Working Note 1:
In case buyback of shares is done out of free reserves and securities premium, a company is required transfer a sum equal to the nominal value of the shares buyback to Capital Redemption Reserve A/C. Thus shareholders' fund after buyback includes CRR. Now CRR is not a free reserve. Hence it cannot form part of paid up capital plus free reserve after buyback.

Let nominal value of shares bought back is x. Then CRR after buyback is x. Moreover total premium on buyback = x (₹ 10 face value and ₹ 20 buyback price, so premium on buyback ₹ 10). So total amount to be deducted from shareholders' fund for buyback = x (capital) +x (premium) = 2x. Moreover free reserves to be reduced by x.

Total paid up capital plus free reserves after buyback = 125,00,000 – x (i.e. CRR) – 2x (i.e. buyback proceeds)

Conditionally, 125,00,000 - x - 2x = 90,50,000, or, x = 11,50,000
Nominal value of buyback = 11,50,000 (i.e. CRR)

Journal

Date	**Particular**	**Dr. (₹)**	**Cr. (₹)**
1.4.2017	Equity Share Buyback A/c Dr. To Bank A/c (Being buyback of 100000 shares of ₹ 10 each at ₹ 20 per share.)	20,00,000	 20,00,000
1.4.2017	Equity Share Capital A/c Dr. General Reserve A/c To Equity Share Buyback A/c (Being cancellation of shares bought back and premium on buyback provided out of General Reserve)	10,00,000 10,00,000	 20,00,000
1.4.2017	General Reserve A/c Dr. To Capital redemption Reserve A/c (Being nominal value of shares bought back transferred to CRR)	10,00,000	 10,00,000

(b) As per AS 11, transactions such as purchase, sales etc. are to be recorded in the books of accounts at the exchange rate prevailing on the date of transaction. Any exchange gain/ loss arising subsequently is to be transferred to Income Statement.
Value of the goods sold = $ 50000
Exchange rate on the date of transaction = ₹ 65.40/$
So sales to be recorded in the books = 50000×65.40 = ₹ 3,270.000
Exchange rate on the date of reporting (31.03.17) = ₹ 66.00/$
Value of the receivables on 31.03.17 = 5000 × 66 = ₹ 33,00,000
Exchange gain on 31.03.2017 = (33,00,000 – 32,70,000) = ₹ 30,000, to be credited to

P/L A/c.
Exchange rate on the date of settlement (30.06.17) = ₹ 65.80/$
Exchange loss on 30.06.17 = 50000×(66.00 – 65.80) = ₹ 10,000 to be debited to P/L A/c.

3. (a) On the basis of the following information provided by X Ltd. prepare a Cash Flow Statement for the year ended on 31st March 2017.

(i) X Ltd. sold all the goods for cash only and purchased the goods in credit only.
(ii) The company earned a Gross Profit of ₹ 4,00,000 with a Gross Profit Ratio of 25%.
(iii) The closing inventory was higher than the opening inventory by ₹ 20,000.
(iv) The company paid ₹ 4,50,000 as wages and ₹ 90,000 as office expenses during the year.
(v) Balance of Suppliers accounts on 31.03.2016 were higher than the balance on 31.03.2017 by ₹ 30,000.
(vi) Tax paid by the company amounts to ₹ 80,000 while provision for taxation was ₹ 70,000.
(vii) The company repaid bank loan of ₹ 1,75,000 which included interest of ₹ 15,000.
(viii) Dividend paid during the year ₹ 50,000 (including dividend distribution tax).
(ix) X Ltd. sold investments of ₹ 6,00,000 at a profit of ₹ 40,000.
(x) Depreciation charged on fixed assets ₹ 1,20,000.
(xi) Furniture purchased during the year ₹ 2,00,000.
(xii) Cash and Cash Equivalents as on 31.03.2016 was ₹ 1,00,000.
(xiii) Cash and Cash Equivalents as on 31.03.2017 was ₹ 4,95,000. **8**

(b) From the following information for a Bank calculate the amount of discount to be transferred to the Statement of Profit and Loss.

(i) Rebate on Bills Discounted (as on 01.04.2016) ₹ 28,000. Discount Received ₹ 1,02,000.
(ii) The following bills have been discounted during the year:

Amount of Bill (₹)	Rate of Discount	Due Date (including grace days)
65,000	13%p.a.	June 14,2017
1,50,000	15% p.a.	July 19,2017
4,30,000	12% p.a.	August 30,2017

Also pass the necessary journal entry for the unexpired discount as on 31.03.2017.
3+1=4

Answer:

3. (a) Workings Note 1:

Gross Profit @ 25% on Sales = ₹ 4,00,000, So Total Sales = ₹ 16,00,000 (all for cash)
COGS = Sales -G.P = ₹ 12,00,000
Let closing inventory is x and hence opening inventory is (x – 20,000)
Now, COGS = Op. Inventory + Purchase + Wages - Cl. Inventory
Or. 12,00,000 = (x-20,000) + Purchase – 4,50,000 - x
Or. Purchase = 7,70,000.

Working Note 2:

Let closing balance of suppliers = y, hence opening balance = (y +30,000)

Suppliers' Account

Dr. **Cr.**

	₹		₹
To Payment to Suppliers (Bal. Fig.)	8,00,000	By Balance b/f	Y + 30,000
To Balance c/f	y	By Purchase	7,70,000
	y + 8,00,000		y + 8,00,000

Cash Flow Statement for the year ended on 31.03.2017

Particulars	**₹**	**₹**
A. Cash Flow from Operating Activities		
Cash Sales		16,00,000
(-) Cash payments		
Payment to suppliers	8,00,000	
Wages paid	4,50,000	
Office expenses paid	90,000	13,40,000
		2,60,000
(-) Income tax paid		80,000
		1,80,000
B. Cash Flow from Investing Activities		
Sale of Investments	6,40,000	
Purchase of furniture	(2,00,000)	4,40,000
C. Cash Flow from Financing Activities		
Bank loan repaid with interest	(1,75,000)	
Dividend paid with distribution tax	(50,000)	(2,25,000)
(A+B+C)		3,95,000
D. Opening Cash and Cash Equivalent		1,00,000
E. Closing Cash and Cash Equivalent		4,95,000

(b) Calculation for rebate on bill discounted

Bill Due Date	Days after due date	Amount (₹)	Rate	Discount
14.06.17	75	65,000	13%	1,736
19.07.17	110	1,50,000	15%	6,781
10.08.17	132	4,30,000	12%	18,661
			Total	27,178

Amount to be credited to P/L = 28000 + 102000 - 27178 = ₹ 102822.

Journal Entry:

Interest and Discount A/C ....Dr	27,178	
To Rebate on Bill Discounted A/C		27,178

4. ABC Ltd. provides the following Trial Balance as on 31st March 2017:

Particulars	**Dr. Balances (₹)**	**Cr. Balances (₹)**
Equity Share Capital: 350000 shares of ₹ 10 each fully paid		**35,00,000**
10% Debentures		**3,00,000**
Motor Van	**4,00,000**	
Machinery	**20,00,000**	
Land and Building	**12,00,000**	
12% Long Term Govt. Securities	**2,00,000**	
Sales		**60,00,000**
Sales Return	**3,00,000**	
Interest on Debenture	**22,500**	
Purchase	**36,00,000**	
Purchase Returns		**4,00,000**
Opening Stock	**3,00,000**	
Discount	**7,500**	
Carriage Outward	**1,50,000**	
Rent and Rates	**50,000**	
Income from Govt. Securities		**24,000**

Trade Receivables	**10,00,000**	
Trade Payables		**2,00,000**
Advertisement	**1,50,000**	
Bad Debt	**20,000**	
Salaries	**6,72,000**	
Misc. Expenditure	**30,000**	
Contribution to P.F. and Gratuity Funds	**1,00,000**	
Cash at Bank and in hand	**2,22,000**	
Total	**1,04,24,000**	**1,04,24,000**

Additional Information:

(i) Closing Stock as on 31st March 2017 was ₹ 3,50,000.

(ii) Depreciation Rates: Motor Vehicle 10%, Machinery 20% and Land & Building 5%.

(iii) Misc. expenditure includes ₹ 20,000 as audit fees.

(iv) Interest on debenture is payable quarterly and the last quarter's interest is yet to be paid.

(v) Trade receivables include a sum of ₹ 25,000 due from Mr. X who has become insolvent and only 25 paisa in a rupee is expected to be recoverable from him.

(vi) Create a provision for doubtful debt @ 2% on trade receivables.

(vii) Provide for income tax ₹ 1,50,000.

Prepare a Statement of Profit and Loss for the year ended on 31st March 2017 and a Balance Sheet as on that date. 12

Answer:

4. Notes to Accounts:

1. Employee Benefit Expenditure	₹
Salaries	6,72,000
Contribution to P.F.	1,00,000
	7,72,000

2. Finance Cost	₹
Interest on loan	22,500
Outstanding Interest	7,500
	30,000

3. Other Expenditure	₹
Discount	7,500
Carriage	1,50,000
Rent	50,000
Advertisement	1,50,000
Bad Debt	20,000
Audit fees	20,000
Misc. Exp.	10,000
Provision for B/D	38,250
	4,45,750

4. Trade Receivable	₹
Total Receivable	10,00,000
(-) Provision @ 2%	38,250
	9,61,750
Provision = 25000 × 0.75 + (1000000 – 25000) × 0.02	38,250

5. Fixed Assets	Motor Van	Machine	L&B
Balance	4,00,000	20,00,000	12,00,000

(-) Depreciation	40,000	4,00,000	60,000
	3,60,000	16,00,000	11,40,000
Total Fixed Assets			31,00,000
Depreciation			5,00,000

Statement of Profit and Loss for the year ended on 31.03.2017

Particulars	Note	₹
I. Revenue from operation (sales less returns)		57,00,000
II. Other Income (Income from investment)		24,000
III. Total revenue		57,24,000
IV. Expenses:		
Purchase		32,00,000
Changes in inventory i.e. opening less. Closing		(50,000)
Employee Benefit expenses	1	7,72,000
Finance cost	2	30,000
Depreciation	5	5,00,000
Other expenses	3	4,45,750
		48,97,750
V. Profit before exceptional and extraordinary items and tax		8,26,250
VI. Exceptional items		Nil
VI Profit before extraordinary items and tax		8,26,250
VII. Extraordinary items		Nil
VIII. Profit before tax		8,26,250
IX. Tax (provision for tax)		1,50,000
X. Profit after tax		6,76,250

Balance Sheet as on 31.03.2017

I. Equity and Liabilities	**Note**	**₹**
1. Shareholders' Funds		
(a) Share Capital		35,00,000
(b) Reserve and Surplus (Balance of Profit)		6,76,250
2. Share Application money pending allotment		Nil
3. Non-current liabilities (10% Debentures)		3,00,000
4. Current Liabilities		
Trade Payable		2,00,000
Outstanding interest		7,500
Provision for Tax		1,50,000
Total		48,33,750
II. Assets		
1. Non-current Assets		
(a) Fixed Assets (Tangible)	5	31,00,000
(b)Non-current Investment (12% L.T. Govt. Securities)		2,00,000
2. Current Assets		
Inventories		3,50,000
Trade Receivable	4	9,61,750
Cash and cash equivalent		2,22,000
Total		48,33,750

5. Write short note (any three): **4×3=12**

(a) Operating Lease and Finance Lease
(b) Right Issue of Shares
(c) Provisioning Arrangements for Non-Performing Assets
(d) Money Received against Share Warrants

Answer:

5. (a) Operating Lease and Finance Lease

A lease is an agreement whereby the lessor conveys to the lessee in return for a payment or series of payments the right to use an asset for an agreed period of time.

A finance lease is a lease that transfers substantially all the risks and rewards incidental to ownership of an asset. Title may or may not eventually be transferred.

An operating lease is a lease other than a finance lease.

As per AS 19, a lease is classified as a finance lease if it transfers substantially all the risks and rewards incidental to ownership. A lease is classified as an operating lease if it does not transfer substantially all the risks and rewards incidental to ownership.

(b) Right Issue of Shares

Where at any time, a company having a share capital proposes to increase its subscribed capital by the issue of further shares, such shares shall be offered to persons who, at the date of the offer, are holders of equity shares of the company in proportion, as nearly as circumstances admit, to the paid-up share capital on those shares by sending a letter of offer subject to the following conditions, namely:—

(i) the offer shall be made by notice specifying the number of shares offered and limiting a time not being less than fifteen days and not exceeding thirty days from the date of the offer within which the offer, if not accepted, shall be deemed to have been declined;

(ii) unless the articles of the company otherwise provide, the offer aforesaid shall be deemed to include a right exercisable by the person concerned to renounce the shares offered to him or any of them in favour of any other person; and the notice referred to in clause (i) shall contain a statement of this right;

(iii) after the expiry of the time specified in the notice aforesaid, or on receipt of earlier intimation from the person to whom such notice is given that he declines to accept the shares offered, the Board of Directors may dispose of them in such manner which is not disadvantageous to the shareholders and the company.

(c) Rates of Provisioning for Non-Performing Assets and Restructured Advances

Category of Advances	Rate (%)
Standard Advances	
(a) Direct advances to agricultural and SME	0.25
(b) Advances to Commercial Real Estate (CRE) Sector	1.00
(c) All other loans	0.40
Sub-standard Advances	
Secured Exposures	15
Unsecured Exposures in respect of Infrastructure loan accounts where certain safeguards such as escrow accounts are available.	20
Unsecured other loans	25
Doubtful Advances - Unsecured Portion	100
Doubtful Advances - Secured Portion	
For Doubtful upto 1 year	25
For Doubtful > 1 year and upto 3 years	40
For Doubtful > 3 years	100

(d) Money received against Share Warrants

- As per Sch. III Disclosure Requirements, it is to be shown as a separate line item on the face of Balance Sheet.
- In case of Listed Companies, Share warrants are issued to Promoters & others in

terms of the Guidelines for Preferential Issues viz. SEBI (Issue of Capital and Disclosure Requirements), Guidelines, 2009.

- Effectively, Share Warrants are amounts which would ultimately form part of the Shareholder's Funds. Since Shares are yet to be allotted against the same, these are not reflected as part of Share Capital, but as a separate line - item.

Section - B (Audit)

Answer Question No. 6 and *any three from* Question No. 7, 8, 9 and 10.

6. (a) Identify the correct alternative: 1×6=6

(i) An auditor should submit a Disclaimer of Opinion when

(A) he is satisfied with the truth and fairness of financial statements.

(B) he has certain reservations as to the presentation of truth and fairness in financial statements.

(C) some material information is not available.

(D) the effect of any disagreement with the management is not so material.

(ii) In case of a company other than a Government Company, any casual vacancy in the post of auditor is to be filled by the

(A) Board of Directors

(B) Managing Director

(C) Comptroller and Auditor General (CAG)

(D) Shareholders

(iii) An Audit Committee should have a minimum of ____________ number of directors.

(A) 4

(B) 3

(C) 5

(D) 6

(iv) SA 530 stands for

(A) Audit Documentation

(B) Audit Sampling

(C) Responsibility of Joint Auditor

(D) Agreeing the terms of Audit Engagements

(v) Unpaid dividend standing at the credit of Unpaid Dividend A/C should be transferred to Investor Education and Protection Fund after _______ years of its remaining unpaid.

(A) six

(B) eight

(C) seven

(D) five

(vi) Which of the following services cannot be rendered by an auditor as per Companies Act 2013?

(A) Vouching

(B) Verification of assets and liabilities

(C) Issuing certificates on relevant matters

(D) Providing investment advisory services

(b) Match the following items in Column 'A' with items shown in Column 'B': 1x4=4

	Column 'A'		Column 'B'
1.	Appointment of Company Auditor	A.	Current Audit File
2.	Remuneration of a Company Auditor	B.	Section 139 of Companies Act 2013
3.	Different accounting schedules such as schedule of debtors and creditors	C.	Permanent Audit File
4.	Analysis of significant ratios and trends	D.	Section 142 of Companies Act 2013

(c) State whether the following statements are true or false: 1x4=4

(i) As per Section 138 of Companies Act 2013, no private company or unlisted

company is required to appoint an internal auditor.

(ii) Audit Memorandum is a detailed plan of audit work clearly specifying the responsibilities of the audit staff and time allotted to perform the same.

(iii) Substantive procedure is also known as test of control.

(iv) Cut-off procedures are adopted to allocate revenues and costs to the proper accounting period.

Answer:

6. (a) (i) C
(ii) A
(iii) B
(iv) B
(v) C
(vi) D

(b) (1) B
(2) D
(3) A
(4) C

(c) (i) False
(ii) False
(iii) False
(iv) True

7. (a) Discuss the various methods of obtaining audit evidences. How will you assess the reliability of audit evidences obtained? 5+3=8

(b) 'An auditor applies various techniques to evaluate the internal control system of an organization'— Discuss. 4

Answer:

7. (a) An auditor applies the following methods for obtaining sufficient and appropriate audit evidence.

(i) Inspection: Inspection involves examining records or documents, whether internal or external, in paper form or otherwise or a physical verification of a tangible asset. Inspection can provide reliable audit evidence depending on their nature and source and effectiveness of the internal control over their generation and processing.

(ii) Observation: Observation consists of looking at a process or procedure being performed by others on a real time basis. For example the auditor may observe the inventory counting by the entity's personnel and obtain evidence that it is done correctly.

(iii) External Confirmation: External confirmation represents audit evidence obtained by the auditor as a direct written response from a third party, in paper form or by electronic or any other medium. For example, confirmation from the customer about the terms of agreement.

(iv) Recalculation: Recalculation consists of checking the mathematical accuracy of documents or records. This may be performed manually or electronically.

(v) Reperformance: Reperformance involves auditor's independent execution of procedures or controls that were originally performed as part of entity's internal control.

(vi) Analytical Procedures: Analytical procedures involve evaluation of financial information by studying possible relationships among both financial and non-financiai data and investigating identified fluctuations from previous years that are inconsistent.

(vii) Inquiry: Inquiry consists of seeking information, both financial and non-financial, from knowledgeable persons within or outside the entity. Inquiries may range from formal written inquiries addressed to external parties to informal inquiries addressed to client's staff.

As per SA 500, reliability of audit evidence depends on its source (whether internal or external) and nature (whether visual, documentary or oral). However, the following generalizations may be considered useful while assessing the reliability of audit evidence.

(i) Evidence obtained from independent and external sources are more reliable.
(ii) Internal evidence becomes more reliable when the related internal control over its preparation and maintenance is effective.
(viii) Evidence obtained directly by the auditor is more reliable than those obtained indirectly or by inference.
(ix) Evidence in documentary form is usually more reliable than oral representation.
(x) Audit evidence provided by original documents is more reliable than audit evidence provided by photocopies or facsimiles or documents that have been filmed or digitized. In order to be certain about the reliability of audit evidence in relation to a particular matter, an auditor should try to obtain evidence from various sources. In case there appears any inconsistency, the auditor must obtain additional evidence by conducting other audit procedures.

(b) Techniques for Evaluation of Internal Control System

i. Narrative Record: It is a complete and exhaustive description of the system. It is appropriate in circumstances where a formal control system is lacking, like in the case of small businesses. Gaps in the control system are difficult to identify using a narrative record.
ii. Check List: It is a series of instructions that a member of the audit staff is required to follow. They have to be signed/ initialed by the audit assistant as proof for having followed the instructions given. A specific statement is required for every weakness area.
iii. Flow Chart: It is a pictorial representation of the internal control system depicting its various elements such as operations, processes and controls, which help in giving a concise and comprehensive view of the organization's working to the auditor. The internal control evaluation process becomes easier through a flow chart as a broad picture of all the controls involved can be gauged in a glimpse.
iv. Internal Control Questionnaire: This is the most widely used method for collecting information regarding the internal control system and involves asking questions to various people at different levels in the organization. The questionnaire is in a pre-designed format to ensure collection of complete and all relevant information. The questions are formed in a manner that would facilitate obtaining full information through answers in "Yes" or "No".

8. (a) Discuss the provisions under Section 139(7) relating to the appointment of the first auditor in a Government Company. How can an auditor, duly appointed by a company, be removed before expiry of his term? 4+3=7

(b) Discuss the duty of an auditor to report certain matters in the audit report u/s 143(3). 5

Answer:

8. (a) Appointment of First Auditor in Case of a Government Company [Section 139(7)]:

(i) In the case of a Government company or any other company owned or controlled, directly or indirectly, by the Central Government, or by any State Government, or Governments, or partly by the Central Government and partly by one or more State Governments, the first auditor shall be appointed by the Comptroller, and Auditor-General of India within sixty days from the date of registration of the company.

(ii) In case the Comptroller and Auditor-General of India does not appoint such auditor within the aforesaid period, the Board of Directors of the company shall appoint such auditor within the next thirty days.

(iii) Further, in the case of failure of the Board to appoint such auditor within the next thirty days, it shall inform the members of the company who shall appoint such auditor within sixty days at an extraordinary general meeting.

(iv) The auditor, so appointed, shall hold office till the conclusion of the first annual general meeting.

Removal of Auditor before the Expiry of His Term:

The auditor appointed under section 139 may be removed from his office before the expiry of his term subject to the fulfillment of the following conditions under Section 140(1) read with Rule 7 of CAAR 2014.

(i) An application to the Central Government for removal of the auditor shall be made in Form ADT-2. The application shall be accompanied with fees as provided for this purpose under the Companies (Registration Offices and Fees) Rules, 2014.

(ii) The application shall be made to the Central Government within thirty days of the resolution passed by the Board.

(iii) The company shall hold the general meeting within sixty days of receipt of approval of the Central Government for passing the special resolution for removal of the said auditor.

(iv) The auditor concerned shall be given a reasonable opportunity of being heard.

(b) Duty Regarding Inclusion of Certain Matters in the Audit Report: As per Section 143(3), the company auditor, in his audit report, shall clearly state -

(i) Whether he has sought and obtained all the information and explanations which to the best of his knowledge and belief were necessary for the purpose of his audit and if not, the details thereof and the effect of such information on the financial statements.

(ii) Whether, in his opinion, proper books of account as required by law have been kept by the company and proper returns adequate for the purposes of his audit have been received from branches not visited by him.

(iii) Whether the report on the accounts of any branch office of the company audited by a person other than the company's auditor has been sent to him and the manner in which he has dealt with it in preparing his report.

(iv) Whether the company's balance sheet and profit and loss account dealt with in the report are in agreement with the books of account and returns.

(v) Whether, in his opinion, the financial statements comply with the accounting standards.

(vi) The observations or comments of the auditors on financial transactions or matters which have any adverse effect on the functioning of the company.

(vii) Whether any director is disqualified from being appointed as a director under sub-section (2) of section 164.

(viii) Any qualification, reservation or adverse remark relating to the maintenance of accounts and other matters connected therewith.

(ix) Whether the company has adequate internal financial controls system in place and the operating effectiveness of such controls.

(9) (a) What is the procedure of appointing a cost auditor in a company? 4

(b) Discuss the basic elements of an audit report. 8

Answer:

(9) (a) Procedure for Appointment of a Cost Auditor

The cost auditor is to be appointed by the Board of Directors (BOD) on the recommendation of the Audit Committee, where the company is required to have an Audit Committee. The cost auditor proposed to be appointed is required to give a letter of consent to the Board of Directors.

The company shall inform the cost auditor concerned of his or its appointment as such and file a notice of such appointment with the Central Government within a period of thirty days of the Board meeting in which such appointment is made or within a period of one hundred and eighty days of the commencement of the financial year, whichever is earlier, through electronic mode, in form CRA-2 along with the fee as specified in Companies (Registration Offices and Fees) Rules, 2014.

Any casual vacancy in the office of a cost auditor, whether due to resignation, death or removal, shall be filled by the Board of Directors (BOD) within thirty days of occurrence of such vacancy and the company shall inform the Central Government in Form CRA-2 within thirty days of such appointment of cost auditor.

(b) The Basic Elements of the Auditors' Report are –

(i) Title: The Auditor's Report should have an appropriate title i.e. "Auditor's Report". It should be distinguished from other Reports, e.g. reports of officers of the entity, Board of Directors.

(ii) Addressee: The Auditor's Report should be appropriately addressed as required by the circumstances of the engagement and applicable laws and regulations. Ordinarily, the Auditor's Report is addressed to the authority appointing the Auditor.

(iii) Opening or Introductory Paragraph:
  (a) The Auditor's Report should identify the Financial Statements of the entity that have been audited, including the date of and period covered by the Financial Statements.
  (b) The Report should include a Statement that the Financial Statements are the responsibility of the entity's management and a Statement that the responsibility of the Auditor is to express an opinion on the Financial Statements based on the audit.

(iv) Scope Paragraph:
  (a) The Auditor's Report should describe the scope of the audit by stating that the audit was conducted in accordance with standards on auditing generally accepted in India.
  (b) The Report should include a statement that the audit was planned and performed to obtain reasonable assurance whether the Financial Statements are free of material misstatement.
  (c) The Auditor's Report should describe the Audit as including examining, on a test basis, evidence to support the amounts and disclosures in Financial Statements, assessing the accounting principles used in the preparation of the Financial Statements, assessing significant estimates made by management, in the preparation of Financial Statements, & evaluating the overall position of Financial Statements.
  (d) The Report should include a statement by the Auditor that the audit provides a reasonable basis for his opinion.

(v) Opinion Paragraph: The Opinion paragraph of the Report should indicate the Financial Reporting framework used to prepare the Financial Statements. It should state the Auditor's opinion as to whether the Financial Statements give a true and fair view in accordance with the financial reporting framework and, where appropriate, whether the Financial Statements comply with the statutory requirements.

(vi) Date of the Report: The date of an Auditor's Report is the date on which the Auditor signs the Report expressing an opinion on the Financial Statements. The Auditor should not date the Report earlier than the date on which the Financial Statements are signed or approved by Management.

(vii) Place of Signature: The Report should name the specific location, which is ordinarily the city where the Audit Report is signed.

(viii) Auditor's Signature: The Report should be signed by the Auditor in his personal name. Where a Firm is appointed as the Auditor, the Report should be signed in the personal name of the Auditor and in the name of the Audit Firm. The Partner/ Proprietor signing the Report should mention his ICAI Membership Number.

10. Write short notes (any three): 4×3=12

(a) Audit of Municipalities and Panchayats

(b) Audit of Bonus share issued by a company

(c) Branch Auditor

(d) Declaration of dividend by a company u/s 123

Answer:

10. (a) Audit of Municipalities and Panchayats

The major objective of audit of Municipalities and Panchayats are enumerated below;

(i) To ensure on the fairness and correctness of contents in the Financial Statement
(ii) To report on adequacy of internal control
(iii) To ensure value of money is fully received on amount spent.
(iv) To detect the frauds and errors.

The following points are to be considered necessary for carrying on audit of Municipalities and panchayats (Local Bodies);

(i) To ensure that the expediters incurred conform to the relevant provision of the law and is in accordance with the financial Rules and regulation formed by the compliant authority.
(ii) To encase that sanction is accorded by the competent authority either special or general.
(iii) To encase that there is provision of funds for expenditure and is authorized by competent Authority.
(iv) To ensure that where huge financial expenditure is made is run economically and is expected to contribute growth.

(b) Audit of bonus share issued by a company (Section 63)

The auditor should take note of the following points:

(i) Confirm that issue of Bonus Share was authorized by articles.
(ii) Verify the minutes of the Board meeting and ordinary resolution passed in the general meeting in which the approval of members is obtained
(iii) Check that the company has issue fully paid-up bonus shares to its members only.
(iv) Confirm that the issue of bonus shares shall not be made by capitalizing reserves created by the revaluation of assets.
(v) 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.
(vi) 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.
(vii) Whether the partly paid-up shares are made fully paid-up.

(viii) Check whether the bonus shares shall not be issued in lieu of dividend.

(c) Branch Auditor

Branch Auditor may be appointed under Section 139 of 2013 Act to audit the Accounts of Branch Office of a Company. Such person, who is appointed as Branch Auditor, should be qualified for appointment as an auditor of the Company under 2013 Act. The Branch Auditor shall prepare a report on the Accounts of the Branch examined by him and send it to Company's Auditor. The report of Branch Auditor will be dealt by Company's auditor in the manner deemed fit. Branch auditor is responsible to report fraud, as applicable to Company's auditor.

(d) Declaration of dividend by a company u/s 123

No dividend shall be declared or paid by a company for any financial year except —

(a) out of the profits of the company for that year arrived at after providing for depreciation in accordance with the provisions of subsection (2), or out of the profits of the company for any previous financial year or years arrived at after providing for depreciation in accordance with the provisions of that sub-section and remaining undistributed, or cut of both; or

(b) out of money provided by the Central Government or a State Government for the payment of dividend by the company in pursuance of a guarantee given by that Government.

Provided that a company may, before the declaration of any dividend in any financial year, transfer such percentage of its profit for that financial year as it may consider appropriate to the reserves of the company.

Provided further that where, owing to inadequacy or absence of profits in any financial-year, any company proposes to declare dividend out of the accumulated profits earned by it in previous/ears and transferred by the company to the reserves, such declaration of dividend shall not be made except in accordance with such rules as may be prescribed in this behalf.

Provided also that no dividend shall be declared or paid by a company from its reserves other than free reserves.

Provided also that no company shall declare dividend unless carried over previous losses and depreciation net provided in previous year or years are set off against profit of the company for the current year.

For the purposes of clause (a) of sub-section (1), depreciation shall be provided in accordance with the provisions of Schedule II.