INTERMEDIATE EXAMINATION
GROUP II

(SYLLABUS 2012)

SUGGESTED ANSWERS TO QUESTIONS
JUNE 2016

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.

Section - A

Answer all *the* following questions.

1. Answer the following questions: 2×5 = 10

(a) NR Limited developed a know-how by incurring expenditure of ₹35 lakhs. The know-how was used by the company from 1st April, 2009. The useful life of the asset is 10 years from the year of commencement of its use. The company has not amortised the asset till 31st March, 2016. Pass journal entry to give effect to the value of know-how as per Accounting Standard (AS)-26 for the year ended 31st March, 2016.

(b) Aarti Limited took over assets of ₹35,46,000 and liabilities of ₹4,85,000 of Jatin Enterprises at an agreed value of ₹33,65,000. Give the necessary journal entry to record the purchase of business in the books of Aarti Limited.

(c) State the maximum limit of managerial remuneration payable by a company earning adequate profits if the company has only three part-time directors and three whole time directors.

(d) Net profit for the year 2014-15 ₹ 25,00,000 and 2015-16 ₹75,00,000. No. of equity shares outstanding until 31st Dec, 2015: 20,00,000. Bonus issue on 1st January, 2016 was one equity share for each equity share outstanding on 31st Dec, 2015.

Calculate Basic Earnings per Share.

(e) Unsecured creditors are ₹3,16,000 out of which preferential creditors are for ₹ 28,800. Amount available for both is ₹3,02,000. Liquidator's remuneration is payable @ 3% on the amount distributed to unsecured creditors (excluding preferential creditors). Calculate the liquidator's remuneration and amount distributed to unsecured creditors.

Answer 1:

(a) **Journal Entry**

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
2016 Mar.,31	Statement of P & L(Prior Period item) Dr. Depreciation A/c Dr. To Know-how A/c (Being depreciation of 7 years charged out of which 6 years charged as prior period item)		21,00,000 3,50,000	 24,50,000

(b) **Journal Entry**

Date	Particulars	L.F.	Debit (₹)	Credit (₹)
	Sundry Assets A/c Dr. Goodwill A/c(Balancing figure) Dr. To Sundry Liabilities A/c To Jatin Enterprises A/c (Being the purchase of business of Jatin Enterprises)		35,46,000 3,04,000	 4,85,000 33,65,000

(c) Maximum managerial remuneration payable, 1% of net profit for the part time directors and 10% of net profit for the whole time directors.

(d) EPS for 2015 – 2016 = $\frac{₹75,00,000}{(20,00,000+20,00,000)}$ = ₹1.875

Adjusted EPS for 2014 – 2015 = $\frac{₹25,00,000}{40,00,000}$ = ₹0.625

(e)

Particulars	₹
Total amount available Less: Paid to preferential creditors Amount available for commission as well as for unsecured creditors ₹2,87,200 Less: Liquidator's remuneration (2,73,200 × $\frac{3}{100+3}$)	3,20,000 28,800 2,73,200 7,957
Amount distributed to unsecured creditors	2,65,243

2. Match the following items in Column 'A' with items shown in Column 'B' **1×5 = 5**

Column 'A'		Column 'B'	
1.	**Treatment of Voluntary Retirement Scheme Payments**	**A.**	**Capital Reserve**
2.	**Balance of Forfeited Shares A/c**	**B.**	**Amalgamation**
3.	**Interest and Dividend Received**	**C.**	**AS-26**
4.	**Pooling of Interest Method**	**D.**	**AS-15**
5.	**Recognition of an Intangible Asset**	**E.**	**Investing Activities of Cash Flow**

Answer 2:

	Column 'A'		Column 'B'
1.	Treatment of Voluntary Retirement Scheme Payments	D.	AS – 15
2.	Balance of Forfeited Shares A/c	A.	Capital Reserve
3.	Interest and Dividend Received	E.	Investing Activities of Cash Flow
4.	Pooling of Interest Method	B.	Amalgamation
5.	Recognition of an Intangible Asset	C.	AS-26

3. Answer *any two* questions: 5×2 = 10

(a) What is Statutory Audit?

(b) What is Test Checking?

(c) What do you understand by Audit Evidence?

(d) What are basic features of Continuous Audit?

(e) Define Secretarial Audit.

Answer 3:

(a) Statutory audit is the checking of accounts required by law. A statute or law may require having an annual audit of financial records of a company or any other entity. The law may require the audit to be conducted in the specified manner. The manner of reporting, contents of the report and the authority to which the report of auditors should be presented are all specified by the statute. Statutory audits are mandatory in nature.

(b) Test checking is concerned with selecting and examining a representative sample from a large number of similar items. There is no hard and fast rule of selecting item for the test checking. The justification for the test checking lies in the theory of probability which states that a sample selected from a series of items will tend to exhibit the same characteristics as present in the population, i.e. full series of items.

(c) Audit Evidence:
While auditing, the auditor come across various assertions of the management. The auditor has to evaluate these assertions so that he would be able to express his opinion on the financial statements. This evaluation can be made in the light of some facts and reasons. These facts and reasons are called 'Audit Evidence'.

(d) Following are the basic features of Continuous Audit:

i. It is a process conducted throughout the year.
ii. It is conducted at regular or irregular intervals.
iii. It focuses on testing 100% of transactions.
iv. Technology is important to enabling it.
v. It provides advance notice about errors and irregularities detected.
vi. Surprise visits by the auditor are involved.

(e) Secretarial audit is a compliance audit by an independent professional who is a qualified Company Secretary in practice. Secretarial audit is not an audit of financial records but an audit of various requirements of all the corporate and other laws applicable on a company. Thus it covers not only compliance of the Companies Act,2013 but also of economic law, industrial laws, labour laws etc.

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Section – B

Answer *any three* questions from Q. No. 4, 5, 6 and 7.

4. (a) Following Balances are provided by the Meenakshi Ltd. for the year ended 31st March, 2015 and 2016:

Particulars	31.03.2015 ₹	31.03.2016 ₹
Equity Share Capital	120,00,000	140,00,000
General Reserve	74,00,000	89,00,000
Profit & Loss A/c	42,00,000	60,00,000
11% Debentures	100,00,000	60,00,000
Goodwill	20,00,000	16,00,000
Land & Building	140,00,000	130,00,000
Plant & Machinery	120,00,000	132,00,000
Investment (Non trading)	48,00,000	44,00,000
Creditors	37,00,000	43,00,000
Provision for tax	25,50,000	38,40,000
Proposed Dividend	18,00,000	25,20,000
Stock	80,00,000	77,00,000
Debtors	57,60,000	83,00,000
Cash at Bank	17,60,000	18,60,000
Prepaid Expenses	3,00,000	2,20,000

Additional Information:

(i) Investment were sold during the year for ₹ 7,00,000.
(ii) During the year an old machine costing ₹ 16,00,000 was sold for ₹7,20,000. Its written down value was ₹ 9,00,000.
(iii) Depreciation charged on plant and machinery @20% on the opening balance.
(iv) There was no purchase or sell of land and building during the year.
(v) Provision for tax made during the year was ₹ 32,20,000.
(vi) During the year premium on redemption of debentures ₹ 4,00,000 was written-off.

You are required to prepare a statement showing the net cash flow from the operating activities. 9

(b) X Ltd. has leased equipment over its useful life that costs ₹7,46,55,100 for a three year lease period. After the lease term the asset would revert to the Lessor. You are informed that:

(i) The estimated unguaranteed residual value would be ₹ 1 lakh only.
(ii) The annual lease payments have been structured in such a way that the sum of their present values together with that of the residual value of the asset will equal the cost thereof.
(iii) Implicit interest rate is 10%.

You are required to ascertain the annual lease payment and the unearned finance income. P. V. factor @ 10% for years 1 to 3 are 0.909, 0.826 and 0.751 respectively. 6

Answer 4:

(a) Statement Showing Net Cash Flow from Operating Activities for the year ending 31st March, 2016

Particulars	₹	₹
Profit & Loss A/c as on 31.03.2016 Less: Profit &Loss A/c as on 31.03.2015		60,00,000 42,00,000
 Add: Transfer to General Reserve Provision for tax	 15,00,000 32,20,000	18,00,000
Proposed Dividend	25,20,000	72,40,000
Profit before tax Adjustment for Depreciation: Land & Building Plant & Machinery Profit on sale of Investment (7,00,000 - 4,00,000) Loss on sale of Plant & Machinery Goodwill written-off Premium on redemption of debentures written-off Operating Profit before Working Capital Changes W. C. Changes: Decrease in Prepaid Expenses Decrease in Stock Increase in Debtors Increase in Creditors Cash generated from operations Income Tax paid	 10,00,000 24,00,000	90,40,000 34,00,000 (3,00,000) 1,80,000 4,00,000 4,00,000 1,31,20,000 80,000 300000 (25,40,000) 6,00,000 1,15,60,000 (19,30,000)
Net Cash Inflow from Operating Activities		96,30,000

Working Notes:

Provision for Tax Account

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Bank A/c (Balancing figure)	1930000	By Balance b/d	2550000
To Balance c/d	3840000	By Profit & Loss A/c)	3220000
	57,70,000		57,70,000

Investment Account

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Balance b/d	4800000	By Bank A/c (sale) By	700000
To Profit & Loss A/c (profit)	300000	Balance c/d	4400000
	51,00,000		51,00,000

(b) **(I) Calculation of Annual Lease Payment**

Cost of the equipment	₹7,46,55,100
Unguaranteed Residual Value	₹1,00,000
PV of unguaranteed residual value (₹1,00,000 × 0.751)	₹75,100

Fair value to be recovered from Lease Payment (₹7,46,55,100 - ₹ 75,100)	₹7,45,80,000
PV factor for 3 years @ 10%	2.486
Annual Lease Payment (₹7,45,80,000 / PV Factor for 3 years @ 10% i.e. 2.486) -	₹3,00,00,000

(II) Calculation of Unearned Finance Income

	₹
Total lease payments [₹3,00,00,000 × 3]	9,00,00,000
Add: Residual value	1,00,000
Gross Investments	9,01,00,000
Less: Present value of Investments (₹7,45,80,000 + ₹75,100)	(7,46,55,100)
Unearned Finance Income	1,54,44,900

5. (a) The following balances were shown in the Balance Sheet of Anukula Limited as at 31st March, 2015:

	₹
8,00,000 Equity Shares of ₹10 each fully paid up	**80,00,000**
50,000, 8% Preference Shares of ₹100 each ₹80 paid up	**40,00,000**
Capital Reserve	**35,00,000**
General Reserve	**80,00,000**
Securities Premium	**70,00,000**
Profit & Loss Account	**52,00,000**
12% Debentures	**10,00,000**
Non-Current Investment at cost	**65,00,000**
Cash and Bank	**92,00,000**

Additional Information:

(i) The company passed a resolution to buy-back 20% of its equity capital @ ₹35 per share. For this purpose, it sold its investments of ₹30 lakhs for ₹28 lakhs.

(ii) The company redeemed the preference shares at a premium of 25%.

(iii) Included in its investments were 'Investments in own debentures' costing ₹10 lakhs (face value ₹11.50 lakhs). These debentures were cancelled.

You are required to pass necessary journal entries in the books of the company for above. 10

(b) Write a short note on the sources of Buy Back of Shares. 5

Answer 5:

(a) **Journal Entries in the Books of Ankula Limited**

(₹ in Lakhs)

	Particulars	Dr.	Cr.
1.	Bank A/c Dr. Profit and Loss A/c Dr. To Investment A/c (Being investment sold for the purpose of buy-back of Equity Shares)	28 2	 30
2.	Preference Share Final Call A/c Dr. To 8% Preference Share Capital A/c (Being final call money due)	10	 10

3.	Bank A/c Dr. To Preference Share Final Call A/c (Being call money received)	10	 10
4.	8% Preference Share Capital A/c Dr. Premium on Redemption of Preference Shares A/c Dr. To Preference Shareholders A/c (Being redemption of preference share capital at premium of 25%.)	50 12.50	 62.50
5.	Preference Shareholders A/c Dr. To Bank A/c (Being payment made to preference shareholders)	62.50	 62.50
6.	General Reserve A/c Dr. To Capital Redemption Reserve A/c (Refer Note) (Being creation of capital redemption reserve)	66	 66
7.	Equity Share Capital A/c Dr. Securities Premium A/c Dr. (Premium payable on buy-back) To Equity Shares Buy-back A/c (Being the amount due on buy-back of equity shares)	16 40	 56
8.	Equity Shares Buy-back A/c Dr. To Bank A/c (Being payment made for buy-back of equity shares)	56	 56
9.	12% Debentures A/c Dr. To Own Debentures A/c To Capital Reserve Ac (Profit on cancellation) (Being own debentures cancelled at profit)	11.5	 10 1.50
10.	Securities Premium A/c Dr. To Premium on Redemption of Preference Shares A/c (Being premium on redemption of preference shares adjusted through securities premium)	12.50	 12.50

Note: Transfer to Capital Redemption Reserve A/c as:

	₹
For Redemption of P. S. Capital	50 lakhs
For Buy-back of Equity Shares	16 Lakhs
Total	66 lakhs

(b) Source of Buy-back of shares:

The Companies Act 2013, permits companies to buy-back their own shares and other securities. A company may now, purchase its own shares or other specified securities out of -

(i) Its free reserves; or
(ii) The securities premium account; or
(iii) The proceeds of any shares or other specified securities.

Provided that no buy-back of any kind of shares or other specified securities shall be made out of the proceeds of an earlier issue of the same kind of shares or same kind of other specified securities.

The expression specified securities includes employees' stock option or other securities as may be notified by the Central Government from time to time, 'Free Reserves' means those reserves which, as per the latest audited balance sheet of the company, are free for distribution as dividend and shall include balance to the credit of securities premium account but shall not include share application money.

6. **(a) The Partners of Sewda Enterprises decided to convert the partnership firm into a Private Limited Company, Patel (P) Limited with effect from 1st January, 2015. However, company could be incorporated only on 1st June, 2015. The business was continued on behalf of the company and the consideration of ₹60,00,000 was settled on that day along with interest @18% per annum. The company availed loan of ₹90,00,000 @15% per annum on 1st June, 2015 to pay purchase consideration and for working capital. The company closed its accounts for the first time on 31st, March, 2016 and presents you the following summarised profit and loss statement:**

Particulars	₹	₹
Sales Revenue		198,00,000
Cost of goods sold	118,80,000	
Discount to dealers	4,62,000	
Directors' remuneration	6,00,000	
Salaries	9,00,000	
Rent	13,50,000	
Interest	15,75,000	
Depreciation	3,00,000	
Office expenses	10,50,000	
Sales promotion expenses	3,30,000	
Preliminary Expenses (to be written off in first year itself)	1,50,000	185,97,000
Profit		12,03,000

Sales from June, 2015 to December, 2015 were 2.5 times of the average sales of pre-incorporation period, which further increased to 3.5 times in January to March, 2016. The company recruited additional work force to expand the business. The salaries from July, 2015 doubled. The company also acquired additional showroom at monthly rent of ₹1,00,000 from July, 2015.

You are required to prepare a profit and loss statement showing apportionment of cost and revenue between pre-incorporation and post-incorporation period. 10

(b) The fair value of plan assets at the beginning and at the end of the year was ₹3,800 and ₹4,300 respectively. The employer's contribution to the plan during the year was ₹300. Benefit payments to retirees were ₹400.

Calculate the actual return to the plan assets. 5

Answer 6:

(a) **Profit and Loss Statement for the 15 months ended 31st March, 2016**

Particulars	Pre- Incorporation (5th months) ₹	Post-incorporation (10 months) ₹
I. Revenue from Operations	30,00,000	168,00,000
II. Expenses:		
Cost of goods sold	18,00,000	100,80,000
Employees Benefit Expense	1,87,500	13,12,500
Finance Cost (interest)	4,50,000	11,25,000
Depreciation	1,00,000	2,00,000

Other Expenses	6,20,000	27,22,000
	31,57,500	154,39,500
Profit (Loss) before Tax	(1,57,500)	13,60,500

Working Note:

1. Sales Ratio
   Let the average sales per month in pre-incorporation period be 'x'
   Sales (Pre-incorporation) = x × 5 =5x
   Sales (Post-incorporation) :
   From June to December, 2015(7 × 2.5x)+ from January to March,2016 (3 × 3.5x) =17.5x + 10.5x = 28x
   Hence, Sales Ratio = 5:28

2. Employees Benefit Expenses (Salaries + Directors' Remuneration)
   Let the average monthly salary from January, 2015 to June, 2015 be X
   Pre-incorporation salary= 5x
   Post-incorporation salary = x(June,2015) + 9 × 2x(July,15 to March,16)
   = x + 18x = 19x
   Hence, salary for pre-incorporation= 9,00,000 × 5/24 = ₹1,87,500
   Post-incorporation = Salary 9,00,000 × 19/24 = ₹7,12,500 + Directors' remuneration ₹6,00,000 = ₹13,12,500

3. Rent ,

	Pre-incorporation (₹)	Post-incorporation (₹)
Additional Rent (1,00,000 × 9)	-----------	9,00,000
Rent of old premises (13,50,000 – 9,00,000)	1,50,000	3,00,000
	1,50,000	12,00,000

4. Interest for pre-incorporation period = ₹ (60,00,000 × 18/100) × 5/12 = ₹4,50,000
   Interest for post-incorporation period = ₹ (90,00,000 × 15/100) × 10/12 = ₹11,25,000

5. Other Expenses

	Pre-incorporation (₹)	Post-incorporation (₹)
Discount to Dealers (5 : 28)	70,000	3,92,000
Rent (W. N. 3)	1,50,000	12,00,000
Sales Promotion Exp. (5 : 28)	50,000	2,80,000
Preliminary Exp.	-	1,50,000
Other Exp. (Time Ratio 1: 2)	3,50,000	7,00,000
	6,20,000	27,22,000

(b)

Particulars	**Amount (₹)**
Fair value of plan asset at the beginning of the year	3,800
Add: Employer's Contribution	300

Add: Actual Return	?
Less: Benefit Payments	(400)
Fair value of plan assets at the end of the year	4,300

Actual = Fair value at the closing of the year - Fair value of the plan assets at the opening of the year - Employer's Contribution + Benefit payments

= (₹4,300 -₹3,800 - ₹300 + ₹400) = ₹600.

7. (a) The Balance Sheets ZEET Ltd. and ASTAR Ltd. as on 31st March, 2015 were as follows:

Liabilities	ZEET Ltd.	ASTAR Ltd.
Equity Share Capital (fully paid shares of ₹20 each)	**30,000**	**12,000**
Securities Premium	**6,000**	**------**
General Reserve	**19,000**	**7,020**
Profit and Loss Account	**5,740**	**1,650**
12% Debentures	**------**	**2,000**
Bills Payable	**240**	**------**
Sundry Creditors	**5,820**	**2,330**
	66,800	**25,000**
Assets		
Land & Buildings	**12,000**	**------**
Plant and Machinery	**28,000**	**10,000**
Furniture & Fixtures	**4,608**	**3,400**
Stock	**15,724**	**8,082**
Debtors	**4,240**	**2,040**
Cash at Bank	**2,228**	**1,218**
Bills Receivable	**------**	**160**
Cost of Issue of Debentures	**---------**	**100**
	66,800	**25,000**

All the bills receivable held by ASTAR Ltd. were ZEET Ltd.'s acceptances.
On 1st April, 2016 ZEET Ltd. took over ASTAR Ltd. in an amalgamation in the nature of merger. It was agreed that in discharge of consideration for the business ZEET Ltd. would allot three fully paid equity shares of ₹20 each at par for every two shares held in ASTAR Ltd. It was also agreed that 12% debentures in ASTAR Ltd. would be converted into 13% debentures in ZEET Ltd. of the same amount and denomination. Expenses of amalgamation amounting to ₹ 2,00,000 were borne by ZEET Ltd. Pass necessary journal entries in the books of ZEET Ltd. **10**

(b) State the criteria of Reportable Segment as per AS-17. **5**

Answer 7:

(a)

Books of ZEET Ltd.
Journal Entries

Particulars	Dr.(₹)	Cr. (₹)
1. Business Purchase A/c Dr.	18,000	
To Liquidators of ASTAR Ltd.		18,000
(Being Business of ASTAR Ltd. taken over for consideration settled as per agreement)		
2. Plant and Machinery A/c Dr.	10,000	
Furniture & Fixtures A/c Dr.	3,400	
Stock A/c Dr.	8,082	
Debtors A/c Dr.	2,040	
Cash at Bank A/c Dr.	1,218	
Bills Receivable A/c Dr.	160	
To General Reserve A/c(7,020 – 6,000)		1,020
To Profit & Loss A/c (1,650 – 100)		1,550
To 12% Debentures A/c		2,000
To Sundry Creditors A/c		2,330
To Business Purchase A/c		18,000
(Being Assets and Liabilities taken over from ASTAR ltd.)		
3. Liquidator of ASTAR Ltd.A/c Dr.	18,000	
To Equity Share capital A/c		18,000
(Being discharge of consideration)		
4. General Reserve A/c** Dr.	2,00,000	
To Bank A/c		2,00,000
(Liquidation expenses paid by ZEET Ltd.)		
5. 12% Debentures A/c Dr.	2,000	
To 13% Debentures A/c		2,000
(Being 12% Debentures discharged)		
6. Bills payable A/c Dr.	160	
To Bills Receivable A/c		160
(Being adjustment for mutual owing on account of bills)		

**** It adjusted against Profit and Loss Account also.**

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

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

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

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

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

Whichever is greater in absolute amount: or

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

A business segment or a geographical segment which is not a reportable segment may be designated as a reportable segment despite its size at the discretion of the management of

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

Section – C

Answer *any two* questions from Q. No. 8, 9 and 10

8. (a) State the objectives of cost audit from the point of view of Government. 7
(b) Discuss briefly the scope of Audit Committee in public limited company. 8

Answer 8:

(a) The objective of Cost audit from the point of view of government:

(i) To ensure whether the national resources are prudently and optimally used.
(ii) To reduce cost of production of commodities and regularize their distribution.
(iii) To determine whether particular industry should be given subsidy/grants.
(iv) To determine whether particular industry should be protected from external competition.
(v) To make comparisons of cost parameters of different firms manufacturing same product.
(vi) To assess the costs of the same product on different regions so as to decide to grant incentives etc.
(vii) To fix the maximum price of a commodity.
(viii) To devise, apply and evaluate cost control measures.

(b) An Audit Committee consists of three to five members formed to serve as communication link among various departments. Audit Committee has a fourfold relationship and therefore has to interact with management, internal auditor, statutory auditor and the public.

The Scope of Audit Committee can be discussed as follows: -

(i) Review of annual financial statements before submission to the Board of Directors.
(ii) Selection of the Statutory Auditor
(iii) Act as lies on between the Statutory Auditor and Board of Directors
(iv) Administrative control of the internal control functions through the feedback between the Internal Auditor and the Audit Committee.
(v) Over seeing internal control operation.
(vi) Over seeing internal audit operations and feedback between internal audit committee and developing the internal auditing authority through broad based internal audit programming.
(vii) Review and approval of financial information for publication
(viii) Review proposed changes in accounting system and procedures.
(ix) Help resolve differences between management, internal and statutory auditor.
(x) Report on the audit committee acting in the Annual Reports of Board of Directors.
(xi) Ensure reliability of organisation's financial statements and operational activities. To be effective and purposeful, the audit committee should maintain the following:-

(1) Audit Committee should have the independence of management, Statutory

Auditor and Internal Auditor. The Board of Directors allows full freedom to the audit committee to investigate into any areas of operation.

(2) The relation between the audit committee and management should be cordial and congenial towards optimum efficiency and healthy growth of the organization.

(3) There should be a regular line of communication through occasional meetings with the management.

(4) There should be good communication relationship interwoven among management, internal auditor and statutory auditor.

9. (a) What is Audit Programme? State its advantages. 8

(b) Distinguish between clean audit report and qualified audit report. 7

Answer 9:

(a) An audit programme is a detailed plan of the auditing work to be performed, specifying the procedures to be followed in verification of each item and the financial statements and the estimated time required. To be more comprehensive, an audit programme is written plan containing exact details with regard to the conduct of a particular audit. It is a description or memorandum of the work to be done during an audit. Audit programme serves as a guide in arranging and distributing the audit work as well as checking against the possibility of the omissions.

The main advantages of an audit programme are as follows:

(i) It serves as a ready check list of audit procedures to be performed.

(ii) The audit work can be properly allocated to the audit assistants or the article clerks.

(iii) The auditor may easily know the extent of work done at any point of time. Thus, the progress of work done can be under the supervision and control of the auditor.

(iv) Audit programme would not only be useful for the audit assistants in carrying the audit work but for the principal too as he would be in a position to account for the individual responsibilities.

(v) A uniformity of the work can be attained as the same programme would be followed from time to time.

(vi) It is a useful basis for planning the programme for the following year.

(vii) It may be used as evidence by the auditor in the event when any charge is brought against him. He can prove that there has been no negligence on his part and he exercised reasonable care and skill while performing the task.

(b) Distinctions between Clean Audit Report and Qualified Audit Report

A clean report which is otherwise known as unconditional opinion is issued by the auditor when he does not have any reservation with regard to the matters contained in the financial statements. In such a case. the audit report may state that the financial statements give a true and fair view of the state of affairs and profit and loss account for the period. Under the following circumstances an auditor is justified, in issuing a clean report:

(a) the financial information has been prepared using acceptable accounting policies, which have been consistently applied;

(b) the financial information complies with relevant regulations and statutory requirements; and

(c) there is adequate disclosure of all material matters relevant to the proper presentation of the financial information, subject to statutory requirements, where applicable.

Qualified audit report, on the other hand, is one which does not give a clear chit about the truth and fairness of the financial statements but makes certain reservations. The gravity of such reservations will vary depending upon the circumstances. In majority of cases, items which are the subject matter of qualification are not so material as to affect the truth and fairness of the whole accounts but merely create uncertainty about a particular item. In such cases, it is possible for the auditors to report that in their opinion but subject to specific qualifications mentioned, the accounts present a true and fair view. Thus, an auditor may give his particular objection or reservation in the audit report and state "subject to the above, we report that balance sheet shows a true and fair view ....". The auditor must clearly express the nature of qualification in the report. The auditor should also give reasons for qualification. According to 'Statement on Qualifications in Auditor's Report' issued by the ICAI. All qualifications should be contained in the auditor's report. The words "subject to" are essential to state any qualification. It is also necessary that the auditors should quantify, wherever possible the effect of these qualifications on the financial statements in clear and unambiguous manner if the same is material and state aggregate impact of qualifications.

Thus, it is clear from the above, that in case of a clean report, the auditor has no reservation in respect of various matters contained in the financial statements but a qualified report may involve certain matters involving difference of opinion between the auditor and the management.

10. (a) What is Secret Reserve? How it may be created? How it is verified by an auditor? 8

(b) What are the special considerations to be kept in the mind during vouching? 7

Answer 10:

(a) Secret Reserve:

Any reserve not appearing on the Balance Sheet is called as a Secret Reserve. The existence of the reserve may be inferred from an intelligent verification of the accounts by the auditor even though the amount cannot be ascertained. Generally such type of reserve appears in financial institutions and insurance companies. Secret reserve may be created by -

i. Writing down the assets much below their cost
ii. Providing excessive depreciation
iii. Providing more reserve for doubtful debts etc.
iv. Writing down the goodwill considerably
v. Omitting certain assets from Balance Sheet
vi. Charging capital expenditure to revenue account
vii. Over valuing the liability
viii. Showing contingent liabilities as real liabilities etc., According to the Provisions of Companies Act, 2013, creation of Secret Reserve is prohibited except in the case of banking, financial, insurance and electricity companies.

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

i. Carefully enquire into the necessity of creating such reserve.
ii. Don't qualify audit report if it is found that the intention of the company is honest and the amount is reasonable.
iii. May pass a remark in audit report that the assets are understated,

iv. Discuss the fact, if found, that the director's intention behind creating secret reserve was not honest and only to facilitate improper dealing in shares.

(b) Special considerations during Vouching:

(A) It is important to note that in vouching of payments, the auditor does not merely seek proof that money has been paid away, but keeps into consideration the following relevant points:

i. Checking the relevant documentary evidence: It helps in assuring the genuineness of the transaction and accuracy in its recording.
ii. Checking the authority on the basis of which the entry has been made: It helps in assuring that the transaction has actually occurred.
iii. Confirming that the amount mentioned in the voucher has been posted to the appropriate account: It helps in assuring the proper classification according to accounting policies and practices.
iv. Checking that complete disclosure regarding the nature of the transaction is made.

(B) Thus, the general principles of vouching as well as auditing can be listed as under:

i. Genuineness
ii. Accuracy
iii. Authenticity
iv. Authorization
v. Classification
vi. Disclosure

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