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) X Ltd., decides to redeem 650, 15% preference shares of ₹ 100 each at 10% premium. It has General Reserve of ₹ 45,500 and securities premium of ₹ 1,000. The new equity shares of ₹ 10 each are to be issued at 25% premium for the purpose of redemption of preference shares. Calculate the minimum number of equity shares to be issued by X Ltd.

Solution:

Nominal Value of preference shares + premium on redemption = Existing securities premium + divisible profits available for redemption + sale proceeds of fresh issue of new shares
65,000 + 6,500= 1,000 + 45,500 + x
X=25,000
Minimum number of equity shares to be issued for redemption of preference share = share proceeds of fresh issue of new shares /issue price = 25,000/12.50 = 2000.

(b) Delhi Company, incorporated on 1st April, 2013, took over running business form 1st January, 2013. The company prepares its first final accounts on 31st December 2013. From the following information, you are required to calculate the sale ratio of pre-incorporation and post-incorporation periods.

(a) Sales of January, 2013 to December, 2013 ₹ 4,80,000.
(b) The sales for the month of January twice of the average sales; for the month of February equal to average sales, sales for fourth months May to August – ¼ of the average of each month; and sales for October and November three times the average sales.

Solution:

Calculation of Average Sales per month = $\frac{4,80,000}{12}$ =₹40,000

Sales for the months of		₹
January	(2 x ₹ 40,000)	80,000
February	(1 x ₹ 40,000)	40,000
May	(¼ x ₹ 40,000)	10,000
June	(¼ x ₹ 40,000)	10,000
July	(¼ x ₹ 40,000)	10,000
August	(¼ x ₹ 40,000)	10,000
October	(3 x ₹ 40,000)	1,20,000
November	(3 x ₹ 40,000)	1,20,000
Total sales for 8 months		4,00,000

Sales for the remaining 4 months = ₹ 4,80,000 – ₹ 4,00,000
= ₹ 80,000

Average sales for the remaining months = $\frac{80,000}{4}$ =₹20,000

Sales for pre-incorporation period:

January	₹ 80,000
February	₹ 40,000
March	₹ 20,000
	1,40,000

Sales for post-incorporation period = ₹ 4,80,000 – ₹ 1,40,000 = ₹ 3,40,000

Sales ratio of Pre-incorporation to post – incorporation period = 7:17

(c) Write a short note on defined contribution plan?

Solution:

Defined Contribution plans (DCP)

1) Retirement benefit is determined by contribution at agreed /specified rate to the fund together with earnings thereof.
2) Contribution (e.g.PF) whether paid or payable for the reporting period is charged to P/L statement.
3) Excess if any is treated as prepayment.

(d) What is the meaning of cash & cash equivalent?

Solution:

Cash means cash in hand and balance of foreign currency. Cash equivalent implies bank balance and other risk-free short term investments, and advances which are readily encashable. Cash equivalent means short term highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value. An investment of short maturity, say three months or less from the date of acquisition is generally considered as cash equivalent. Equity investments are not considered as cash equivalent because of high market risk. Investments in call money market, money market, mutual funds, repo transactions, badla transactions, etc., are usually classified as cash equivalent.

(e) Green India Ltd. has five segments namely T,P,R,S & U. The total assets of the company are ₹ 22 cores, segment T has ₹ 4 cores., segment P has ₹ 6 crores., segment R has ₹3 crores, S has ₹ 5.5 crores and U has ₹ 3.5 crores, defereed tax assets included in the assets each segments are T-₹ 1.50 crores; P-₹ 1.29 crores; R- ₹ 1.10 crores; S- ₹ 2.25 crores & U- ₹ 1.35 crores. The accountant contended that all the five segments are reportable segments. Comments?

Solution:

(₹ in Crores)

	T	P	R	S	U
Segment assets	4.00	6.00	3.00	5.50	3.50
(-) def tax asset net assets	1.50	1.29	1.10	2.25	1.35
Net assets	2.50	4.71	1.90	3.25	1.35

% of segment asset in total assets 17.22% 32.46% 13.09% 22.39% 14.81%

Result: All the above segments are reportable segments become the segment assets in total assets are exceeds 10%

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

1.	Long term liability	A.	Preliminary expenses
2.	Fictitious asset	B.	Historical cost
3.	Unearned income	C.	Debenture
4.	Asset required	D.	Liability
5.	Accumulated depreciation	E.	Asset

Solution:

1. — C.

2. — A.
3. — E.
4. — B.
5. — D.

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

(a) Write a short notes tax audit?

The main objective of the tax audit is to compute the taxable income according to the law and for maintaining transparency in the financial statements filed by the assesses with the income – tax department.
The tax audit U/s. 44AB of the income-tax Act 1961 is significant practice area for chartered Accountants since the introduction of tax audit, we have been given responsibilities to discharge the duties as tax auditors for the proper compliance of tax law by the assesses.

(b) Differences between auditing & Accounting?

Solution:

	Accounting	Auditing
i	It is the collection, classification and summarization of data for preparation of books of accounts, and to make financial statements.	Auditing is an analytical and critical examination of books of accounts, financial records and the financial statements prepared thereon.
ii	It is the recording of transactions at the time of occurrence.	It is the post examination of recorded transactions.
iii	It measures the business events in monetary terms, records them, and communicates the financial results through financial statements.	Auditing reviews financial records to form an opinion on the authenticity of financial statements.
iv	The primary responsibility is of the management towards the shareholders/owners, to maintain the financial records in such a manner that financial statements can be prepared from the records.	The auditor is an independent person appointed by the business entity to review the financial statement and to give an opinon thereon.
v	An accountant is not expected to reviews/report on the financial statement but to report the compilation of records to the management	An auditor is required to submit a report with his opinion on 'true and fair' assertion made in the financial statements to the owners.
vi	An accountant works for/under the management	The auditor is an independent person answerable/liable to the owners/shareholders and not just to the management.
vii	No such liability	In certain circumstances, the auditor could be held liable to third parties also.
viii	Maintenance of accounts may not be mandatory for small individuals or partnership firms, e.g. under section 44AA of the Income Tax Act, but could be mandatory under other laws, e.g. for Companies under the Companies Act.	Audit could be exempt for various individuals or small partnerships, e.g. under section 44AB of the Income Tax Act, and even in case where maintaining books of accounts is a statutory requirement under section 44AA, but may be mandatory under other laws, e.g. for Companies under the Companies Act.

(c) Define audit sampling?

Solution:

"Audit Sampling", it means the application of audit procedures to less than 100% of the items within an account balance or class of transactions to enable the auditor to obtain and evaluate audit evidence about some characteristic of the items selected in order to form or assist in forming a conclusion concerning the population.

(d) Write a short note on meetings and powers of Audit Committee?

Solution:

Meeting of Audit Committee

The Audit Committee should meet at least four times in a year and not more than four months shall elapse between two meetings. The quorum shall be either two members or one third of the members of the audit committee whichever is greater, but there should be a minimum of two independent members present.

Powers of Audit Committee

The Audit Committee shall have powers, which should include the following:

(i) To investigate any activity within its terms of reference.
(ii) To seek information from any employee.
(iii) To obtain outside legal or other professional advice.
(iv) To secure attendance of outsiders with relevant expertise, if it considers necessary.

(e) Briefly explain audit programme?

Solution:

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 description of memorandum of the work to be done during an audit. Audit programme serves as a guide in arranging and distribution the audit work as well as checking against the possibility of the omissions.

Section – B

Answer any three of the following: [15x3=45]

4. (a) KG Limited furnishes the following summarized Balance sheet as at 31st March, 2013

Liabilities	(₹ In lakhs)	Assets	(₹ In lakhs)
Equity share capital (fully paid up shares of ₹ 10 each)	1,200	Machinery	1,800
		Furniture	226
Securities Premium	175	Investment	74
General Reserve	265	Inventory	600
Capital Redemption Reserve	200	Trade Receivables	260
Profit & loss A/c	170	Cash at bank	740
12% Debentures	750		
Trade Payables	745		
Other current liabilities	195		
	3,700		3,700

On 1st April, 2013, the company announced the buy-back of 25% of its equity shares @ ₹ 15 per share. For this purpose, it sold all of its investments for ₹ 75 lakhs.
On 5th April, 2013 the company achieved the target of buy back. On 30th April, 2013 the company issued one fully paid up equity share of ₹ 10 by way of bonus for every four equity shares held by the equity share holders.
You are required to:
(1) Pass necessary journal enteris for the above transactions.
(2) Prepare balance sheet of KG Limited after bonus issue of the shares. [10]

Solution:

In the books of KG Limited
Journal Entries

Date 2013	Particulars	Dr. (₹ In lakhs)	Cr. (₹ In lakhs)
April 1	Bank A/c Dr. To Investment A/c To Profit on sale of investment A/c (being investment sold on profit)	75	 74 1
April 5	Equity shares buy back A/c Dr. To Bank A/c (Being the payment made on account of buy back of 30 lakh equity shares)	450	 450
	Equity Share Capital A/c Dr. Premium payable on buy back A/c Dr. To equity share buy-back A/c (Being the amount due to equity shareholders on buy back)	300 150	 450
April 5	General Reserve A/c Dr. Profit and Loss A/c Dr. To Capital Redemption Reserve A/c (Being amount equal to nominal value of buy back shares form free reserves transferred to capital redemption reserve account as per the law)	265 35	 300
April 30	Capital Redemption Reserve A/c Dr. To Bonus Shares A/c (W.N.1) (Being the utilization of capital redemption reserve to issue bonus shares)	225	 225
	Bonus Shares A/c Dr. To Equity Share Capital A/c (being issue of one bonus equity share for every four equity shares held)	225	 225
	Securities Premium A/c Dr. To Premium payable on buy back A/c (being premium payable on buy back adjusted from securities premium account)	150	 150

Balance sheet (After buy back and issue of bonus shares)

Particulars	Note No	Amount (₹ In lakhs)
I. **Equity and Liabilities**		
(1) Shareholder's funds		
(a) Share Capital	1	1,125
(b) Reserves and Surplus	2	436
(2) Non-current Liabilities		
(a) Long-term borrowings – 12% Debentures		750
(3) Current Liabilities		
(a) Trade Payables		745

(b) Other current liabilities		195
Total		3,251
II. **Assets** (1) Non-current assets (a) Fixed assets (i) Tangible assets	3	2,026
(2) Current Assets (a) Current investments (b) Inventory (c) Trade receivables (d) Cash and cash equivalents (W.N.2)		 600 260 365
Total		3,251

Notes to Accounts

1.	**Share capital** Equity share capital (Fully piad up shares of ₹ 10 each)			1125
2.	**Reserve and Surplus** (i) General Reserve Less: Transfer to CRR (ii) Capital Redemption Reserve (200+300) Less: Bonus Issue (iii) Securities Premium (175 – 150) (iv) Profit and Loss A/c (170 – 35 + 1)	 265 (265) 500 225	 - 275 25 136	 436
3	**Tangible assets** Machinery Furniture		 1800 226	 2026

Working Notes:

1. Amount of bonus shares = 25% of (1,200-300) lakhs = ₹ 225 lakhs

2. Cash at bank after issue of bonus shares

	₹ In lakhs
Cash balance as on 1st April, 2013	740
Add: shale of investment	75
	815
Less: Payment for buy back of shares	450
	365

(b) Viva ltd. received a specific grant of ₹ 30 lakhs for acquiring the plant of ₹ 150 lakhs during 2007-08 having useful life of 10 years. The grant received was credited to deferred income in the balance sheet. During 210-11, due to non-compliance of conditions laid down for the grant, the company had to refund the whole grant to the Government. Balance in the deferred income on that date was ₹ 21 lakhs and written down value of plant was ₹105 lakhs.

(i) What should be the treatment of the refund of the grant and the effect on cost of the fixed asset and the amount of depreciation to be charged during the year 2010-11 in profit and loss account?

(ii) What should be the treatment of the refund, if grant was deducted from the cost of the plant during 2007-08 assuming plant account showed the balance of ₹ 84 lakhs as on 1.4.2010? [5]

Solution:

As per para 21 of AS-12, 'Accounting for Government Grants', the amount refundable in respect of a grant related to specific fixed asset should be recorded by reducing the deferred income balance. To the extent the amount refundable exceeds any such deferred credit, the amount should be charged to profit and loss statement.

(i) In this case the grant refunded is ₹ 30 lakhs and balance in deferred income is ₹ 21 lakhs, ₹ 9 lakhs shall be charged to the profit and loss account for the year 2010-11. There will be no effect on the cost of the fixed asset and depreciation charged will be on the same basis as charged in the earlier years.

(ii) If the grant was deducted from the cost of the plant in the year 2007-08 then, para 21 of AS-12 states that the amount refundable in respect of grant which relates to specific fixed assets should be recorded by increasing the book value of the assets, by the amount refundable. Where the book value of the asset is increased, depreciation on the revised book value should be provided prospectively over the residual useful life of the asset. Therefore, in this case, the book value of the plant shall be increased by ₹ 30 lakhs. The increased cost of ₹ 30 lakhs of the plant should be amortized over 7 years = ₹ 16.286 lakhs presuming the depreciation is charged on SLM.

5. (a) On 1st April, 2012 in MK Ltd.'s ledger 9% debentures appeared with a opening balance of ₹ 50,00,000 divided into 50,000 fully paid debentures of ₹ 100 each issued at par.

Interest on debentures was paid half-yearly on 30th September and 31st March every year.
On 31.5.2012, the company purchased 8,000 debentures of its own @ ₹98 (ex-interest) per debenture.
On 31.12.2012 it cancelled 5,000 debentures out of 8,000 debentures acquired on 31.5.2012.
On 31.1.2013 I resold 2,000 of its own debentures in the market @ ₹ 101 (ex-interest) per debenture.
You are required to prepare:
(i) Own debentures account;
(ii) Interest on debentures account; and
(iii) Interest on own debentures account. [8]

Solution:

MK Ltd.'s ledger
Own Debentures Account

(i)

Dr. Cr.

Date	Particulars	₹	Date	Particulars	₹
31.5.12	To Bank	7,84,000	31.12.12	By 9% Debentures A/c	5,00,000
31.12.12	To Capital Reserve (profit on cancellation)	10,000	31.1.13	By Bank-resale of 2,000 debentures	2,02,00
31.1.13	To profit and loss A/c (profit on resale)	6,000	31.3.13	By Balance c/d	98,000
		8,00,000			8,00,000

(ii) Interest on Debentures Account

Dr. Cr.

Date	Particulars	₹	Date	Particulars	₹
31.5.12	To Bank A/c (interest for 2 months on 8,000 debentures)	12,000	31.3.13	By profit and Loss A/c	4,38,750
30.9.12	To Interest on own debentures A/c (interest for 4 months on 8,000 debentures	24,000			

30.9.12	To Bank A/c (interest for 6 months on 42,000 debentures)	1,89,000			
31.12.12	To Interest on own debentures A/c (interest for 3 months on 5,000 debentures)	11,250			
31.3.13	To Interest on own debentures A/c (interest for 6 months on 1,000 debentures)	4,500			
31.3.13	To Bank (interest for 6 months on 44,000 debentures)	1,98,000			
		4,38,750			4,38,750

(iii) Interest on own Debentures Account

Dr. **Cr.**

Date	Particulars	₹	Date	Particulars	₹
31.3.13	To Profit and Loss A/c	45,750	30.9.12	By Interest on debentures A/c	24,000
			31.12.12	By Interest A/c debentures A/c	11,250
			31.01.13	By Bank (interest for 4 months on 2,000 debentures)	6,000
			31.03.13	By Interest on debentures	4,500
		45,750			45,750

Working Notes:

31.5.12	Acquired 8,000 debentures @ ₹98 per debenture (ex-interest) Purchase price of debenture (8,000 x ₹98) = Interest for 2 months (₹8,00,000 x9%x2/12) =	 7,84,000 12,000
30.9.12	Interest on own debentures (₹8,00,000 x9%x1/2) less ₹12,000 Interest on other debentures ₹42,00,000 x9%x1/2	 24,000 1,89,000
31.1.13	Cancellation of 5,000 own debentures Face value ₹100 less acquired at ₹98 = 2x5,000	 10,000
31.1.13	Resale of 2,000 debentures sold for 101 (ex-interest) acquired for ₹98 (ex-interest) 2,000 x 3 per debenture	 6,000
31.12.12	Interest on cancelled 5,000 debentures 5,000 x ₹100 x9% x ¼	 11,250
31.3.13	Interest on 1,000 own debentures ₹1,00,000 x9%x ½	 4,500

(b)Write about finance lease and operating lease. **[7]**

Solution:

(a) Finance Lease:

It is a lease, which transfers substantially all the risks and rewards incidental to ownership of an asset to the lessee by the lessor but not the legal ownership. In following situations the lease transactions are called finance lease.

- The lease will get the ownership of leased asset at the end of the lease term.
- The lessee has an option to buy the leased asset at the end of term at price, which is lower than its expected fair value at the date on which option will be exercised.
- The lease term covers the major part of the life of asset.
- At the beginning of lease term, present value of minimum lease rental covers substantially the initial fair value of the leased asset.
- The asset given on lease to lessee is of specialized nature and can only be used by the lessee without major modification.

(b) Operating Lease:

It is a lease which does not transfer substantially all the risk and reward incidental to ownership.

Classification of lease is made at the inception of the lease; if at any time the lessee and lessor agree to change the provision of lease and it results in different category of lease, it will be treated as separate agreement.

Applicability:

The Accounting standard is not applicable to following types of lease:

- Lease agreement to explore natural resources such as oil, gas, timber, metal and other mineral rights.
- Licensing agreements for motion picture film, video recording, plays, manuscripts, patents and other rights.
- Lease agreement to use land.

6. (a) The summarized Balance Sheet of Full Stop Limited as on 31st March 2013, being the date of voluntary winding up is as under:

Liabilities	₹	Assets	₹
Share capital:		Land & building	5,20,000
5,000, 10% Cumulative		Plant & machinery	7,80,000
Preference shares of ₹ 100		Inventory in trade	3,25,000
Each fully paid up	5,00,000	Book debts	10,25,000
Equity share capital:		Profit & loss account	5,50,000
5,000 equity shares of ₹ 100			
Each ₹ 60 per share called And paid up	3,00,000		
5,000 equity shares of ₹ 100 Each ₹ 50 per share called up and paid up	2,50,000		
Securities premium	7,50,000		
10% debentures	2,10,000		
Preferential creditors	1,05,000		
Bank overdraft	4,85,000		
Trade creditors	6,00,000		
	32,00,000		32,00,000

Preference dividend is in arrears for three years. By 31-03-2013, the assets realized were as follows:

	₹
Land & building	6,20,000
Inventory in trade	3,10,000
Plant & machinery	7,10,000
Book debts	6,60,000

Expenses of liquidation are ₹86,000. The remuneration of the liquidator is 2% of the realization of assets. Income tax payable on liquidation is ₹67,000. Assuming that the final payments were made on 31-03-2013, prepare the liquidator's statement of account. [9]

Solution:

Liquidator's Statement of Account

Receipts	₹	Payments	₹
Land & building	6,20,000	Liquidators remuneration	46,000
Inventory in trade	3,10,000	Liquidation expenses	86,000
Plant & machinery	7,10,000	10% debentures	2,10,000
Book debts	6,60,000	Preferential creditors	1,05,000
		Income tax payable	67,000
		Bank overdraft	4,85,000
		Trade creditors	6,00,000
		Preference shareholders:	
		Capital	5,00,000
		Arrears of preference dividend for 3 years	1,50,000
		Refund on 5,000 shares of ₹ 60 paid up @ ₹ 10.10 per share (Refer W.N)	50,500
		Refund on 5,000 shares of ₹ 50 paid up @ 0.10 per share (Refer W.N)	500
	23,00,000		23,00,000

Working note:

	₹
Total equity capital paid up (3,00,000 + 2,50,000)	5,50,000
Less: Balance available after payment to secured, unsecured, preferential creditors and preference shareholders (23,00,000 – 46,000 – 86,000-2,10,000 – 1,05,000 – 67,000 – 4,85,000 – 6,00,000 – 5,00,000 – 1,50,000)	(51,000)
Loss to be borne by 10,000 equity shareholders	4,99,000
Loss per share	49.90
Hence, amount of refund on ₹ 50 per share paid up (₹ 50 – ₹ 49.90)	0.10
Amount of refund on ₹ 60 per share paid up (₹60 - ₹ 49.90)	10.10

(b) Gemini Ltd. came up with public issue of 30,00,000 equity shares of ₹ 10 each at ₹ 15 per share. A,B and C took underwriting of the issue in 3:2:1 ratio.
Applications were received for 27,00,000 shares.
The marked applications were received as under:

A	**8,00,000 shares**
B	**7,00,000 shares**
C	**60,00,00 shares**

Commission payable to underwriters is at 5% on the face value of shares.

(i) Compute the liability of each underwriter as regards the numbers of shares to be taken up.
(ii) **Pass journal entries in the books of Gemini Ltd. to record the transactions relating to underwriters. [6]**

Solution:

(i) Computation of liability of underwriters in respect of shares

	(in Shares)

	A	B	C
Gross liability (Total issue – promoters etc) in agreed ration of 3:2:1	15,00,000	10,00,000	5,00,000
Less: Unmarked applications (Subscribed shares – marked shares) in 3;2:1	(3,00,000)	(2,00,000)	(1,00,000)
Marked shares as per agreed ratio	12,00,000	8,00,000	4,00,000
Less: Marked applications actually received	(8,00,000)	(7,00,000)	(6,00,000)
Shortfall/surplus in marked shares	4,00,000	1,00,000	2,00,000
Surplus of C distributed to A & B in 3;2 r ratio	(1,20,000)	(80,000)	(20,00,000)
Net liability for underwriting shares	2,80,000	20,000	Nil

(ii) Journal Entries in the books of Gemini Ltd.

Particulars		₹	₹
A's A/c	Dr.	42,00,000	
B's A/c	Dr.	3,00,000	
To Share Capital A/c			30,00,000
To Securities Premium A/c			15,00,000
(Being the shares to be taken up by the underwriters)			
Underwriting Commission A/c	Dr.	15,00,000	
To A's A/c			7,50,000
To B's A/c			5,00,000
To C's A/c			2,50,000
(Being the underwriting commission due to the underwriters)			
Bank A/c	Dr.	34,50,000	
To A's A/c			34,50,000
(Being the amount received from underwriter A for the shares taken up by him after adjustment of his commission)			
B'S A/c	Dr.	2,00,000	
To Bank A/c			2,00,000
(Being the amount paid to underwriter B after adjustment of the shares taken by him against underwriting commission due to him)			
C's A/c	Dr.	2,50,000	
To Bank A/c			2,50,000
(Being the underwriting commission paid to C)			

Note: C had sold in excess of the underwriting obligation and hence he will not be required to purchase any shares but will get commission for underwriting.

7. (a) The balance sheet of bad luck Co. Ltd. As at 31.03.2015 is:

Liabilities	**₹**	**Assets**	**₹**
1,00,000 equity shares of ₹ 10 each	**10,00,000**	**Goodwill**	**2,00,000**
Fully paid-up		**Other Assets**	**9,00,000**
10% 4,000 debentures of ₹ 100 each	**4,00,000**	**Profit & loss A/c**	**5,00,000**
Interest on debentures	**40,000**		
Sundry creditors	**16,00,000**		**16,00,000**

For the purpose of reconstruction of the company, necessary resolutions are passed on the following lines:

(i) The equity shares are to be sub-divided into shares of ₹ 1 each and each shareholder shall surrender 60% of his holding.

(ii) Out of the surrendered shares, 60,000 shares will be converted to 8% preference shares of ₹ 10 each.

(iii) Debentures holders will reduce their total claims by ₹ 1,40,000 and in considerations, the debenture holders are to get the entire preference share capital converted from shares surrendered.

(iv) Creditors claims are to be reduced to the extent of ₹ 1,00,000 and in consideration they are to receive equity shares of ₹ 1 each amounting to ₹40,000 from the shares surrendered.

(v) Goodwill and profit and loss A/c (Dr.) are to be written – off completely.

(vi) The remaining surrendered shares shall be cancelled.

You are required to give the journal entries. [6]

Solution:

In the books of bad luck Co. Ltd Journal

Date	Particular	L.F	Debit	Credit
2014 April, 1	Equity Share (₹ 10) Capital A/c Dr. To Equity Share (₹ 1) Capital A/c (1,00,000 equity shares of ₹ 10 each, fully piad, sub-divided into 10,00,000 equity shares of ₹ 1 each, fully paid, as per special resolution No….. dated….. as confirmed by the court)		10,00,000	 10,00,000
	Equity Share (₹ 1) Capital A/c Dr. To Share Surrendered A/c (6,00,000 equity shares of ₹ 1 each, fully paid, surrendered to the company as per special resolution No…. dated ….. as confirmed by the court)		6,00,000	 6,00,000
	Share Surrendered A/c Dr. To 8 % Pref. Share Capital A/c (out of the shares surrendered , 60,000 shares of ₹ 1 each converted into 8% pref. shares as per reconstruction scheme …… as confirmed by court)		60,000	 60,000
	10% Debentures A/c Dr. Interest on Debentures A/c Dr. To capital reduction A/c (Amount of 1,000, 10% debentures and accrued interest sacrificed by the debenture holders, transferred to capital reduction A/c as per special resolution No…… dated….. As confirmed by the court)		1,00,000 40,000	 1,40,000
	Sundry Creditors A/c Dr. To Capital Reduction A/c (Amount sacrificed by creditors, transferred to capital reduction A/c as per special resolution No…….. dated…… As confirmed by the court)		60,000	 60,000
	Share Surrendered A/c Dr. To equity share (₹ 1) capital A/c (40,000 equity shares of ₹ 1 each out of shares surrendered, issue to the creditors as per special resolution No….. dated….. As confirmed by the court)		40,000	 40,000
	Share Surrendered A/c Dr. To Capital Reduction A/c (Balance of shares surrendered, not used, transferred to capital reduction A/c as per special resolution No…… dated……. As confirmed by the court)		5,00,000	 5,00,000
	Capital Reduction A/c Dr. To Goodwill A/c To Profit & Loss A/c (amount of capital reduction utilized for writing – off goodwill and debit balance of profit & loss A/c)		7,00,000	 2,00,000 5,00,000

(b) The following were the summarized balance sheets of P Ltd. and V Ltd. as at 31st March 2014:

Liabilities	P Ltd. (₹ In lakhs)	V Ltd. (₹in lakhs)
Equity share capital (Fully paid shares of ₹ 10 each)	15,000	6,000
Securities premium	3.000	-
Foreign project reserve	-	310
General Reserve	9,500	3,200
Profit and loss account	2,870	825
12% Debentures	-	1,000
Trade payables	1,200	463
Provisions	1,830	702
	33,400	12,500

Assets	P Ltd. (₹ In lakhs)	V Ltd. (₹in lakhs)
Land and Buildings	6,000	-
Plant and Machinery	14,000	5,000
Furniture, fixtures and fittings	2,304	1,700
Inventory	7,862	4,041
Trade receivables	2,120	1,100
Cash at bank	1,114	609
Cost of issue of debentures	-	50
	33,400	12,500

All the bills receivable held by V Ltd. were P Ltd's acceptances.

On 1st April 2014, took over V Ltd. in an amalgamation in the nature of merger. It was agreed that in discharge of consideration for the business P ltd. would allot three fully paid equity shares of ₹ 10 each at par for every two shares held in V Ltd. it was also agreed that 12% debentures in V Ltd. would be converted into 13% debentures in P Ltd. of the same amount and denomination.

Details of trade receivables and trade payables as under:

Assets	P Ltd (₹ In lakhs)	V ltd. (₹ In lakhs)
Trade payables	120	-
Bills payable	1,080	463
Creditors	1,200	463
Trade receivables		
Debtors	2,120	1,020
Bills receivable	-	80
	2,120	1,100

Expenses of amalgamation amounting to ₹ 1 lakhs were borne by P Ltd.

You are required to:

(i) Pass journal entries in the books of P Ltd. and
(ii) Prepare P Ltd.'s balance sheet immediately after the merger. [9]

Solution:

Book of P Ltd. Journal Entries

Particulars	Dr. (₹In Lakhs)	Cr. (₹ In Lakhs)
Business Purchase A/c Dr. To Liquidator of V Ltd. (being business of V Ltd. taken over for consideration settled as per agreement)	9,000	 9,000
Plant and Machinery Dr.	5,000	
Furniture & Fittings Dr.	1,700	
Inventory Dr.	4,041	
Debtors Dr.	1,020	
Cash at Bank Dr.	609	
Bills receivable Dr.	80	
To Foreign Project Reserve		310
To General Reserve (3,200 – 3,000)		200
To Profit and Loss A/c (825 – 50)		775
To Liability for 12% debentures		1,000
To Creditors		463
To Provisions		702
To Business Purchase (Being assets & Liabilities taken over from V Ltd.)		9,000
Liquidator of V Ltd. A/c Dr. To Equity Share Capital A/c (purchase consideration discharged in the form of equity shares)	9,000	 9,000
Profit & Loss A/c Dr. To Bank A/c (liquidation expenses paid by P Ltd.)	1	 1
Liability for 12% debentures A/c Dr. To 13% Debentures A/c (12% debentures discharged by issue of 13% debentures)	1,000	 1,000
Bills Payable A/c Dr. To Bills Receivable A/c (cancellation of mutual owing on account of bills)	80	 80

Balance sheet of P Ltd. as at 1st April, 2012 (after merger)

Particulars	Notes	₹ (in lakhs)
Equity and Liabilities		
1. Share holders funds		
(a) Share capital	1	24,000
(b) Reserves and Surplus	2	16,654
2.Non-current liabilities		
(a) Long-term borrowings	3	1,000
3. Current liabilities		
(a) Trade payables (1,543 + 40)		1,583
(b) Short-term provisions		2,532
Total		45,769
Assets		
1. Non-current assets		
(a) Fixed Assets		
Tangible assets	4	29,004

2. Current assets (a) inventories (b) trade receivables (c) Cash and cash equivalents		 11,903 3,140 1,722
Total		45,769

Notes to accounts

	₹
1. Share capital Equity share capital Authorized, issued, subscribed and paid up 24 crores equity shares of ₹ 10 each (of the above shares, 9 crores shares have been issued for consideration other than cash)	 **24,000**
2. Reserves and surplus General Reserve (9,500 + 200) Securities Premium Foreign Project Reserve Profit and Loss Account (2,870 + 775 – 1) **Total**	 9,700 3,000 310 3,644 **16,654**
3. Long-term borrowings Secured 13% debentures	 **1,000**
4. Tangible assets Land & buildings Plant & machinery Furniture & fittings **Total**	 6,000 19,000 4,004 **29,004**

Working Note:

Computation of purchase consideration

The purchase consideration was discharged in the form of three equity shares of P Ltd. for every two equity shares held in V Ltd.

Purchase consideration = ₹ 6,000 lacs x 3/2 = ₹ 9,000 lacs

Note:

The question is silent regarding the treatment of fictitious assets and therefore they are not transferred to the amalgamated company. Thus the cost of issue of debentures shown in the balance sheet of the V Ltd. company is not transferred to the P Ltd. company.

Section – C

Answer any two of the following **[15x2=30]**

8.(a) What are the differences between internal control, internal check and internal audit? [9]

Solution:

S. No	Basis	Internal Audit	Internal Control	Internal check
1	Meaning	It is a continuous critical review of financial and operating activities by a staff member of	It consists of all the methods and procedures adopted to assist in achieving the objective of efficient conduct of	A system of allocation of responsibility, division of work and methods of recording transactions, whereby the work of an employee is checked continuously by

		the auditor.	business. It includes internal check and internal audit.	another.
2	Way of checking	In an internal audit system, each component of work is checked.	In internal controls systems, work of one person is automatically checked by another.	It operates in routine to doubly check every part of a transaction at the time of occurrence and recording of the same.
3	Objective	Its objective is to evaluate the internal control system and to detect frauds and errors.	Its objective is to ensure adherence to management policies, safeguarding of assets, prevention and detection of frauds and errors, accuracy and completeness of accounting records.	Its objective is to ensure that no one employee has exclusive control over any transaction or group of transactions and their recording in the books.
4	Point of time	In an internal audit system, work is checked after it is done.	In an internal control system, checking is done simultaneously with the conduct of work. Every transaction is checked as soon as it is entered.	Methods of recording transactions are devised where work of an employee is checked continuously by correlating it with the work of others.
5	Thrust of system	The thrust of internal system is to detect errors and frauds	The thrust of internal check system is to prevent errors.	The thrust of internal control lies in fixing of responsibility and division of work to avoid duplication.
6	Cost involvement	In an internal audit system, work is checked specially therefore cost is involved in addition to accounting.	The system provest to be costly in case of small businesses because more number of employees are engaged.	It is a part of internal control and a method of division of work, therefore does not add to the cost.
7	Report	The internal auditor submits his report to the management.	Internal controls provide for built in MIS reports.	The summary of day to day transactions work as report for the senior.

(b) Write about audit risk? [6]

Solution:

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

"Audit risk" is the risk that the auditor gives an in appropriate audit opinion when the financial statements are materially misstated. Such misstatements can result from either fraud or error. SA 400 on "Risk Assessments and internal controls" identifies the following three components of audit risk:

(i) **Inherent risk** – it is the susceptibility of an account balance or class of transaction to misstatements that could be material, either individually or when taken together with misstatements in other balance or classes, assuming that there were no internal controls.

(ii) **Control risk** – It is the risk that misstatement, that could occur in an account balance or class of transactions and that could be material, either individually or where taken together with misstatements in other balances or classes, will not be prevented/detected/corrected on timely basis by the accounting and internal control systems.

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

9. (a) What is the procedure of audit of commercial account? [8]

Solution:

Audit of Commercial Accounts

The government also engages in commercial activities and for the purpose it may incorporate following types of entities:

(i) Departmental enterprises engaged in commercial and trading operations, which are governed by the same regulations as other Government departments such as defence factories, mints, etc.
(ii) Statutory corporations created by specific statues such as LIC, Air India, etc.
(iii) Government companies, set up under the Companies Act, 2013.

All aforesaid entities are required to maintain accounts on commercial basis. The audit of departmental entities is done in the same manner as any Government department, where commercial accounts are kept. Audit of statutory corporations depends on the nature of the statute governing the corporation. In respect of government companies, the relevant provisions of Companies Act, 2013 are applicable. As per section 139 of the Companies Act, 2013 the statutory auditor of a Government company shall be appointed or re-appointed by the CAG. Such an auditor must be a chartered accountant. Further, the Companies Act, 2013, provides that the CAG shall have the powers:

(i) to direct the manner in which the company's accounts shall be audited by the auditor, and to give the auditor instructions in regard to any matter relating to the performance of his functions; and
(ii) to conduct a supplementary or test audit of the company's accounts by such person, as he may authorise in this behalf, and for the purposes of such audit to require information or additional information to be furnished to any person or persons, so authorised on such matters by such person or persons, and in such form as the CAG may direct.

The statutory auditor shall submit a copy of his audit report to the CAG, who shall have the right to comment upon or supplement the audit report in such manner he may think fit.

Any such comments upon or supplement to the audit report shall be placed before the company, at the same time, and in the same manner, as the audit report. Thus, it is seen that there is a two layer audit of a Government company, by the statutory auditors, being qualified chartered accountants, and by the CAG. The general standards, principles, techniques and procedures for audit adopted by the C&AG are a mixture of government audit and commercial audit as known and practiced by professional auditors. The concepts of autonomy and accountability of the institution / bodies / corporations / companies have influenced the nature and scope of audit in applying the conventional audit from the angle of economy, efficiency and effectiveness.

(b) What is the role of cost auditor in the company? [7]

Solution:

Role of Cost Audit

Government needs authentic and reliable data of cost for various purposes like price fixation of controlled commodities. The information is also useful in various decisions like fixation of duty drawback, export incentives, amount of excise duty the product can bear, deciding whether special incentives are required to a particular industry etc.

Usefulness of Cost data to Company - The cost data is useful to company in

- Price fixation of final products
- Controlling wasteful expenditure
- Reduction of waste and scrap
- Optimum utilisation of labour, material and machinery
- Deciding proper product mix to optimise production and profitability
- To eliminate loss making products
- Improving efficiency
- Supplying cost data when required by Government
- Taking 'make or buy' decision
- Making break even analysis for decision making etc.

Maintenance of Cost Records

Realising the importance of proper cost records and control, section 148(1) of the 2013 Act provides that Central Government can direct that particulars relating to the utilisation of material or labour or to other items of cost as may be prescribed shall also be included in the books of account kept by that class of companies. The direction can be issued to such class of companies engaged in the production of such goods or providing such services as may be prescribed by a notification.
In respect of companies regulated by special Act (like insurance, banking, electricity), the Central Government shall, consult the regulatory body constituted or established under such special Act before issuing such order in respect of any class of companies - provision to section 148(1) of the 2013 Act.

Cost Audit

If the Central Government is of the opinion, that it is necessary to do so, it may, by order, direct that the audit of cost records of class of companies, which are covered under section 148(1) of the 2013 Act (for maintenance of cost records) and which have a net worth of such amount as may be prescribed or a turnover of such amount as may be prescribed, shall be conducted in the manner specified in the order [section 148(2) of the 2013 Act.]
The cost audit is necessary only when specific order is issued by Central Government.

Audit by Cost Accountant

Cost Audit can be done only by a 'Cost Accountant'. The Cost Accountant/ firm of cost accountants will be appointed by Board of Directors of the company. His remuneration will be fixed by members in the prescribed manner [section 148(3) of the 2013 Act].
"Cost accountant" means a cost accountant as defined in section 2(1)(b) of the Cost and Works Accountants Act, 1959 [section 2(28) of the 2013 Act].
As per government guidelines, a Cost Accountant holding certificate of practice on part time basis is not entitled to conduct cost audit. Thus, only a Cost Accountant in whole-time practice can conduct cost audit.

10. (a) What is India's response to auditors needs? [7]

Solution:

India's response to Audit Needs

The Institute of Chartered Accountants of India was set up in 1949 to regulate the profession of chartered accountancy in India. Since its establishment, the Institute has taken numerous steps to ensure that its members discharge their duties with due professional care, competence and sincerity. One of the steps is the establishment of the Auditing Practices Committee, or the Auditing and Assurance Standards Board, as it is now known in September, 1982.
One of the main objectives of the Board is to issue auditing standards. Accordingly, the Board issues Statements on Standard Auditing Practices and Auditing and assurance Standards under the authority of the Council.

Rationale of Auditing Standards
In simplest possible terms, auditing standards represent a codification of the best practices of the profession, which are already existing. Auditing standards help the members in proper and optimum discharge of their profession duties. Auditing standards also promote uniformity in practice as also comparability.

Auditing standards – setting in India
As mentioned earlier, the Auditing and Assurance Standards Board of the Institute formulates the auditing standards. Broadly, following is the procedure for formulating auditing standards:
i.. The Auditing and Assurance Standards Board identifies the areas where auditing standards need to be formulated and the priority in regard to their selection.
ii. In the preparation of the auditing standards, the Board is normally, assisted by study groups comprising of a cross section of members of the Institute.
iii. On the basis of the work of the study groups, an Exposure Draft of the proposed auditing standard is prepared by the Board and issued for comments of the members.
iv. After taking into the comments received, the draft of the proposed auditing standard is finalised by the Board and submitted to the Council of the Institute.
v. The Council considers the final draft of the proposed auditing standard and, if necessary, modifies the same in consultation with the Board. The auditing standard is then issued under the authority of the Council.
While formulating the auditing standards, the Board also takes into consideration the applicable laws, customs, usages and business environment in the country.

International harmonization of auditing standards
The Institute of Chartered Accountants of India is a member of the International Federation of Accountants. Therefore, as a matter of policy, the auditing standards issued by the ICAI are in harmony with the International Standards on Auditing. Till date, the IAASB of the IFAC has issued thirty nine Engagement Standards, comprising one Standard on Quality control (ISQC), thirty two ISAs, two International Standards on Review Engagements (ISREs), two International Standards on Assurance Engagements (ISAEs) and two International Standards on Related Services (ISRSs). The ICAI has issued thirty five auditing standards corresponding to the

Engagement Standards issued by the IAASB of the IFAC and three auditing standards are in the pipeline.
Further, the Council of the Institute of Chartered Accountants of India has also approved the following technical drafts:
i. Preface to the Standards on Quality Control, Auditing, Review, Other Assurance and Related Services
ii. Due Process of the Auditing and Assurance Standards Board
iii. Revised Classification and Numbering Pattern of the Auditing and Assurance Standards
iv. Framework for Assurance Engagements

(b) How audit is conducted for investments? [8]

Solution:

Investment:
i. Insist on a schedule of investments, when number of investments held by the auditee is very large.
ii. Examine the investment schedule with reference to the relevant ledger accounts.
iii. See that the investments have been shown properly in the Balance Sheet
iv. He should verify the existence of investments by inspecting the certificate, deposit receipts etc.,
v. Obtain a certificate from bank of certain securities given to the bank for safe custody.
vi. Examine the transfer deed, broker's contract note if certificate of investments is not received upto the date of audit of the securities purchased during the year under audit.
vii. Examine the trust deed if securities are held by a trust on behalf of the client.
viii. Verify the Sales proceeds from pass book of the sale of any securities made after the date of Balance Sheet but before the audit.
ix. Verify relevant vouchers and certificates whether securities are free from any charge or not
x. See whether investments are properly valued or not giving consideration to the provisions of the Articles of Association in case of trust companies as they are valued at cost but in case of finance companies they are valued, being traded as current assets, at cost price or market price, whichever is less.
xi. See that regarding the investments in subsidiaries, disclosure requirements of section 133 are complied with.
xii. Check the balance in the schedule of investments in the name of the client and compare it with the general ledger and Balance Sheet. See that the investments are in the name of the client.
xiii. See that investments made by the company are not contrary to the provisions of section 186 of the Indian Companies Act, 2013.
xvi. In case of application money paid for shares which are still to be allotted, the fact is to be specifically disclosed in Balance Sheet.
xvii. Confirm that uncalled amount on partly paid shares held as investment is shown as contingent liability in Balance sheet.
xviii. The auditor has to report, as per section 143 of the Companies Act, whether any shares, debenture sold at price lower than their cost, in the case of finance company, whether proper records of investments are kept.
xix While auditing the investments the auditor should keep in mind the provisions of AS 13.