Paper 12- Company Accounts & Audit

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

Section – A

I. Answer all the following questions:

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

(i) Income from Operating Activities is ₹70 lakhs;
Fixed Asset sold for ₹100 lakhs;
Machinery Sold for ₹130 lakhs;
Income from Financing Activities is ₹20 lakhs, compute the net effect on Cash Flow.

Answer:

Particulars	₹ in lakhs	₹ in lakhs
A. Cash flow from Operating Activities		70
B. Cash flow from Investing Activities		
Sale of Fixed Asset	100	
Sale of Machinery	130	230
C. Cash flow from Financing Activities		20
Net increase Cash Flow (A+B+C)		320

(ii) The Following data apply to a company's defined benefit pension plan for the year:

Particulars	Amount (₹)
Fair market value of plan assets (beginning of year)	**4,00,000**
Fair market value of plan assets	**5,70,000**
Employer Contribution	**1,40,000**
Benefit Paid	**1,00,000**

Calculate the actual return on plan assets.

Answer:

The actual return is computed as follows:

Particulars		Amount (₹)
Fair market value of plan assets (end of year)		5,70,000
Fair market value of plan assets (beginning of year)		4,00,000
Change in plan assets		1,70,000
Adjusted for		
Employer contributions	1,40,000	
Less: Benefit Paid	1,00,000	40,000
Actual return on plan assets		1,30,000

(iii) The share capital of M Ltd. consists of 1,00,000 equity shares of ₹10 each, and 25,000 preference shares of ₹100 each, fully called up. Besides, its securities premium account shows a balance of ₹40,000 and general reserve of ₹7,00,000. The company decides to buy-back 30,000 equity shares of ₹12 each. For this purpose, it utilises the securities premium in full and general reserve to the extent necessary.

Pass the necessary journal entries only showing the effects on the securities premium account and the general reserve account.

Answer:

Journal Entries

Particulars	Dr. (₹)	Cr.(₹)
Equity Share Capital A/c Dr. Securities Premium A/c Dr. General Reserve A/c Dr. To, Equity Shareholders A/c (Being the amount due to equity shareholders for buying-back of 30,000 equity shares)	3,00,000 40,000 20,000	 3,60,000
General Reserve A/c Dr. To, Capital Redemption Reserve A/c (Being the nominal amount or equity shares bought back transferred)	3,00,000	 3,00,000

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

Answer:

Journal Entry

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

(v) PROMET LTD. follows a policy of refunding money to the dissatisfied customers if they claim within 15 days from the date of purchase and return the goods. It appears from the past experience that in a month only 0.2% of the customers claims refunds.
The company sold goods amounting to ₹ 30 Lakh during the March, 2016.
State how the matter will have to deal with in the accounts for the year 2015-16.

Answer:

There is a probable present obligation as a result of past obligating event. The obligating event is the sale of product. Provision should be recognized as per AS-29.
So, a provision of ₹ 6,000 (₹ 30 lakh × 0.2%) should be provided in the financial accounts for the year 2015-16.

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

	Column 'A'		Column 'B'
1.	**Provision for Restructuring cost**	**A.**	**AS - 15**
2.	**Diluted Potential equity share**	**B.**	**Investing Activities of Cash Flow**

3.	**Amalgamation in the nature of merger**	**C.**	**AS-20**
4.	**Interest and Dividend Received**	**D.**	**AS-29**
5.	**Treatment of Voluntary Retirement Scheme Payments**	**E.**	**Pooling of Interest Method**

Answer:

	Column 'A'		**Column 'B'**
1.	Provision for Restructuring cost	D.	AS-29
2.	Diluted Potential equity share	C.	AS-20
3.	Amalgamation in the nature of merger	E.	Pooling of Interest Method
4.	Interest and Dividend Received	B.	Investing Activities of Cash Flow
5.	Treatment of Voluntary Retirement Scheme Payments	A.	AS – 15

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

(i) List the uses of Interim Audit.

Answer:

Following are the use of Interim Audit:

- Early detection and rectification of errors & frauds;
- Publishing of interim results in some cases;
- Timely completion of records and final audit;
- Moral checks on employees.

(ii) What do you understand by test checking in Audit Work?

Answer:

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 full series of items.

(iii) What are the advantages of Social Audit?

Answer:

The advantages of Social Audit may be enumerated as below:

(i) Encourages community participation among different business entities.

(ii) Ensures continuous efforts towards environmental protection and use of environment friendly production processes.

(iii) Builds customer satisfaction and trust through ethical business practices.

(iv) Promotes collective decision making and sharing responsibilities.

(v) Develops human resources by working towards improvement of workers' and the underprivileged persons' working / living conditions.

(iv) What do you understand by Audit Evidence?

Answer:

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

(v) Vouch foreign travelling expenditure of a Director and list any two issues.

Answer:

Following are the two issues related to the vouching of foreign travelling expenditure of a Director:

- Visa for travel — which shows the purpose of travel.
- Amount of Foreign exchange — Sanctioned for the travel including the authenticity/jurisdiction of the sanctioning authority. Sanction given by the board , if any.

Section - B

II. Answer any three questions out of the following: [3×15=45]

4. (a) OM Ltd. had ₹20,00,000, 8% Debentures of ₹100 each as on 31st March,2016. The company purchased Debentures in the Open Market following immediate cancellation:

On 01.07.2016: 2,000 Debentures at ₹97 (cum-interest).
On 29.02.2016: 3,600 Debentures at ₹99 (ex- interest).

Debenture Interest due dates are 30th September and 31st March.

Give Journal Entries in the books of the Company for the year ended 31st March, 2017. [10]

Answer:

Journal Entries

Date	Particulars	Dr.(₹)	Cr.(₹)
01.07.2016	Investment in Own 8% Debentures A/c Dr. Interest on Own 8% Debentures A/c Dr. To, Bank A/c [Being, 2,000 Debentures purchased at ₹97 cum-interest. Payment = 1,94,000, Interest from 1st July to 30th September = 2,00,000 × 8% × ¼ = 4,000, hence, balance = Cost.]	1,90,000 4,000	 1,94,000
01.07.2016	8% Debentures A/c Dr. To, Investment in Own 8% Debentures A/c To, Profit on Cancellation of Own Debentures A/c [Being, Cancellation of Own Debentures.]	2,00,000	 1,90,000 10,000
30.09.2016	Interest Expense A/c Dr.	72,000	

	To, Bank A/c (18,00,000 × 8% × ½) [Being, half yearly Debenture Interest paid on ₹18,00,000 for 6 months.]		72,000
29.02.2017	Investment in Own Debentures A/c (3,600 × ₹99) Dr. Interest on Own 8% Debentures A/c Dr. To, Bank A/c [Being, 3,600 Debentures purchased at ₹99 ex-interest. Interest from 1st October to 29th February , i.e. for 5 months = 3,600 × 100 × 8% × $\frac{5}{12}$ = ₹12,000.]	3,56,400 12,000	 3,68,400
29.02.2017	8% Debentures A/c Dr. To, Investment in Own 8% Debentures A/c To, Profit on Cancellation of Own Debentures A/c [Being, cancellation of Own Debentures.]	3,60,000	 3,56,400 3,600
31.03.2017	Interest Expenses A/c Dr. To, Bank A/c (14,40,000 × 8% × $\frac{6}{12}$) [Being, Half-Yearly Interest paid on Debentures ₹14,40,000 for 6 months.]	57,600	 57,600
31.03.2017	Profit & Loss A/c Dr. To, Interest on Own 8% Debentures A/c To, Interest Expense A/c [Being, Interest Expense transferred to Profit & Loss A/c]	1,45,600	 16,000 1,29,600
31.03.2017	Profit on Cancellation of Owned Debentures A/c Dr. To, Profit & Loss A/c [Being, Profit on cancellation transferred to Profit & Loss A/c]	13,600	 13,600

- In the above case the Profit on Cancellation of Owned Debenture is routed through the **"Profit on Cancellation of Owned Debentures A/c"**.

(b) As at the end of a financial year, on 31st March, Vidisha Ltd. has 5,000 Shares of Face Value ₹10 each. The Stock Options outstanding at that date are for 1,000 Shares. Net Loss for the year is ₹90,000. Fair Value of the Shares on the date of grant and the Exercise Price are ₹8.10 and ₹ 6 per Share respectively. Compute the Basic and Diluted EPS. [5]

Answer:

Basic EPS = $\frac{\text{Net Loss attributable to Equity Shareholders}}{\text{Weighted Average Number of Shares}} = \frac{(₹90,000)}{5,000 \text{ Shares}}$ = (₹18.00) per share (negative).

As per AS - 20, Basic and Diluted EPS should be presented with equal prominence for all periods presented, irrespective of a loss per Share, i.e. even if the amounts disclosed are negative.

Diluted EPS = (₹18.00) per Share (negative). Anti-dilutive effect of Potential Equity Shares, i.e. Stock Options will be ignored, (since this will reduce the Loss per Share).

5. (a) The BBK Co. Ltd. resolved by a special resolution to buy – back 1,50,000 of its equity shares of the face value of ₹10 each on which ₹8 has been paid up. The general reserve balance of the company stood at ₹40,00,000 and no fresh issue of shares was made.
Journalize the transactions. [6]

Answer:

In the Books of BBK Co. Ltd.
Journal Entries

Date	Particulars	Debit ₹	Credit ₹
	Equity Share Final Call A/c Dr. To Equity Share Capital A/c (Final call of ₹2 per share due on 1,50,000 equity shares as per Board resolution)	3,00,000	 3,00,000
	Bank A/c Dr. To Equity Share Final call A/c (Final call money on 1,50,000 shares received)	3,00,000	 3,00,000
	Equity Share Capital A/c Dr. To Equity Shareholders A/c (Amount due to Equity shareholders transferred to their account for Buy Back)	15,00,000	 15,00,000
	Equity Shareholders A/c Dr. To Bank A/c (Payment to shareholders towards buy-back)	15,00,000	 15,00,000
	General Reserve A/c Dr. To Capital Redemption Reserve A/c (Transfer of nominal value of shares bought- back.)	15,00,000	 15,00,000

(b) From the following information, prepare a Cash Flow Statement:

Balance Sheet As at …

Particulars	Note	31.03.2015 ₹	31.03.2014 ₹
I. EQUITY AND LIABILITIES			
(1) Shareholders' Funds			
(a) Share Capital		**12,50,000**	**10,00,000**
(b) Reserves and Surplus	**1**	**4,90,000**	**4,00,000**
(2) Non-Current Liabilities (Long Term Loan)		**4,00,000**	**5,00,000**
(3) Current Liabilities			
Trade Payables		**4,00,000**	**5,00,000**
Short-term Provisions (Provision for tax)		**60,000**	**50,000**
Total		**26,00,000**	**24,50,000**
II. ASSETS			
(1) Non-Current Assets			
Tangible Fixed Assets	**2**	**13,00,000**	**11,50,000**
Non-Current Investments		**50,000**	**1,00,000**
(2) Current Assets			
Inventories		**2,80,000**	**3,00,000**
Trade Receivables		**4,20,000**	**4,00,000**
Cash & Cash Equivalents		**5,50,000**	**5,00,000**
Total		**26,00,000**	**24,50,000**

Note 1: Reserves and Surplus

Particulars	31.03.2015 ₹	31.03.2014 ₹
Profit and Loss A/c	**4,80,000**	**4,00,000**

Capital Reserve	**10,000**	**—**
	4,90,000	**4,00,000**

Note 2: tangible Fixed Assets

Particulars	31.03.2015 ₹	31.03.2014 ₹
Land & Building	**3,80,000**	**4,00,000**
Machinery	**9,20,000**	**7,50,000**
	13,00,000	**11,50,000**

Additional Information:

(1) Depreciation written off on land and building ₹ 20,000.

(2) The company sold some investment at a profit of ₹ 10,000, which was credited to Capital Reserve.

(3) Income-tax provided during the year ₹ 55,000.

(4) During the year the company purchased a machinery for ₹ 2,25,000. They paid ₹ 1,25,000 in cash and issued 10,000 equity shares of ₹ 10 each at par.

You are required to prepare a Cash Flow Statement for the year ended 31st March, 2015 by using indirect method. [9]

Answer:

Cash Flow Statement for the year ended 31st March,2015

Particulars	₹	₹
I. Cash Flows from Operating Activities:		
Net Profit before tax for the year [₹ 80,000 + ₹ 55,000]	1,35,000	
Add: Depreciation on machinery	55,000	
Depreciation on land & building	20,000	
Operating profit before change in working capital	2,10,000	
Add: Decrease in Inventories	20,000	
Less: Increase in Trade Receivables	(20,000)	
Less: Decrease in Trade Payables	(1,00,000)	
Cash generated from Operations	1,10,000	
Less: income tax paid	(45,000)	
Net Cash generated from Operating Activities		65,000
II. Cash flow from Investing Activities:		
Purchase of machinery (2,25,000 - 1,00,000)	(1,25,000)	
Sale of investment	60,000	
Net Cash used in Investing Activities		(65,000)
III. Cash flow from Financing Activities:		
Issue of equity shares (2,50,000 - 1,00,000)	1,50,000	
Repayment of long term loan	(1,00,000)	
Net Cash generated from Financing Activities		50,000
Net Increase in Cash and Cash Equivalents		50,000
Cash and Cash Equivalents at the beginning (2,00,000 + 3,00,000)		5,00,000
Cash and Cash Equivalents at the end (1,40,000 + 4,10,000)		**5,50,000**

Working Notes:

1. Machinery Account

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Balance b/d To Bank A/c To Equity Share Capital A/c	7,50,000 1,25,000 1,00,000	By Depreciation (Bal.fig.) By Balance c/d	55,000 9,20,000
	9,75,000		9,75,000

2. Provision for Taxation Account

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Bank A/c (Bal.fig.) To Balance c/d	45,000 60,000	By Balance b/d By Profit and Loss A/c	50,000 55,000
	1,05,000		1,05,000

3. Investment Account

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Balance b/d To Capital Reserve A/c (Profit on sale of investments)	1,00,000 10,000	By Bank A/c (Bal.fig.) By Balance c/d	60,000 50,000
	1,10,000		1,10,000

6. (a) M Ltd. has the following business/geographical segments.

Examine which of these are reportable Segments under AS - 17.

(Information in ₹000's)

Segments	Revenue	Profit/ (Loss)	Assets
A	**9,600**	**1,750**	**4,100**
B	**300**	**180**	**450**
C	**100**	**70**	**450**

[7]

Answer:

Particulars (₹ in Lakhs)	**A**	**B**	**C**	**Total**
1. Segment Revenue	9,600	300	100	10,000
2. Percentage of Segment Revenue	96%	3%	1%	100%
3. Segment Result i.e. Profit	1,750	180	70	2,000
4. Percentage of Segment Result, absolute amount of Profit or Loss, whichever is higher i.e. percentage of 2,000	87.5%	9%	3.5%	100%
5. Segment Assets	4,100	450	450	5,000
6. Percentage of Segment Assets	82%	9%	9%	100%
7. Reportable Segment	Yes	No	No	
8. Criteria satisfied	All	Nil	Nil	

A. **Single Segment Principle:** Disclosure of Segment Information as per AS - 17 is not required, if there is not more than one business / geographical segment. This is because, the relevant information is available from the Balance Sheet and Profit & Loss Account itself.

B. **Analysis and Conclusion**: Since Segments B and C do not meet the reportable segment criteria and also] 75% condition is satisfied by Segment A alone, only Segment A is identified as a Reportable Segment.

(b) The following particulars of SQL Ltd. which went into voluntary liquidation,

You are required to prepare the Liquidator's Final Statement of Account.

(1) Cash with liquidators (after all assets are realized and secured Creditors and Debenture holders are paid) is ₹ 3,75,000.

(2) Preferential creditors to be paid ₹ 17,500.

(3) Other unsecured creditors ₹ 1,15,000 to be paid.

(4) 2,500,10% preference shares of ₹ 100 each fully paid up to be paid.

(5) 1,500 equity shares of ₹ 100 each, ₹ 75 per shares paid up to be paid as calculated.

(6) 3,500 equity shares of ₹ 100 each, ₹ 60 per shares paid up to be paid as calculated.

(7) Liquidator's remuneration is 2% on payments to preferential and other unsecured creditors. [8]

Answer:

Liquidator's Final Statement of Account

Particulars	₹	Particulars	₹
To Cash in hand	3,75,000	By Liquidator's Remuneration (2% on ₹1,32,500)	2,650
To Cash at bank (Amount received on call for 3,500 equity shares @ ₹6.53 per share)	22,855	By Preferential creditors	17,500
		By Unsecured creditors	1,15,000
		By Preference shareholders	2,50,000
		By Equity shareholders (Amount paid to holders of 1,500 equity shares @ ₹8.47 per equity share)	12,705
	3,97,855		**3,97,855**

Workings:

Calculation of amount receivable from equity shareholders or payable to equity shareholders.

Particulars	₹	₹
Cash in hand (Assets realized)		3,75,000
Less: Payments made:		
Liquidator's Remuneration	2,650	
Preference Creditors	17,500	
Unsecured Creditors	1,15,000	
Preference Shareholders	2,50,000	3,85,150
		10,150
Add: Amount payable to equity shareholders (paid up);		
1,500 equity shares of ₹100 each ₹75 paid up	1,12,500	

3,500 equity share of ₹100 each ₹60 paid up equity	2,10,000	3,22,500
Total loss to be borne by equity shareholders		3,32,650

No. of equity shares: 5,000 shares

Loss per equity shares $\frac{3,32,650}{5,000}$ = ₹66.53

Amount receivable from 3,500 equity shareholder (₹60 paid up)

= 3,500 × ₹6.53 = ₹ 22,855

Amount payable to 1,500 equity shareholders (₹75 paid up)

= 1,500 × ₹8.47(75 - 66.53)

= ₹12,705

7. M & N have been carrying on same business independently. Due to competition in the market, they decided to amalgamate and form a new company called MN Ltd. following is the Balance Sheet of M & N as at 31st March:

(in '₹)

Liabilities	M	N	Assets	M	N
Capital	7,75,000	8,85,000	Plant & Machinery	4,85,000	6,14,000
Current liabilities	6,23,500	5,57,600	Building	7,50,000	6,40,000
			Current Assets	1,63,500	1,58,600
	13,98,500	14,12,600		13,98,500	14,12,600

Following are the additional information:

(i) Liabilities of M include ₹ 50,000 due to N for purchases made. N made a profit of 20% on sale to M.

(ii) M has goods purchased from N, cost to N being ₹ 10,000. This is included in the Current Assets of M as on 31st March.

(iii) The assets of M and N are revalued as under:

Particulars	M	N
Plant & Machinery	5,25,000	6,75,000
Building	7,75,000	6,48,000

(iv) The Purchase Consideration is to be discharged as under:

- **Issue 24,000 Equity Shares of ₹ 25 each fully paid, up in proportion of the profitability in the preceding 2 years, which are given below:**

Particulars	M	N
1st Year	2,62,800	2,75,125
2nd Year	2,12,200	2,49,875
Total	4,75,000	5,25,000

- **Issue 12% Preference Shares of ₹ 10 each at par, to provide Income equivalent to 8% Return on Capital Employed in the business as on 31st March, after revaluation of assets of M & N respectively.**

You are required to:

A. Compute the amount of Equity and Preference Shares issued to M & N.

B. Prepare the Balance Sheet of MN Ltd immediately after amalgamation. [15]

Answer:

Computation of Shares issuable to M & N

	Particulars	M	N
	Plant and Machinery	5,25,000	6,75,000
	Building	7,75,000	6,48,000
	Current Assets	1,63,500	1,58,600
	Total of above	14,63,500	14,81,600
	Less: Current Liabilities	(6,23,500)	(5,57,600)
(a)	Net Assets Taken over = Capital Employed	8,40,000	9,24,000
(b)	8% Return on Capital Employed	67,200	73,920
(c)	Valued of Preference Capital to earn above Income =(b) ÷12%	5,60,000	6,16,000
(d)	Preference Shares to be issued = (c) ÷ ₹ 10	56,000 Shares	61,600 Shares
(e)	No. of Equity Shares to be issued (Given 24,000 Shares in Ratio of 475 : 525)	11,400 Shares	12,600 Shares
(f)	Value of Equity Share Capital = (e) × ₹ 25	2,85,000	3,15,000
(g)	Total Purchase Consideration = (c) + (f)	8,45,000	9,31,000
(h)	Goodwill = (g) - (a)	5,000	7,000

Computation of Current Assets for B/s purposes

Particulars	M	N
Balances before amalgamation	1,63,500	1,58,600
Less: Liabilities of M due to N	---	(50,000)
Less: Unrealised Profit on Stock, i.e., ₹ 10,000 × 20%, adjusted/added to Goodwill	(2,000)	---
Total	1,61,500	1,08,600

Balance Sheet of MN Ltd as at 31st march (after Takeover)

	Particulars as at 31st March	Note	This Yr.	Prev. Yr.
I	Equity and Liabilities:			
(1)	Shareholders' Funds : Share Capital	1	17,76,000	
(2)	Current Liabilities (6,23,500 + 5,57,600 – Mutual Owings 50,000)		11,31,100	
	Total		29,07,100	
II	Assets			
(1)	Non-Current Assets			
	Fixed Assets: (i) Tangible Assets	2	26,23,000	
	(ii) Intangible Assets — Goodwill (5,000 + 7,000 + 2,000)		14,000	
(2)	Current Assets (WN 2) (1,61,500 + 1,08,600)		2,70,100	
	Total		29,07,100	

Note: Since Assets are revalued and Goodwill is accounted for, the Assets and Liabilities are not taken over at their Currying Amounts. Hence, Purchase Method of accounting is followed here.

Note 1: Share Capital

Particulars	This Yr.	Prev. Yr.
Authorised: ……………. Equity Shares of ₹ ……….. each	25,00,000	
………… 12% Preference Shares of ₹ 10 each		
Issued, Subscribed & Paid Up 24,000 Equity Shares of ₹ 25 each	6,00,000	
1,17,600 12% Preference Shares of ₹ 10 each	11,76,000	
(All the above Equity and Preference Shares issued for non-cash		

consideration)		
Total	17,76,000	

Note 2: Tangible Fixed Assets

Particulars	This Yr.	Prev. Yr.
(a) Building (7,75,000 + 6,48,000)	14,23,000	
(b) Plant & Machinery (5,25,000 + 6,75,000)	12,00,000	
Total	26,23,000	

Section – C

III. Answer any two questions out of the following: [2×15=30]

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

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

Answer:

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

The main advantages of an audit programme are as follows:

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

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

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

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

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

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

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

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

Clean Audit Report	Qualified Audit Report
The Auditor issues a Clean Report (also called as unconditional opinion) when he does not have any reservation with regard to the matters contained in the Financial Statements.	A Qualified Audit Report is one where an Auditor gives an opinion subject to certain reservations.

In a Clean Report, the Auditor states that the Financial Statements give a true and fair view of the state of affairs and results for the period.	The Auditor's reservation is generally stated as - "Subject to the above, we report that the Balance Sheet shows a true and fair view."
The Auditor is justified in issuing a clean report if – (i) The accounts are prepared using generally accepted accounting principles. (ii) The Auditor has examined sufficient reliable evidence in respect of transactions recorded in the books. (iii) The transactions recorded represent a true recording of the events. (iv) The transactions are within the legal competence of the entity. (v) There are no material misstatements in the Financial Statements. (vi) The Financial Statements comply with the format and disclosure requirements as per the Statute.	A Qualified Opinion should be expressed when the Auditor concludes that – (i) An Unqualified Opinion cannot be expressed, (ii) The effect of any disagreement with Management is not so material and pervasive as to require an Adverse Opinion, or (iii) The Limitation on scope is not so material and pervasive as to require a Disclaimer of Opinion.
There is no specific duty of Management for Clean Reports.	Management is bound to give explanation & full details in respect of each qualification in the Auditors Report.

9. (a) Discuss the position of an auditor in case he chooses to rely upon the certificates from the management in respect of closing stock, cash in hand etc. List the circumstances under which he will be justified in accepting and relying upon the certificates. [9]

(b) The responsibilities of joint auditors are joint and several — Discuss. [6]

Answer:

(a)

1. Role of management representations:

a. Management representations are generally given for certifying the value of inventories, provision for Liabilities, Disclosure of contingent Liabilities, etc. These are intended to impress upon the Directors their responsibility for accounts.

b. Mere Possession of such certificates does not absolve the auditor from carrying out a proper audit. These certificates can only act as second line of defense for an auditor who has carried out his work with reasonable care, skill and diligence.

c. The auditor should not seek or accept certificates from the management when the subject matter is such that it is capable of direct verification by the auditor himself.

2. Situations when management certificates can be justifiable:

a. The subject matter should not be capable of direct verification by the Auditor.

b. The matter relates to items, which are beyond the competence of a professionally qualifies Accountant.
c. There are proper records and reliable internal checks in the client's system that can enable the directors to prepare and issue the certificates.
d. The certificate should be prima facie in agreement with the records maintained.
e. The certificate should be put to commonsense tests by the auditor.

3. In case of Third party certificates e.g. Bankers, Architects, Agents etc. the following rules of reliance may be taken into account:
a. The party issuing the certificate is reputable and trustworthy,
b. The certificates relate to an item which is normally dealt with or held by such party,
c. The auditor himself is not in a position to verify the item because of its technical nature or because it would be too costly or cumbersome for him to do so,
d. The certificate prima facie is reliable and reasonable, and
e. Reference to the third party if available in the books and documents of the client as in possession of the concerned goods, property or securities belonging to the clients.

(b) In respect of audit work divided among the joint auditors, each joint auditor is responsible only for the work allocated to him, whether or not he has prepared a separate report on the work performed by him. On the other hand, all the joint auditors are jointly and severally responsible –
(i) in respect of the audit work which is not divided among the joint auditors and is carried out by all of them;
(ii) in respect of decisions taken by all the joint auditors concerning the nature, timing or extent of the audit procedures to be performed by any of the joint auditors. It may, however, be clarified that all the joint auditors are responsible only in respect of the appropriateness of the decisions concerning the nature, timing or extent of the audit procedures agreed upon among them; proper execution of these audit procedures is the separate and specific responsibility of the joint auditor concerned;
(iii) 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 the joint auditors;
(iv) for examining that the financial statements of the entity comply with the disclosure requirements of the relevant statute; and
(v) for ensuring that the audit report complies with the requirements of the relevant statute.

10. (a) What are the essential features of a good Internal Audit Report? [10]

(b) Write a note on — Audit of Abridged Financial Statement. [5]

Answer:

The contents of an Internal Audit Report are based on - (a) nature of internal audit function in the Company, (b) level of reporting, (c) degree of management support, and (d) capabilities of internal audit staff.

A good Internal Audit Report should have the following features -

- Objectivity: In order to maintain the credibility of internal audit function, the comments and opinions expressed in the Report should be as objective and unbiased as possible.
- Clarity: The language used should be simple and straightforward. Use of technical jargon(s) should be avoided. Each draft of the report should be read from the user's

viewpoint to confirm clarity.

- Accuracy: The information contained in the report, whether quantified or otherwise, should be accurate. Approximation or assumptions made should be clearly stated along with reasons, if material.
- Conciseness: Brevity is a vital aspect. However, important information should not be omitted.
- Constructiveness: Destructive criticism should be avoided. The report should clearly demonstrate that the Internal Auditor is trying to assist the management in effective discharge of its responsibilities.
- Readability: The reader's interest should be captured and retained throughout. Appropriate paragraph heading may be used.
- Timeliness: The report should be submitted promptly because if the time lag between the occurrence of an event and its reporting is considerable, the opportunity for taking action may be lost or a wrong decision may be taken in the absence of the information.
- Findings and conclusions: These may be given either department-wise or in the order of importance. All the facts and data pertaining to the situation should be assembled, classified and analysed. Each conclusion and opinion should normally follow the findings. Tables or graphs may be used for the presentation of statistical data in appendices.
- Recommendations: The Internal Audit Report should include recommendations for potential improvements. In order to enable the management to accept and implement the recommendations, the Internal Auditor should be able to convince the management that the conclusions are logical and valid and the recommendations represent effective and feasible ways of taking action.
- Auditee's views: The Auditee's views about audit conclusions or recommendations may also be included in the audit report in appropriate circumstances.
- Summary: A summary of conclusions and recommendations may be given at the end. This is useful in case of lengthy reports.
- Supporting information: The Internal Auditor should supplement his report by such documents and data, which adequately and convincingly support the conclusions. Supporting information may include the relevant standards or regulations.
- Draft Report: Before writing the Final Report, the Internal Auditor should prepare a draft report. This would help him in finding out the most effective manner of presenting his reports. It would also indicate whether there is any superfluous information or a gap in reasoning.

(b) Audit of Abridged Financial Statement —

i. Legal Requirements: The Auditor should examine whether the requirements relating to Abridged Balance Sheet and Abridged Profit & Loss Account as laid down in the Act have been duly complied with.
ii. Subsequent Events: If the Audit Report on Abridged Financial Statements is issued on a date subsequent to the issuance of the Audit Report on Annual Accounts as per Schedule III, the Auditor's responsibility in relation to events occurring after the Balance Sheet date is limited to the events occurring up to the date of his report on the annual accounts.
iii. Unqualified Report: If the Auditor is satisfied that the Abridged Financial Statements are proper in all respects, he should issue an Unqualified Audit Report.
iv. Qualified Report: The Auditor should express a Qualified Opinion or an Adverse Opinion, as appropriate, if he has certain reservations about the Abridged Financial Statements, e.g. if a material piece of information has not been disclosed in the Abridged Financial Statements or has been disclosed in an inappropriate manner.