Paper 12- Company Accounts & Audit

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Full Marks : 100 **Time allowed: 3 hours**

Section – A

1. Answer the following questions: [5x2=10]

(a) Explain when the research development cost of a project can be defused to future period as per AS-26.

Solution:

The expenditure incurred on account of research or development phase can be deferred to the subsequent years, if an enterprise can demonstrate all of the following, namely:

- The technical feasibility of completing the intangible asset so that it will not be available for use or sale.
- The intention to complete the intangible asset and use or sell it.
- The ability to use or sell the intangible asset.
- How the intangible asset will generate probable future economic benefits. Among other benefits, the enterprise should demonstrate the existence of a market for the output of the intangible asset.
- Availability of adequate technical, financial and other reseoruces to complete the development and to use of sell the intangible asset, and
- The ability to measure the expenditure attributable to the intangible asset during the development reliably.

(b) A company with an issued and subscribed capital of ₹ 10.00.000 in 1.00.000 shares of face value ₹ 10 each of which ₹ 8 per share is paid up has accumulated a reserve of ₹3,00,000. Out of this reserve ₹ 2,00,000 is intended to be utilized in declaring a bonus at the rate of 25% on the paid up capital so that the shares may become dully paid.
Show the necessary journal entries.

Solution:

Particulars	Debit ₹	Credit ₹
Equity share final call A/c Dr. To, Equity share capital A/c (Being the final call due on 1,00,000 Equity Shares @ ₹2 each)	2,00,000	 2,00,000
Bonus to share holder A/c Dr. To, Equity share final cost A/c (Being the final call due is converted in to bonus)	2,00,000	 2,00,000
Reserve A/c Dr. To Bonus to share holder A/c (Being the reserve amount is used for bonus)	2,00,000	 2,00,000

(c) KP Ltd. forfeited 20,000 equity shares of ₹ 15 each (including ₹ 5 per share as premium), for nonpayment of final call of ₹ 3 per share. Out of these 10,000 shares were reissued at a discount of ₹ 4 per share.

Solution:

Equity share capital A/c	200,000	
To Equity Sh. Final call A/c		60,000

To Forfeited share A/c		1,40,000
(20,000 shares forfeited for non-payment of final call money)		
Bank A/c	60,000	
Forfeited share A/c	40,000	
To, Equity Share Capital A/c		1,00,000
(Reissue of 10,000 sh. @ ₹6 each)		
Forfeited share A/c	30,000	
To Capital Reserve A/c		30,000
(balance of forfeited share A/c relating to 10,000 shares transferred)		

(d) Write a short note on sweat equity shares.

Solution:

Sweat equity shares means such equity shares as are issued by a company to its directors or employees at a discount or for consideration, other than cash, for providing their know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called;

Notwithstanding anything contained in Section 53, Companies Act ,2013 a company may issue sweat equity shares of a class of shares already issued, if the following conditions are fulfilled, namely:—

the issue is authorised by a special resolution passed by the company; the resolution specifies the number of shares and other details and the class or classes of directors or employees to whom such equity shares are to be issued; not less than one year has, at the date of such issue, elapsed since the date on which the company had commenced business; and

(e) The following particulars are available from the books of RYMIT LTD:
Net profit before provision for income tax and managerial remuneration ₹98,00,000
But after depreciation
Depreciation provided in the books ₹30,00,000
Depreciation allowable under schedule II of the companies Act 2013 ₹25,00,000
You are required to calculate the managerial remuneration if there is one whole-time director.

Solution:

Calculation of Net Profit under section 197 of the companies Act, 2013:

Particulars	₹
Net profit before provision for income tax and managerial remuneration but after depreciation	98,00,000
Add: Depreciation provided in the books	30,00,000
Less: Depreciation allowable under schedule-II of the companies Act, 2013	25,00,000
Net profit	1,03,00,000

Calculation of Managerial Remuneration for only one whole time director-5% of ₹ 1,03,00,000 =₹ 5,15,000

2. Matching the following: [5x1=5]

1.	**Result of Transaction**	**A.**	**AS – 9**
2.	**Charged against profit**	**B.**	**Current Liability**
3.	**Bank over draft**	**C.**	**Event**

4.	**Revenue recognition**	**D.**	**AS – 29**
5.	**Provision & contingents**	**E.**	**Depreciation**

Solution:

1. — C.
2. — E.
3. — B.
4. — A.
5. — D.

3. Answer the following question: [5x2=10]

(a) What is test checking?

Solution:

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 while test checking the following aspects need to be considered:

(i) Presentation and disclosure.
(ii) Adherence to the generally accepted accounting practices.
(iii) Compliance with the statutory requirements.
(iv) Existence of errors and frauds.
(v) Arithmetical accuracy.
(vi) Materiality of the items involved.

(b) Define vouching.

Solution:

Vouching is the examination by the auditor of all documentary evidences, which are available to support the authenticity of the transaction entered in the client's record". – Spicer and Pegler

The act of examining all documentary evidences (vouchers) is referred to as vouching. Its basic objective is to establish the authenticity of the transactions recorded in the primary books of account.

(c) Write a short note on cut off procedure.

Solution:

(i) **Definition**: Periods usually coincide with calendar months, Which lead to the need for specific demarcation between transactions forming the part of the one period from those included in the following period. Thus, cut-off procedures are adopted to allocate revenues and costs to the proper accounting period.

(ii) **Areas of concern**: Close attention should be paid to the accounts payable and accounts receivables functions. These two functions are the most susceptible to recording of transactions in the wrong accounting period.

(iii) **Cut-of-point**: Serially numbered documents like invoice for sales or purchase bills are allocated to the respective accounting periods by establishing cut-off points based on the serial number.

(iv) **Importance:** Cut-off procedures require detailed testing by the auditor so as to ensure proper accounting of assets and liabilities, which may arise without the corresponding physical delivery of goods taking place.

(d) What is continuous audit.

Solution:

A continuous auditing is "a method used to perform control and risk assessments automatically on a more frequent basis. Continuous auditing changes the audit paradigm from periodic review of a sample of transactions to ongoing audit testing of 100 percent of transactions. It becomes an integral part of modern auditing. Technology is a key to enabling such an approach."

Continuous audit may be defined as the examination and verification of firm's financial transactions and their supporting documents, continuously throughout the year, at regular or irregular intervals.

A continuous audit driven system generates alarm triggers that provide advance notice about anomalies and errors detected by the system. It is performed usually by firm's internal auditors to eliminate the year-end workload.

(e) What is secret reserve?

Solution:

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 through the amount cannot be ascertained. Generally such type of reserve appears in financial institutions and insurance companies.

Section – B

Answer any Three Questions: [15×3=45]

4. (a) Beekay Ltd. purchased fixed assets costing ₹ 5,000 lakh on 01.04.2012 payable in foreign currency (US$) on 05.04.2013. Exchange rate of 1US$=₹ 50.00 and ₹ 54.98 as on 01.04.2012 and 31.03.2013 respectively.
The company also obtained a soft loan of US$ 1 lakh on 01.04.2012 payable in three annual equal installments. First installment was due on 01.05.2013.
You are required to state, how these transactions would be accounted for in the books of accounts ending 31st March, 2013. [7]

Solution:

As Per As 11 (Revised) 'The effects of changes in foreign exchange rates, exchange differences arising on the settlement of monetary items or on reporting an enterprise's monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements. Should be recognized as income or as an expense in the period in which they arise. However, Ministry of Corporate Affairs has recently amended As 11 through a notification. As per the notification, exchange different arising on reporting of long-term foreign currency monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, in so far as they relate to requisition of depreciable capital asset, can be added to or deducted from cost of asset. The MCA has given an option for the enterprises to capitalize the exchange differences arising on reporting of long term foreign currency monetary items till 31st March, 2020. Thus the company can capitalize the exchange differences arising due to long term loans linked with acquisition of fixed assets.

Transaction 1: Calculation of exchange difference on fixed assets

Foreign Exchange Liability = $\frac{5,000}{50}$= US$ 100 lakhs
Exchange Difference = US $ 100 lakhs x(₹ 54.98 - ₹ 50) = ₹498 lakhs.
Loss due to exchange difference amounting ₹ 498 lakhs will be capitalized and added in the carrying value of fixed assets. Depreciation on the unamortized amount will be provided in the remaining years.
Transaction 2: Soft loan exchange difference (US $1 lakhs i.e. ₹ 50 lakhs)
Value of loan 31.13.13 US $ 1 lakh x ₹ 54.98= ₹54.98 lakhs
As 11 also provides that in case of liability designated as long-term foreign currency monetary item (having a term of 12 months or more at the time of origination) the exchange difference is to be accumulated in the Foreign Currency Monetary item Translation Difference (FCMITD) and should be written off over the useful life of such long –term liability, by recognition as income or expenses in each of such periods.
Exchange difference between reporting currency (INR) and foreign currency (USD) as on 31.03.2013= Us $ 1.00 lakh X ₹ (54.98 – 50) = ₹ 4.98 lakh.
Loan account is to be increased to 54.98 lakh and the account is to be debited by 4.98 lakh. Since loan is repayable in 3 equal annual installments, ₹ 4.98 lakh/3 = ₹ 1.66 lkh is to be charged in profit and loss account for the year ended 31st March, 2013 and balance in FCMITD A/c ₹ (4.98 lakh – 1.66 lakh)= ₹ 3.32 lakh is to be shown on the 'Equity & Liabilities' side of the Balance sheet as a negative figure under the head 'reserve and surplus' as a separate line item.

(b) Rama Limited issued 8% debentures of ₹3,00,000 in earlier year on which interest is payable half yearly on 31st March and 30th September. The company has power to purchase its own debentures in the open market for cancellation thereof. The following purchases were made during the financial year 2012-12-13 and cancellation made on 31st March, 2013:
(i) On 1st April, ₹ 50,000 nominal value debentures purchased for ₹ 49,450, ex-interest.
(ii) On 1st September, ₹ 30,000 nominal value debentures purchased for ₹ 30,250 cum interest.
Show the journal entries for the transactions held in the year 2012-13. [8]

Solution:

In the books of Rama Limited
Journal Entries

	Particulars	**Dr. (₹)**	**Cr. (₹)**
1st April, 2012	Own debentures A/c Dr. To Bank A/c (Being own debentures purchased ex-interest)	49,450	49,450
1st Sept. 2012	Own debenture A/c Dr. Interest on own debentures A/c Dr. $\left[30,000 \times 8\% \frac{5}{12}\right]$ To Bank A/c (Being own debentures purchased cum- interest)	29,250 1,000	 30,250
30th Sept. 2012	Interest on debentures A/c Dr. [₹3,00,000 × 8%×(5/12)] To Bank A/c Dr. To Interest on own debentures A/c (Being interest @ 8% paid on ₹ 2,20,000 & adjustment of interest on ₹ 50,000 & ₹30,000 own debentures)	12,000	 8,800 3,200
31st March, 2013	Interest on debentures A/c Dr. To own debentures A/c To profit on cancellation of debentures A/c (being cancellation of own debentures)	12,000	 8,800 3,200
31st March, 2013	Interest on own debentures A/c Dr. To profit and loss A/c (3,200 + 3,200-1,000) (Being total interest paid on own debentures credited	5,400	 5,400

	to P/L A/c)		
31st march, 2013	Profit and Loss A/c (12,000 + 12,000) Dr. To Interest on debentures A/c. (being total interest paid on debentures transferred to P/L A/c)	24,000	24,000
31st March, 2013	Profit on cancellation of debentures A/c Dr. To Capital Reserve A/c (Being profit on cancellation of debentures transferred to capital reserve A/c)	1,300	1,300

5. (a) In April, 2010, A limited 18,00,000 Equity shares of ₹ 10 each, ₹ 5 per share was called up on that date which was paid by all the shareholders. The remaining ₹ 5 was called up on 1-9-2010. All the shareholders (except one having 3,60,000 shares) paid the sum in September 2010. The net profit for the year ended 31-3-2011 is ₹ 33 lakhs after dividend on preference shares and dividend distribution tax of ₹ 6.60 lakhs.
Compute the basic EPS for the year ended 31st March, 2011 as per AS 20. [9]

Solution:

Basic Earnings per share (EPS)= $\frac{Net\ profit\ attributable\ to\ equity\ shareholders}{weighted\ average\ number\ of\ equity\ shares\ outstanding\ during\ the\ year}$

$$\frac{33{,}00{,}000}{13{,}20{,}000\ Shares\ (as\ per\ working\ note)} = Rs. 2.5\ per\ share$$

Working Note:
Calculation of weighted average number of equity shares
As per para 19 of As 20 'Earnings per share', partly paid equity shares are treated as a fraction of equity share to the extent that they were entitled to participate in dividend relative to a fully paid equity share during the reporting period. Assuming that the partly paid shares are entitled to participate in the dividend to the extent of amount paid, weighted average number of shares will be calculated as follows:

Date	No. of equity shares	Amount paid per share	Weighted average no. of equity shares
1.4.2010	18,00,000	5	18,00,000 x 5/10x5/12=3,75,000
1.9.2010	14,40,000	10	14,40,000 x 7/12= 8,40,000
1.9.2010	3,60,000	5	3,60,000x5/10x7/12=1,05,000
			13,20,000

(b) On 1st April, 2012, a company offered 100 shares to each of its 500 employees at ₹ 50 per share. The employees are given a year to accept the offer. The shares issued under the plan shall be subject to lock-in on transfer for three years from the grant date. The market price of shares of the company on the grant date is ₹ 60 per share. Due to post-vesting restrictions on transfer, the fair value of shares issued under the plan is estimated at ₹ 56 per share.
On 31st March, 2013, 400 employees accepted the offer and paid ₹ 50 per share purchased Nominal value of each share is ₹ 10.
Record the issue of share in the books of the company under the aforesaid plan. [6]

Solution:

Fair value of an option = ₹ 56 – ₹ 50 = ₹ 6
Number of shares issued = 400 employees x100 share /employee = 40,000 shares
Fail value of ESP = 40,000 shares x ₹ 6 = ₹ 2,40,00

Vesting period = 1 month
Expenses recognized in 2012 – 13 = ₹ 2,40,000

Date	Particulars	₹	₹
31.03.2013	Bank (40,000 shares x ₹ 50) Dr. Employees Compensation Expanse A/c Dr. To Share Capital (40,000 shares x ₹ 10) To Securities Premium (40,000 shares x ₹ 46) (Being option accepted by 400 employees & payment made @ ₹ 56 share) Profit & Loss A/c Dr. To Employees Compensation Expense A/c (being employees compensation expense transferred to profit & loss A/c)	20,00,000 2,40,00 2,40,000	 4,00,000 18,40,000 2,40,000

6. (a) **'X' Ltd. issued 1,00,000 equity shares of ₹ 10 each at par. The entire issue was underwritten as follows:**
A-60,000 shares (Firm underwriting 8,000 shares)
B – 30,000 shares (Firm underwriting 10,000 shares)
C – 10,000 shares (Firm underwriting 2,000 shares)
The total applications including firm underwriting were for 80,000 shares.
The marked applications were as follows:
A – 20,000 shares; B- 14,000 shares, C- 6,000 shares.
The underwriting contract provides that credit for unmarked applications be given to the underwriters in proportion to the shares underwritten. Determine the liability of each underwriter. **[6]**

Solution:

Statement showing liability of underwriters

	A	B	C	D
Gross Liability (total issue-purchase by promoters etc)	60,000	30,000	10,000	1,00,000
Less: Firm Underwriting₹	(8,000)	(10,000)	(2,000)	(20,000)
	52,000	20,000	8,000	80,000
Less: Marked applications received	(20,000)	(14,000)	(6,000)	(40,000)
	32,000	6,000	2,000	40,000
Less: Unmarked Application	(12,000)	(6,000)	(2,000)	(20,000)
Balance	20,000	--	--	20,000
Add: Firm underwriting	8,000	10,000	2,000	20,000
Total liability of underwriters including firm underwriting	28,000	10,000	2,000	40,000
Total liability in amount @ ₹ 10 each	₹2,80,000	₹1,00,000	₹20,000	₹4,00,000

(b) M/s. ABC Limited has gone into liquidation on 25th June, 2012. Certain creditors could not receive payments out of realization of assets and contributions from A list contributories. The following are the details of certain transfer which took place in the year ended 31st March, 2012

Share holders	No. of shares transferred	Date of ceasing to be a member	Creditors remaining unpaid and outstanding on the date of transfer (₹)
P	**4,000**	**10-5-2011**	**9,000**
Q	**3,000**	**22-7-2011**	**12,000**

R	**2,400**	**15-9-2011**	**13,500**
S	**1,600**	**14-12-2011**	**14,000**
T	**1,000**	**09-03-2012**	**14,200**

All the shares are of ₹ 10 each, ₹ 18 8 per share paid up. Show the amount to be realized from the persons listed above. Ignore remuneration to liquidator and other expenses. [9]

Solution:

Statement of Liability of B List Contributories

Share holder	No. of shares Transferred	Maximum liability up to ₹ 2 per share	Division of liability as on				Total
			22.07.2011	15.09.2011	14.12.2011	09.03.2012	
Q	3,000	6,000	4,500	-	-	-	4,500
R	2,400	4,800	3,600	720	-	-	4,320
S	1,600	3,200	2,400	480	300	-	3,188
T	1,000	2,000	1,500	300	192	8	2,000
	8,000	16,000	12,000	1,500	500	8	14,008

Notes:

(i) 'P' transferred shares before one year preceding the date of winding up, therefore, he cannot be held liable for any liability on liquidation.

(ii) Liability of 'T' has been restricted to the maximum allowable limit of ₹ 2,000. Therefore amount payable by T on 09.03.2012 is ₹ 8 only

(iii) 'Q' will not be responsible for further debts incurred after 10th May, 2011 (from the date when he ceases to be a member). Similarly, 'R' & 'S' will not be liable for the debts incurred after the date of their transfer of shares.

Working Note:

Calculation of Ratio for discharge of liabilities

Date	Cumulative liability	Increase in liabilities	Ratio of no.of shares held by Q,R S & T.
22.07.2011	12,000	-	30:24:16:10
15.09.2011	13,500	1,500	24:16:10
14.12.2011	14,000	500	16:10
09.03.2012	14,200	200	Only T

7. (a) Given below are the summarized balance sheets of Vasudha Ltd. and Vaishali Ltd as at 31st March, 2013.

Liabilities	**Vasudha Ltd.**	**Vaishali Ltd.**	**Assets**	**Vasudha Ltd.**	**Vaishali Ltd.**
Issued Share capital			**Factory Building**	**2,10,000**	**1,60,000**
Equity shares of ₹ 10 each	**5,40,000**	**4,03,300**	**Trade receivables**	**2,86,900**	**1,72,900**
General Reserves	**86,000**	**54,990**	**Inventory**	**91,500**	**82,500**
Profit & Loss A/c	**66,000**	**43,500**	**Goodwill**	**50,000**	**35,000**
Trade payables	**44,400**	**58,200**	**Cash at Bank**	**98,000**	**1,09,590**
	7,36,400	**5,59,990**		**7,36,400**	**5,59,990**

Goodwill of the companies Vasudha Ltd. and Vaishali Ltd. is to be valued at ₹ 75,000 and ₹ 50,000 respectively. Factory Building of Vasudha Ltd is worth ₹ 1,95,000 and of Vaishali Ltd ₹ 1,75,000. Inventory of Vaishali has been shown at 10% above of its cost.

It is decided that Vasudha Ltd will absorb Vaishali Ltd. by taking over its entire business by issue of shares at the intrinsic value.
You are required to draft the balance sheet of the Vasudha Ltd after putting through the scheme assuming that the assets & liabilities of Vaishali Ltd. were incorporated in Vasudha ltd at fair value and assets and liabilities of Vasudha Ltd. have been carried at carrying values only. [8]

Solution:

Balance sheet of Vasudha Ltd. as on 31st March, 2013 (After absorption)

	Particulars	**Note No**	**Amount**
	Equity and liabilities		
1	Share holders funds (a) Share capital (b) Reserves and surplus	 1 2	 9,43,300 2,72,990
2	Current liabilities (a) Trade payables (44,400 + 58,200)		 1,02,600
	Total		13,18,890
	Assets		
1	(a) Fixed assets (i) Tangible assets (ii) Intangible assets	 3 4	 3,85,000 1,00,000
	Current assets		
	(a) Inventories (91,500 + 75,000) (b) Trade receivables (2,86,900 + 1,72,900) (c) Cash and cash equivalents (98,000 + 1,09,590)		1,66,500 4,59,800 2,07,590
	Total		13,18,890

Notes to accounts

		₹	₹
1	Share capital Equity share capital (54,000 + 40,330) Equity shares of Rs. 10 each		 9,43,300
2	Reserve and surplus Profit and Loss A/c General reserves Securities Premium A/c (refer W.N)	 66,000 86,000 1,20,990	 2,72,990
3	Tangible assets Factory building (2,10,000 + 1,75,000)		 3,85,00
4	In tangible assets Goodwil (50,000 + 50,000)		 1,00,000

Note: As the assets of vasudha Ltd. are shown in the books after absorption at carrying value only, no adjustment for revaluation of the same has been done in the balance sheet. However, assets of vaishali Ltd have been taken at the fair value as indicated.

Working Note:

	Vasudha Ltd.	**Vaishali Ltd.**
Goodwill	75,000	50,000
Factory building	1,95,000	1,75,000
Trade receivables	2,86,900	1,72,900
Inventory	91,500	(82,500/110%)=75,000
Cash at bank	98,000	1,09,590
	7,46,400	5,82,490
Less: Trade payables	44,400	58,200
Net assets	7,02,000	5,24,290

Number of shares	54,000	40,330
Intrinsic value	₹ 13	₹ 13

Hence, Vasudha Ltd. will give its 40,330 shares of ₹ 10 each @ ₹ 13 each to vaishali Ltd. Discharge of purchase consideration.

	Share capital	Securities premium
40,330 shares @ ₹ 10 each	4,03,300	
40,330 shares @ ₹3 each		1,20,990

(b) The summarized Balance sheet of X Limited as on 31st March 2013, was as follows:

Liabilities	(₹)	Assets	(₹)
Authorised and subscribed capital	**10,00,000**	**Fixed Assets:**	
10,000 equity shares of ₹ 100 each		**Machineries**	**3,50,000**
Fully paid		**Current Assets:**	
Unsecured loans:		**Inventory**	**2,53,000**
15% Debentures	**3,00,000**	**Trade receivables**	**2,30,000**
Accrued interest	**45,000**	**Bank**	**20,000**
Current Liabilities:		**Profit & loss A/c**	**5,80,000**
Trade payables	**52,000**		
Provision for income tax	**36,000**		
	14,33,000		**14,33,000**

It was decided to reconstruct the company for which necessary resolution was passed and sanctions were obtained from the appropriate authorities. Accordingly, it was decided that:

(i) Eeach share be sub-divided into 10 fully paid up equity share of ₹ 10 each.

(ii) After sub-division, each shareholder shall surrender to the company 50% of his holding for the purpose of reissue to debenture holders and trade payables as necessary.

(iii) Out of shares surrendered 10,000 shares of ₹ 10 each shall be converted into 10% preference shares of ₹ 10 each fully paid up.

(iv) The claims of the debentures holders shall be reduced by 50%. In consideration of the reduction, the debentures holder shall receive preference shares of ₹ 1,00,000 which are converted out of shares surrendered.

(v) Trade payables claim shall be reduced by 25%. Remaining trade payables are to be settled by the issue of equity shares of ₹ 10 each of out of shares surrendered.

(vi) The shares surrendered and not re-issued shall be cancelled

Pass Journal entries giving effect to the above and the resultant Balance sheet. [7]

Solution:

In the books of X limited journal entries

	Particulars	Dr.(₹)	Cr.(₹)
(i)	Equity Share Capital (₹ 100) A/c Dr. To Share Surrender A/c To Equity Share Capital (₹ 10) A/c (Sub-division of 10,000 equity shares of ₹ 100 each into 1,00,000 equity shares of ₹ 10 each and surrender of 50,000 of such sub-divided shares as per capital reduction scheme)	10,00,000	 50,00,00 5,00,000
(ii)	15% Debentures A/c Dr. Accrued Interest A/c (proportionate 50%) Dr. To Reconstruction A/c (Transferred 50% of the claims of the debentures holders to reconstruction A/c in consideration of which 10% preference shares are being issued, out	 1,50,000 22,500	 1,72,500

	of share surrender A/c as per capital reduction scheme)		
(iii)	Trade payables A/c Dr. To Reconstruction A/c (Transferred claims of the trade payables to reconstruction A/c 25% of which is reduction and equity shares are issued in consideration of the balance amount)	52,000	 52,000
(iv)	Share surrender A/c Dr. To 10% Preference Share Capital A/c To Equity Share Capital A/c To reconstruction A/c (Issued preference and equity shares to discharge the claims of the debenture holders and the trade payables respectively as per scheme and the balance in share surrender account is transferred to reconstruction account)	5,00,000	 1,00,000 39,000 3,61,000
(v)	Reconstruction A/c Dr. To Profit & Loss A/c To Capital Reserve A/c (Adjusted debit balance of profit and loss account against reconstruction account and the balance is transferred to capital reserve account)	5,85,500	 5,80,000 5,500

X Limited (and reduced) Balance Sheet as on …..

Particulars	Notes No	₹ 000
Equity and Liability		
1.Share holders funds		
a) Share capital	1	6,39,000
b) Reserve and Surplus	2	5,500
3. Non-current liabilities		
Long-term borrowings	3	1,50,000
4. Currents liabilities		
a) other current liabilities	4	22,500
b) short-term provision	5	36,000
Total		8,53,000
Assets		
1. Non-current assets		
a) Fixed assets		
(i) Tangible assets	6	3,50,000
2. Current assets		
a) Inventories		2,53,000
b) trade receivables		2,30,000
c) Cash and cash equivalents	7	20,000
Total		8,53,000

Notes to Account

		₹
1	Share capital 53,900 equity shares of ₹ 10 each 10,000 10% preference share of ₹ 10 each (all the above shares are allotted as fully paid up pursuant to capital reduction scheme by conversion of equity shares	 5,39,000 1,00,000 6,39,000

	without payment received in cash)	
2	Reserves and surplus Capital reserves	
3	Long-term borrowings Unsecured 15% debentures	5,500 1,50,000
4	Other currents liabilities Accrued interest on 15% debentures	22,500
5	Short-term provisions Provision for income tax	36,000
6	Tangible assets Machineries	 3,50,000
7	Cash and cash equivalents Balances with banks	 20,000

Section – C

8. (a)What are the techniques for evaluation of internal control system. [8]

Solution:

Techniques for evaluation of Internal control system:

(i) **Narrative Records:**
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 organizations working to the auditor. A complete flow chart would depict the process of raising documents, personnel involved in doing so, the flow of documents through various departments, maintenance of records, flow of goods and consideration, and dealing with results. 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 complete and all relevant information. The questions are formed in a manner that would facilitate obtaining full information through answers in "Yes" or "No"

(b) Write about audit of educational institution. [7]

Solution:

Audit of an educational institution:

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 not e 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, nothing 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 of return, with the respective class registers, showing names of students on rolls and test amount of gees 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 or term 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 authorized 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) Vouch in come from endowments and legacies, as well as interest and dividends form investment also inspect the securities in respect of investments held.

(xii) Verify any government or local authority grant with the relevant papers of grant. If any expense has been disallowed for purposes of grant, ascertain the reasons and compliance thereof.

(xiii) Report any old heavy arrears on account of fees, dormitory rents, etc, to the managing committee.

(xiv) Confirm that caution money and other deposits paid by students on admission have been shown as liability in the balance sheet and not transferred to revenue.

(xv) See that the investments representing endowment funds for prizes are kept separate and any income in excess of the prizes has been accumulated and invested along with the corpus.

(xvi) Verify that the provident fund money of the staff has been invested in appropriate securities.

(xvii) Vouch donations, if any, with the list published with the annual report. If some donations were meant for any specific purpose, see that the money was utilized for the purpose.

(xviii) Vouch all capital expenditure in the usual way and verify the same with the sanction for the committee as contained in the minute book.

(xix) Vouch in the usual manner all establishment expenses and enquire into any unduly heavy expenditure under any head.

(xx) See that increase in the salaries of the staff have been sanctioned and minuted by the committee.

(xxi) Ascertain that the system ordering inspection on receipt and issue of provision, foodstuffs, clothing and other equipment is efficient and all bills are duly authorized and passed before payment.

(xxii) 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.

(xxiii) Confirm that the refund of taxes deducted from the income from investment (interest on securities, etc.,) has been claimed and recovered since the institutions are generally exempted from the payment of income-tax.

(xxiv) 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.

[Students may mention any 14 points out of the above.]

9. (a) How auditor was appointed what are his power & duties? [9]

Solution:

Appointment of Auditors:

First Auditor

- First auditor of the company, other than a Government company, shall be appointed by the BOD within 30 days from the date of registration of the company;
- If BOD fails to appoint, by the member of the company within 90 days at an extraordinary general meeting appoint the first auditor;
- In case of Government company, first auditor shall be appointed by CAG within 60 days from the date of registration;
- If CAG fails to appoint, by the BOD of the company within next 30 days;
- If again BOD fails to appoint the first auditor of the company, by the member of the company within 60 days at an extraordinary general meeting;
- Tenure of the first auditor of the company in both the above cases till the conclusion of the first annual general meeting;

Subsequent Auditor

- At the first annual general meeting, appoint an individual or a firm as an auditor who shall hold office from the conclusion of that meeting till the conclusion of its sixth annual general meeting;
- Before such appointment, the written consent of the auditor to such appointment and a certificate from him shall be in accordance with the condition as may be prescribed;
- Within 15 days of the meeting the company shall file a notice of such appointment with the
- registrar;
- No listed company or a company belonging to such class or classes of companies as may be prescribed, shall appoint or re-appoint—
  (a) an individual as auditor for more than one term of five consecutive years; and
  (b) an audit firm as auditor for more than two terms of five consecutive years:

Power and Duties of the company auditor are as follows:

Every auditor of a company shall have a right of access at all times to the books of account and vouchers of the company, whether kept at the registered office of the company or at any other place and shall be entitled to require from the officers of the company such information and explanation as he may consider necessary for the performance of his duties as auditor and amongst other matters inquire into the following matters:

(i) Whether the loans & advances made by the company on the basis of security have been properly secured & the terms are not against the interest of the company or its members.

(ii) Whether the transactions merely representing book-entries as recorded in the books are not against the interest of the company;

(iii) The securities have been sold by company other than banking Investment Company, at a price-less than purchase price.
(iv) Whether loans & advances made by the company have been shown as deposits.
(v) Personal expenses have been charged to revenue account;
(vi) Whether cash has actually been received in respect of any shares shown in the books to have been allotted for cash
(vii) Whether the position as stated in the books is correct, regular and is not misleading.

(b) As an auditor how will you verify loose tools appearing in the financial statement of the company? [6]

Solution:

Loose tools at the end of the year should be checked by the auditor as follows:

(i) The auditor should see that the cost of loose tools is properly determined and verified by the Chief Engineer.
(ii) If the loose tools are manufactured by the organization, the authorized officer shall verify the value of such tools.
(iii) He should physically verify these tools or obtain a list of tools duly certified by the responsible officer. Any discrepancies shall be investigated.
(iv) Ensure that the closing stock of tools is valued at cost. See that the valuation is done on the basis, which is consistent taking into consideration obsolescence, damage, brokerage etc.,
(v) See that the loose tools are disclosed in the balance sheet on asset side under the head "Current Assets".

10. (a) What is the importance of audit report? [8]

Solution:

Audit Report is nothing but a statement of observation gathered & considered while proving conclusive evidence of company's financial position. It is a medium through which an auditors expresses his opinion on the financial statement under audit. It is an important part of the audit as it provides the results of the audit conducted by the auditor.

According to J.B.Ray - "The Report shall either contain as expression of opinion regarding the financial statements, taken as a whole or an assertion to the effect that an opinion cannot be expressed when an overall opinion cannot be expressed, the reason therefore should be stated. In all cases, where auditor's name is associated with financial statements the report should contain a clear cut indication of the character of the auditor's examination, if any, and the degree of responsibility he is taking."

Importance of Audit Report

(i) An Audit report is the end product of the audition and is very important & concluding part of the audit process.
(ii) Audit report gives the auditor's opinion on the accounts & record of the company as examined by him.
(iii) Audit report reflects the work done by the auditor.
(iv) Audit report is the instrument which, measures the auditors responsibility in regard to the true & fairness of the financial statement of the company.

(v) Audit report indicates the real position of the financial status of the company & which is used by different people as a reliable document.

(b) What are the objectives of verification of assets & liabilities? [7]

Solution:

Verification means – "**Proving the truth"** An auditor has not only to see the arithmetical accuracy and bonadides of the transactions in the books of accounts by vouching only, but has also to see that the assets as recorded in the balance sheet actually exist. The fact that there is an entry regarding purchases fo an asset and has been found to be currently recorded, is not a proof that the asset is in the possession of the concern at the date of baalce sheet. It is possible that after the asset had been acquired and the necessary entries made in the books of accounts, the asset might have been disposed of or pledged or mortgaged and no entry had been made regarding these facts in the books of accounts before the closing of the financial year. He has also to see whether a particular asset as appearing in the balance sheet exists or not. Verification of liabilities is also as important as the verification and assets. If the liabilities are overstated or understated, the balance sheet will not represent a true and fair view of the state of affairs of the company.

In short, verification is a function of examining assets & liabilities to check (i) value (ii) ownership (iii) title (iv) existence (v) possession and (vi) to see whether the assets are free from any charge or encumbrance etc.

Objects of verification –

Verification of assets and liabilities is done with the following objects.

i To know whether the balance sheet exhibits a true and fair view of the state of affairs of the business.
ii To find out whether the assets were in existence.
iii To find out the ownership and title of the assets.
iv To show correct valuation of assets and liabilities.
v To verify the arithmetical accuracy of the books of accounts.
vi To ensure that the assets have been recorded properly.
vii To detect frauds & errors, if any
viii To find out whether there is an adequate internal control regarding acquisition, utilization and disposal of assets.