

INTERMEDIATE EXAMINATION

GROUP - II (SYLLABUS 2016)

SUGGESTED ANSWERS TO QUESTIONS JUNE - 2018

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 alternatives: 1×6=6
- (i) Premium on redemption of redeemable preference shares can be paid out of
 - (A) Capital Redemption Reserve Account
 - (B) Existing Shares Premium Account
 - (C) Proceed of fresh issue of shares
 - (D) All of the above
 - (ii) Which of the following is not a component of Cash Flow Statement?
 - (A) Cash payments to suppliers for goods and services
 - (B) Charging of Depreciation
 - (C) Cash advances and loans made to third parties
 - (D) Cash repayments of amounts borrowed
 - (iii) The Electricity Act, 2003 replaced which of the following three existing legislations?
 - (A) The Indian Electricity Act, 1910
 - (B) The Electricity (Supply) Act, 1948
 - (C) The Electricity Regulatory Commissions Act, 1998
 - (D) All of the above
 - (iv) General Ledger of a Banking Company does not contain
 - (A) Control Accounts of all personal ledgers
 - (B) Assets Accounts
 - (C) Contra Accounts
 - (D) Balance Sheet
 - (v) Which of the following is a principle of insurance?
 - (A) Principle of indemnity
 - (B) Insurable interest
 - (C) Principle of uberrimae fidei
 - (D) All of the above
 - (vi) Underwriting commission payable on the shares taken up by the promoters is

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- (A) 2.5%
 (B) 2%
 (C) 5%
 (D) Nil

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

	Column 'A'		Column 'B'
1.	Government Grants	A.	Capital Redemption Reserve
2.	Redemption of Debentures	B.	AS 16
3.	Un-guaranteed Residual Value	C.	AS 12
4.	Borrowing Cost	D.	AS 19

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

- (i) Marked applications are those applications which bear the stamp of an underwriter.
 (ii) In order to spread the risk of under-subscription, the principal underwriters may enter into subsidiary agreements with sub-leasees.
 (iii) When debentures are issued at discount, it is prudent to write off the loss during the life of debentures.
 (iv) Any surplus cash may be utilized by the company for buy-back and avoid the payment of dividend tax.

Answer:

1. (a)

(i)	B
(ii)	B
(iii)	D
(iv)	D
(v)	D
(vi)	D

(b)

1	C
2	A
3	D
4	B

(c)

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

2. (a) On 01.01.2017 Jay Ltd. had 2,000, 12% Debentures of ₹ 100 each. On 01.05.2017 the company purchased 400 own Debentures at ₹ 97 cum-interest in the open market. Interest on debentures is payable on 30th June and 31st December each year.

Required: Give the necessary journal entries assuming that the own Debentures purchased were retained as investments till 31.12.2017, on which date they were cancelled.

Assume that the company follows English Calendar Year. 6

- (b) M/s. Ayush Ltd. began construction of a new building on 1st January, 2017. It obtained ₹ 3,00,000 lakh special loan to finance the construction of the building on 1st January, 2017 at an interest rate of 12% p.a. The company's other outstanding two

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non-specific loans were:

Amount	Rate of Interest
₹ 6,00,000	11% p.a.
₹ 11,00,000	13% p.a.

The expenditure that were made on the building project were as follows:

	Amount (₹)
January, 2017	3,00,000
April, 2017	3,50,000
July, 2017	5,50,000
December, 2017	1,50,000

Building was completed on 31st December, 2017. Following the principles prescribed in AS 16 on 'Borrowing Cost', calculate the amount of interest to be capitalized and pass one Journal entry for capitalizing the cost and borrowing in respect of the building.

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Answer:

2. (a)

Journal of Jay Ltd.

Date	Particulars	L.F.	Dr.(₹)	Cr.(₹)
May 01	Own Debentures A/c Interest on Own Debenture A/c To Bank A/c (Being the purchase of 400 debentures @ ₹97 cum-interest)	Dr. Dr.	37,200 1,600	38,800
June 30	Debentures Interest A/c To Interest on Own Debentures A/c To Bank A/c (Being the interest paid/credited on ₹2,00,000 debentures held by outsiders and by the company own debentures for 2 months)	Dr.	12,000	2,400 9,600
Dec. 31	Debentures Interest A/c To Bank A/c To Interest on Own Debentures A/c (Being the interest paid / credited on ₹1,60,000 debentures held by outsiders and ₹40,000 own debentures for six months)	Dr.	12,000	9,600 2,400
Dec. 31	Profit and Loss A/c To Debenture Interest A/c (Being the transfer of debenture interest to P&L A/c)	Dr.	24,000	24,000
Dec. 31	Interest on Own Debentures A/c To Profit & Loss A/c (Being the transfer of interest on own debentures to P&L A/c)	Dr.	3,200	3,200
Dec. 31	12% Debentures A/c To Own Debentures A/c To Capital Reserve A/c (Being the cancellation of 400 own debentures)	Dr.	40,000	37,200 2,800
Dec. 31	Profit & Loss Appropriation A/c To Debenture Redemption Reserve A/c (Being the transfer of an amount equivalent to the cash sum applied in redeeming the debentures)	Dr.	37,200	37,200

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(b) (i) Computation of average accumulated expenses:

	₹
₹3,00,000 X 12/12	3,00,000
₹ 3,50,000 X 9/12	2,62,500
₹ 5,50,000 X 6/12	2,75,000
₹ 1,50,000 X 1/12	12,500
₹ 13,50,000	8,50,000

(ii) Calculation of average interest rate other than for specific borrowings:

Amount of loan (₹)	Rate of interest	Amount of interest (₹)
6,00,000	11 %	= 66,000
11,00,000	13%	=1,43,000
17,00,000		2,09,000
Weighted average rate of interest	$\frac{2,09,000}{17,00,000} \times 100$	=12.29%

(iii) Interest amount to be capitalized:

Particulars	₹
Specific borrowings (₹ 3,00,000 × 12%)	= 36,000
Non-specific borrowings [₹ 5,50,000 (₹ 8,50,000 - ₹ 3,00,000) × 12.29%]	= 67,595
Amount of interest to be capitalized	= 1,03,595

(iv) Computation of actual interest costs incurred during the year —

Particulars	Amount (₹)
₹3,00,000 × 12%	36,000
₹6,00,000 × 11%	66,000
₹11,00,000 × 13%	1,43,000
	2,45,000

Amount to be capitalized is ₹13,50,000 + ₹1,03,595 i.e. ₹14,53,595 which is not more than ₹2,45,000.

(iv)

Journal Entry

Date	Particulars	Dr. (₹)	Cr. (₹)
31.12.2017	Building Account (13,50,000 + 1,03,595) Dr. To Bank Account (Being amount of cost of building and borrowing cost thereon capitalized)	14,53,595	14,53,595

3. (a) The following are the summarized Balance Sheets of ABC Limited as on 31st March, 2016 and 2017:

Liabilities	31.03.16	31.03.17	Assets	31.03.16	31.03.17
Share Capital	4,60,000	4,60,000	Land & Building	3,00,000	3,00,000
Profit & Loss Balance	32,000	46,000	Machinery	1,04,000	1,40,000
Reserve	1,20,000	1,20,000	Investments	2,20,000	1,48,000
8% Debentures	1,80,000	1,40,000	Stock	1,64,000	2,12,000
Depreciation Fund	80,000	88,000	Debtors	1,34,000	86,000
Creditors	2,06,000	1,92,000	Cash	1,80,000	1,80,000
Outstanding expenses	26,000	24,000	Prepaid expenses	2,000	4,000
	11,04,000	10,70,000		11,04,000	10,70,000

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Additional Information:

- (i) 10% Dividend was paid during 2016-17.
- (ii) Old Machinery costing ₹ 24,000 (accumulated depreciation ₹ 12,000) was sold for ₹ 8,000.
- (iii) 40,000 8% Debenture were redeemed by purchase from open market at ₹ 96 for a debenture of ₹ 100 on 31.03.2017.
- (iv) Investments worth ₹ 72,000 were sold at book value.
- (v) Bad debt written off during the year ₹ 10,000.

Prepare a Statement of Cash Flow for the year ended 31.03.2017. 8

- (b) Given below are details of interest on advance of a Commercial Bank as on 31.03.2017:

Particulars	Interest Earned (₹ in Crore)	Interest Received (₹ in Crore)
Performing Assets		
Term Loan	120	80
Cash Credit and Overdraft	750	620
Bills Purchased and Discounted	150	150
Non-Performing Assets		
Term Loan	75	5
Cash Credit and Overdraft	150	12
Bills Purchased and Discounted	100	20

Find out the income to be recognized for the year ended 31st March, 2017. 4

Answer:

3. (a)

ABC Ltd.

Cash Flow Statement for the year ended 31.03.2017

Particulars	₹	₹	₹
1. Cash Flows under Operating Activities			
Operating Profit (As per adjusted P/L A/c)		96,800	
Add: Decrease in Debtors		48,000	
		1,44,800	
Less: Increase in stock	48,000		
Increase in prepaid expenses	2,000		
Decrease in creditors	14,000		
Decrease in outstanding expenses	2,000	66,000	
Net cash from Operating Activities			78,800
2. Cash Flows from Investing Activities :			
Sale of machinery		8,000	
Sale of investment		72,000	
Less: Purchase of machinery		80,000	
Net cash from Investing		60,000	20,000
3. Cash Flows from Financing Activities :			
Redemption of Debenture (96/100 × 40,000)		(38,400)	
Payment of interest		(14,400)	
Payment of dividend		(46,000)	
Net cash from Financing activities			(98,800)
Net change in cash and cash equivalent for the year			Nil
Add : Cash at the beginning of the year			1,80,000
Cash at the end of the year			1,80,000

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(1) Machinery Account

Dr.			Cr.
Particulars	₹	Particulars	₹
To Balance b/d	1,04,000	By Bank - Sale proceeds	8,000
" Bank - Purchase (Bal. Fig.)	60,000	" Depreciation fund	12,000
		" Adj. P/L A/c - loss on sale	4,000
		By Balance c/d	1,40,000
	1,64,000		1,64,000

(2) Depreciation Fund Account

Dr.			Cr.
Particulars	₹	Particulars	₹
To Machinery A/c	12,000	By Balance b/d	80,000
To Balance c/d	88,000	" Adj. P/L A/c— Depreciation	20,000
	1,00,000		1,00,000

(3) Investment Account

Dr.			Cr.
Particulars	₹	Particulars	₹
To Balance b/d	2,20,000	By Bank	72,000
		By Balance c/d	1,48,000
	2,20,000		2,20,000

(4) Adjusted Profit & Loss Account

Dr.			Cr.
Particulars	₹	Particulars	₹
To Machinery A/c - loss on sale	4,000	By Balance b/d	32,000
" Depreciation Fund - Depreciation	20,000	" 8% Debenture-Profit on cancellation	1,600
" Dividend	46,000	By Operating profit (Bal. figure)	96,800
" Interest (1,80,000 x 8/100);	14,400		
To Balance c/d	46,000		
	1,30,400		1,30,400

Note: There is no need to make any adjustment entry for bad debt as it has already been written off.

- (b) As per RBI Circular, Interest on non-performing assets are considered on Cash Basis whereas interest on performing assets are considered on Accrual Basis.

Statement Showing the Recognition of Income

(₹ in Crore)

Particulars	Amount (₹)	Amount (₹)
1. Interest on Term Loans		
(i) Performing Assets	120	
(ii) Non-performing Assets	5	
		125
2. Interest on Cash Credit and Overdraft		
(i) Performing Assets	750	
(ii) Non-performing Assets	12	
		762
3. Interest on Bills Purchased and Discounted		
(i) Performing Assets	150	
(ii) Non-performing Assets	20	
		170
Income to be recognized		1057

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4. ABC Limited has an authorized capital of ₹ 5,00,000 divided into 5000 equity shares of ₹ 100 each. On 31.03.2018, 2500 shares were fully called up. The following are the balance extracted from the ledger of the company as on 31.03.2018:

	₹		₹
Inventory	50,000	Advertisement	3,800
Sales	4,25,000	Bonus	10,500
Purchases	3,00,000	Accounts receivable	38,700
Productive wages	70,000	Accounts payable	35,200
Discount allowed	4,200	Plant and Machinery	80,500
Discount received	3,150	Furniture	17,100
Insurance (year up to 30.06.2018)	6,720	Cash at bank	1,30,000
Salaries	18,500	Cash in hand	4,700
Rent	6,000	Reserves	25,000
General expenses	8,950	Loan from Managing Director	15,700
Profit and Loss a/c (cr.)	6,220	Bad debts	3,200
Printing and Stationary	2,400	Calls in arrears	5,000
		Share capital	2,50,000

Also the following information are given:

- (a) Closing inventory is ₹ 91,500
- (b) Depreciation to be charged on plant and furniture at 15% and 10% respectively
- (c) Outstanding liabilities—wages at ₹ 5,200, salaries at ₹1,200 and rent at ₹ 600
- (d) Salesman are entitled to a commission of 1% on sales
- (e) ₹ 4,000 are to be transferred to General reserves
- (f) Dividend on paid up share capital is to be provided @ 5%

You are required to prepare Profit and Loss Statement for the year ended 31.03.2018 and the Balance Sheet as on that date in accordance with the Companies Act, 2013 in the Vertical Form along with the Notes on Accounts. 12

Answer:

4.

Balance Sheet of ABC Limited as on 31st March, 2018

Particulars	Note No.	Amount (₹)
I. Equity & Liabilities		
(1) Shareholders' Funds:		
(a) Share Capital	1	2,45,000
(b) Reserves & Surplus	2	30,995
(2) Non-Current Liabilities		
(a) Long Term Borrowing	3	15,700
(3) Current Liabilities:		
(a) Trade Payable		35,200
(b) Other Current Liabilities	4	11,250
(c) Short Term Provision	5	12,250
		3,50,395
II. Assets		
(1) Non-Current Assets		
Fixed Assets		
Tangible Assets	6	83,815
(2) Current Assets:		
(a) Inventories		91,500
(b) Trade Receivables		38,700
(c) Cash & Cash Equivalents		1,34,700
(d) Short Term Loans & Advances (Prepaid Insurance)		1,680
		3,50,395

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Profit and Loss Statement for the year ended 31st March, 2018

Particulars	Note No.	Amount (₹)	Amount (₹)
I. Revenue From Operation			4,25,000
II. Other Income			3,150
III. Total Revenue (I+II)			4,28,150
IV. Expenses:			
(a) Cost of material consumed	7	3,33,700	
(b) Employees cost/ benefits expenses	8	30,200	
(c) Depreciation & amortization expenses		13,785	
(d) Other expenses	9	38,440	
Total Expenses			4,16,125
V. Profit for the year (III-IV)			12,025
Balance brought forward from previous year			6,220
Profit available for appropriation			18,245
Appropriation:			
Proposed dividend		12,250	
Transfer to General Reserve		4,000	
			16,250
Balance carried forward			1,995

Notes:

1. Share Capital:	₹
Issued, Subscribed & Paid up	2,50,000
Less: Calls in arrears	5,000
	2,45,000
2. Reserves & Surplus:	
General Reserve	29,000
Surplus (P & L A/c)	1,995
	30,995
3. Long Term Borrowings:	
Unsecured:	
Loan from Managing Director	15,700
	15,700
4. Other Current Liabilities:	
Outstanding Expenses	7,000
Salesmen Commission	4,250
	11,250
5. Short Term Provisions:	
Proposed Dividend	12,250
	12,250

6. Tangible Fixed Assets:

Item	Closing Balance (₹)	Depreciation (₹)	Net (₹)
Plant & Machinery	80,500	12,075	68,425
Furniture	17,100	1,710	15,390
Total	97,600	13,785	83,815

7. Cost of materials consumed:	₹
Opening stock	50,000
Purchases	3,00,000
Less: Closing Stock	(91,500)
Wages	75,200
	3,33,700
8. Employees Benefit Expenses:	
Salary	19,700
Bonus	10,500

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	30,200
9. Other Expenses:	
Administrative Expenses (5,040+6,600+8,950+2,400)	22,990
Provision for bad debts	3,200
Marketing Expenses (4,200+3,800+4,250)	12,250
	38,440

5. Write short note on (any three):

4×3=12

- (a) Geographical Segment as per AS-17**
- (b) Advantages of buy-back of shares**
- (c) Distinguish between Life and Non-Life Insurance**
- (d) Share Application money pending allotment**

Answer:

- 5. (a)** A geographical segment is a distinguishable component of an enterprise that is engaged in providing products or services within a particular economic environment and that is subject to risk and returns that are different from those of components operating in other economic environments. Factors that should be considered in identifying geographical segments include:
- (i) Similarity of economic and political conditions;
 - (ii) Relationships between operations in different geographical areas;
 - (iii) Proximity of operations;
 - (iv) Special risks associated with operations in a particular area;
 - (v) Exchange control regulations; and
 - (vi) The underlying currency risks.
- (b)** Buy-back of shares have the following advantages:
- (i) A company with capital, which cannot be profitably employed, may get rid of it by resorting to buy-back, and re-structure its capital.
 - (ii) Free reserves which are utilized for buy-back instead of dividend enhance the value of the company's shares and improve earnings per share.
 - (iii) Surplus cash may be utilized by the company for buy-back and avoid the payment of dividend tax.
 - (iv) Buy-back may be used as a weapon to frustrate any hostile take-over of the company by undesirable persons.
- (c)** There are certain basic differences between life policies and other types of policies. These are listed below:
- (i) Human life cannot be valued exactly. Therefore each insured is permitted to insure his life for a specified sum, depending on his capacity to pay premiums. This is also one form of investment and the policy amount depends on his investment decision. In the event of the policy maturing, the insurer must pay the policy amount, as actual loss cannot be determined. This is not the case with other policies. Other policies are contracts of indemnity. Therefore, notwithstanding the amount for which the policy is taken, the insurer would pay (reimburse) only the actual loss suffered or the liability incurred.
 - (ii) Life insurance contracts are long-term contracts. Once a policy is taken, premiums have to be paid for number of years till maturity and the policy amount is paid on maturity. Of course, a life policy can be surrendered after certain number of years and the insured is paid a proportion of the premiums paid known as surrender value. In the case of other policies, they are for a short period of one year although the policy can be renewed year after year.
 - (iii) Life insurance is known also by another term 'assurance' since the insured gets an assured sum. Other policies are known as insurance.
 - (iv) The determination of profit is by different methods for life and general insurance business. In the case of life business, periodically actuaries estimate the liability

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under existing policies. On that basis, a valuation Balance Sheet is prepared to determine the profit. In the case of general insurance business, a portion of the premium is carried forward as a provision for unexpired liability and the balance net of claims and expenses is taken as profit (or loss).

(d) Share application money pending allotment

As per Schedule III it is to be shown as a separate line item on the face of Balance Sheet. Other provisions in this respect are as follows:

- (i) Share Application Money not exceeding the Issued Capital and to the extent not refundable, is to be disclosed as a separate line item after - Share Holders Funds and before - Non-Current Liabilities.
- (ii) If the Company's Issued Capital is more than the Authorized Capital, and approval of increase in Authorized Capital is pending, the amount of Share Application Money received over and above the Authorized Capital should be shown under the head - Other Current Liabilities.
- (iii) The amount shown as Share Application Money Pending Allotment will not include Share Application Money to the extent refundable. For example, the amount, in excess of Issued Capital, or where Minimum Subscription requirement is not met. Such amount will have to be shown separately under 'Other Current Liabilities'.
- (iv) Calls Paid in Advance are to be shown under - Other Current Liabilities. The amount of interest which may accrue on such advance should also be reflected as a Liability.

Section - B (Audit)

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

- 6. (a) Identify the correct alternative in each of the following cases: 1×6=6**
- (i) If the Debentures are issued as collateral security either to Banks or Creditors the Auditor needs to ensure that such issue is approved by**
 - (A) Shareholders**
 - (B) Board of Directors**
 - (C) Debenture Trustee**
 - (D) Audit Committee**
 - (ii) As per SQC 1, Audit working papers should be retained for a period of**
 - (A) 2 years**
 - (B) 5 years**
 - (C) 7 years**
 - (D) 10 years**
 - (iii) Current Audit files contains**
 - (A) Articles of Association and Memorandum of Association**
 - (B) Analysis of significant ratios and trends**
 - (C) Notes regarding significant Accounting policies**
 - (D) Audit Programme**
 - (iv) Form for maintenance of Cost Records of a Company is**
 - (A) CRA-1**
 - (B) CRA-2**
 - (C) CRA-3**
 - (D) CRA-4**
 - (v) Secretarial Audit is applicable to every Public Company having a turnover of**
 - (A) ₹ 100 crores**

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- (B) ₹ 150 crores
- (C) ₹ 250 crores
- (D) ₹ 200 crores

(vi) Statutory Auditor is appointed by the Shareholders in the

- (A) General Meeting
- (B) Statutory Meeting
- (C) EGM
- (D) Board Meeting

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

	Column 'A'		Column 'B'
1.	Independent appraisal activity	A	Secretarial Audit Report
2.	SA700	B	Section 123
3.	Form MR3	C	Internal Audit
4.	Declaration of dividend	D	Forming an opinion and reporting on financial statements

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

- (i) Section 70 deals with the Audit of Debenture.
- (ii) An Audit Committee should have 4 directors.
- (iii) CARO-Companies (Auditor's Report) order, 2016 is applicable to Banking Companies.
- (iv) Internal Check is part of Accounting Control.

Answer:

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

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

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

7. (a) Distinguish between Permanent and Current Audit File. 6

(b) "Internal Audit is an important tool for the management."—Discuss. 6

Answer:

7. (a) Permanent and Current Audit File: In case of recurring audits, some working papers files may be classified into permanent audit files and current audit files: while the former is updated with the information of continuing importance, the latter contains information relating to audit of a single period. The contents of these files are given below:

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Sr. No.	Permanent Audit File	Current Audit File
1	Legal and organizational structure of the entity, e.g. Memorandum of Association and Article of Association in case of a company	Correspondence relating to acceptance of annual re-appointment
2	Extracts or copies of legal documents, agreements and minutes relevant to the audit.	Extracts of important matters in the minutes of Board Meetings and General Meetings relevant to the audit
3	A record of study and evaluation of internal controls	Copies of management letters
4	Analysis of significant ratios and trends.	Analysis of transactions and balances
5	Copies of the audited financial statements of previous year(s)	Copies of communication with other auditors, experts and third parties
6	Notes regarding significant accounting policies	Audit programme
7	Significant audit observations of the earlier years	Conclusions reached on significant aspects of audit

(b) Internal audit is an important management tool for the following reasons:

- a. Internal audit ensures compliance of Companies (Auditors Report) Order, 2016.
- b. It ensures compliance of accounting standards and policies.
- c. It ensures reliability of MIS through internal audit's independent appraisal and review.
- d. It looks into the standard of efficiency of business operation.
- e. It can evaluate various problems independently and suggest improvement.
- f. This system makes the internal control system effective.
- g. It ensures the adequacy, reliability, accuracy and understandability of financial and operational data.
- h. It performs as an integral part of 'Management by system'.
- i. It can add valuable assistance to management in acquiring new business, promoting new products and expansion or diversification of business etc.

8. (a) Discuss the provisions of Companies Act, 2013 as regards reporting of frauds by Company Auditor. **6**

(b) Discuss about the manner in which rotation of Auditors may be done by the company on expiry of their term. **6**

Answer:

8. (a) The provisions of Companies Act 2013 regarding reporting of frauds by a company auditor are as follows:

- (1) 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.
 - (i) 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;
 - (ii) 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;

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- (iii) 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.
- (2) 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.
- (3) 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.
- (4) The report shall be in the form of a statement as specified in Form ADT-4.
- (5) 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 20,4 respectively.
- (b)** The Audit Committee shall recommend to the Board, the name of an individual auditor or of an audit firm who may replace the incumbent auditor on expiry of the term of such incumbent.
- (1) Where a company is required to constitute an Audit Committee, the Board shall consider the recommendation of such committee, and in other cases, the Board shall itself consider the matter of rotation of auditors and make its recommendation for appointment of the next auditor by the members in annual general meeting.
- (2) For the purpose of the rotation of the auditors-
- (i) In case of an auditor (whether an individual or audit firm), the period for which the individual or the firm has held office as auditor prior to the commencement of the Act shall be taken into account for calculating the period of five consecutive years or ten consecutive years, as the case may be;
- (ii) The incoming auditor or audit firm shall not be eligible, if such auditor or audit firm is associated with the outgoing auditor or audit firm under the same network of audit firms.

Explanation I: For the purposes of these rules, the term "same network" includes the firms operating or functioning, hitherto or in future under the same brand name, trade name or common control.

Explanation II: For the purpose of rotation of auditors,-

- (a) A break in the term for a continuous period of five years shall be considered as fulfilling the requirement of rotation;
- (b) If a partner who is in charge of an audit firm and also certifies the financial statements of the company, retires from the said firm and joins another firm of chartered accountants, such other firm shall also be ineligible to be appointed for a period of five years.

(9) (a) What is the procedure to be followed for fixing the remuneration of a Cost Auditor? 5

(b) Distinguish between 'Audit Report' and 'Audit Certificate'.

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Answer:

(9) (a) Authority for fixing the Remuneration of a Cost Auditor:

Rule 14 of the Companies [Audit and Auditors] Rules 2014 has laid down the procedure of appointment and fixing the remuneration of a cost auditor. It states as follows:

Remuneration of the Cost Auditor: For the purpose of sub-section (3) of section 148 –

- (a) In the case of companies which are required to constitute an audit committee -
- (i) The Board shall appoint an individual, who is a cost accountant in practice, or a firm of cost accountants in practice, as cost auditor on the recommendations of the Audit committee, which shall also recommend remuneration for such cost auditor;
 - (ii) The remuneration recommended by the Audit Committee under (i) shall be considered and approved by the Board of Directors and ratified subsequently by the shareholders;
- (b) In the case of other companies which are not required to constitute an audit committee, the Board shall appoint an individual who is a cost accountant in practice or a firm of cost accountants in practice as cost auditor and the remuneration of such cost auditor shall be ratified by shareholders subsequently.

(b)

	Basis	Audit Report	Audit Certificate
1	Meaning	Audit Report is a statement of collected and considered information so as to give a clear picture of the state of affairs of the business to the persons who are not in possession of the full facts.	While Audit Certificate is a written confirmation of the accuracy of the information stated there in.
2	Opinion	Audit Report contains the opinion of the auditor on the accounts.	While Audit Certificate does not contain any opinion, but only confirms the accuracy of the figures with the books of accounts.
3	Basis	Audit Report is made out on the basis of information obtained and books of account verified by the auditor.	While Audit Certificate is made out on the basis of the particular data capable of verification as regards accuracy.
4	Guarantee	Audit Report may not guarantee correctness of financial statement in absolute terms.	While Audit Certificate guarantees absolute correctness of the figures and information mentioned in the Certificate.
5	Coverage	Audit Report always covers entire accounts of the concern.	While Audit Certificate covers only, certain part of the accounts of the concern.
6	Responsibility	Audit Report does not hold auditor responsible for anything wrong in the accounts.	While Audit Certificate makes an auditor responsible, if anything mentioned in the certificate found as wrong, later on.
7	Suggestion	Audit Report may provide certain suggestions for improvement.	While Audit Certificate does not provide any such suggestion.
8	Nature	Audit Report is based on the vouching and verification of books of accounts, voucher,	While Audit Certificate is based on checking arithmetical accuracy of the facts.

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		assets and liabilities.	
9	Scope	Audit Report covers all transactions done during the year.	While the Audit Certificate is very specific.
10	Characteristics	Audit Report is subjective, as it is opinion oriented.	While Audit Certificate is objective, as it is fact oriented
11	Form	Audit Report is required to be presented in the prescribed format.	While Audit Certificate, except in few cases, is not required to be presented in any standard format.
12	Address	Audit report is addressed to the members of the company at large or appointing authority.	While Audit certificate is addressed to particular person or sometimes may include the words like "To whomsoever it may concern."

10. Write short notes (any three):

4×3=12

- (a) Responsibility of a Joint Auditor
- (b) Elements of 'cost of inventory' as per AS 2
- (c) Audit of Education Institutions
- (d) Auditor's duty regarding Issue of Debentures

Answer:

10. (a) Responsibility of a Joint Auditor:

1. For the audit work divided among themselves, each joint auditor is responsible only for the work allocated to him. Accordingly, among other duties,
 - (i) Each joint auditor is required to scrutinize the audit report of the branch/divisions specifically allocated to him.
 - (ii) Each joint auditor is required to obtain and evaluate information and explanations from the management of the divisions, zones or units specifically allocated to him.
2. In respect of undivided work.
 - (i) In respect of decision taken jointly regarding the nature, timing or extent of audit procedures to be performed by any of the joint auditor. (However, they will be responsible only with respect to the appropriateness of the decision, proper execution of the audit procedures is the separate and specific responsibility of the joint auditor concerned.)
 - (ii) 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 them.
 - (iii) In respect of compliance with disclosure requirement (i.e. Notes on accounts) of the relevant statute while examining the financial statements.
 - (iv) For ensuring that the audit report complies with the requirements of the relevant statute.

(b) Elements of 'cost of inventory' as per AS 2

Cost of inventory includes the following

1. Cost of purchase
2. Cost of conversion
3. Other costs incurred in bringing the inventories to their present location and condition.
 1. Cost of purchase includes—
Purchase price, Duties and Taxes, Freight inward, other expenditures directly attributable to the acquisition less duties and taxes recoverable by enterprises

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from taxing authorities. Trade discount, Rebate, Duty drawback, Other similar items.

2. Cos of conversion —

It consists of the cost directly related to the units + Systematic Allocation of fixed and variable production overheads that are incurred in converting material into finished goods.

Fixed Production overhead means Indirect cost of production that remains relatively constant regardless of volume of production. Allocation of fixed production overhead is done on normal capacity.

Variable Production overhead means indirect cost of production that varies directly or nearly directly with the volume of production. Allocation of variable production overhead is done on actual production.

In case of Joint-products, when the cost of conversion of each product is not identifiable separately, total cost of conversion is allocated between the products on the rational and consistent basis, if by-products, scrap or waste materials are not of material value, they are measured at net realisable value, then the net realisable value is deducted from cost of conversion. Net cost of conversion is distributed among the main products.

3. Other costs: Cost incurred in bringing the inventories to their present location and condition.

(c) Audit of Education Institutions

The special steps involved in the audit of an educational institution are the following:

- (i) Examine the Trust Deed, or Regulations in the case of school or college and note all the provisions affecting accounts. In the case of a university, refer to the Act of Legislature and the Regulations framed there under.
- (ii) Read through the minutes of the meetings of the Managing Committee or Governing Body, noting resolutions affecting accounts to see that these have been duly complied with, specially the decisions as regards the operation of bank accounts and sanctioning of expenditure.
- (iii) Check names entered in the Students' Fee Register for each month or term, with the respective class registers, showing names of students on rolls and test amount of fees charged; and verify that there operates a system of internal check which ensures that demands against the students are properly raised.
- (iv) Check fees received by comparing counterfoils of receipts granted with entries in the cash book and tracing the collections in the Fee Register to confirm that the revenue from this source has been duly accounted for.
- (v) Total up the various columns of the Fees Register for each month preterm to ascertain that fees paid in advance have been carried forward and the arrears that are irrecoverable have been written off under the sanction of an appropriate authority.
- (vi) Check admission fees with admission slips signed by the head of the institution and confirm that the amount had been credited to a Capital Fund, unless the Managing Committee has taken a decision to the contrary.
- (vii) See that free studentship and concessions have been granted by a person authorised to do so, having regard to the prescribed Rules.
- (viii) Confirm that fines for late payment or absence, etc., have either been collected or remitted under proper authority.
- (ix) Confirm that hostel dues were recovered before students' accounts were closed and their deposits of caution money refunded.
- (x) Verify rental income from landed property with the rent rolls, etc.
- (xi) Verify the inventories of furniture, stationery, clothing, provision and all equipment, etc.
These should be checked by reference to Stock Register and values applied to various items should be test checked.
- (xii) Confirm that the refund of taxes deducted from the income from investment

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(interest on securities, etc.) has been claimed and recovered since the institutions are generally exempted from the payment of income-tax.

(xiii) Verify the annual statements of accounts and while doing so see that separate statements of account have been prepared as regards Poor Boys Fund, Games Fund, Hostel and Provident Fund of Staff, etc.

(d) Auditor's duty regarding Issue of Debentures:

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