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: **[5 ×2 = 10]**

(a) Actual Return = F.V of assets at the end – F.V of assets at the beginning – employee's contribution - Benefit's paid

$\Rightarrow$ 6,00,000 – 4,00,000 – 1,30,000 + 1,00,000

$\Rightarrow$ 1,70,000.

(b) Conditions:

1. All the assets and liabilities of transferor co. are taken over by transferee co.
2. The share holder's holding at least 90% (or) more of the equity shares of the transferor co. become the equity shareholders of the transferee co.
3. Consideration is paid in equity shares by the transferee co except fractional shares (for fractional shares cash is paid).
4. Business of the transferor co. is carried on by transferee co.
5. No adjustment's is made in the book value of assets and liabilities of the transferor co.

(c) Sales Ratio —

Let, Sales per month be 1 in second half year

$\therefore$ Sales per month is 0.50 in first half year

$\therefore$ Sales for 1st 4 months = 4 x 0.50 = 2

$\therefore$ Sales for next 8 months = 2 x 0.50 + 6 x 1 = 7

Sales Ratio — 2:7

(d) Effective Capital

Particulars	(`in crores)
Share Capital	18,000
Reserves and surplus	7,200
Security Premium	1,200
Long term loans	6,000
Investments	3,600
Preliminary exp written off	3,000
	25,800

(e) AS – 19 is not applicable to the following types of lease:

$\Rightarrow$ Lease agreement's to use land.

$\Rightarrow$ Licensing agreements for motion pictures films, video recording plays, manuscripts, patents and other rights.

$\Rightarrow$ Lease agreement to explore natural resources such as oil, gas, timber, metal and mineral rights.

2. Match the following: **[5 ×1 = 5]**

1.	Preliminary expenses	B	Deferred Revenue expenditure
2.	Tax paid	D	Revenue expenditure
3.	Capital profit	A	Premium on issue of shares
4.	Contingent Liability	E	Notes to account
5.	Current Liability	C	Dividend unpaid

3. Answer the following **[5 × 2 = 10]**

(a) It is a 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. It serves as a guide in arranging and distributing the audit work as well as checking against the possibility of the omissions. The auditor should prepare a written audit program setting for the procedures that are needed to be implemented while carrying out the audit plan.

(b) It 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 lies in the theory of probability which states that a sample selected from a series of item will tend to exhibit the same characteristics as present in the population.

(c) It involves examination of all the operation and activities of the entity under audit. It is one of the management tools to get first hand information. It is very useful in large organizations where management cannot control the actual operation's due to layer of delegation of responsibility.

(d) Objective:

In audit the a/c's and records are verified as to their truth and fairness. Investigation is for special purpose procedure.
Audit is conducted in accordance with the generally accepted auditing procedure. Investigation involves an extended auditing procedure.

(e) Statutory audit of the public company implies the audit of the transactions of the company which are the subject matter of report u/s 143. The auditor however has to certify as correct only as much of the statutory report as relates to the shares allotted by the company, cash received in respect of the such shares and other receipts and payments of the company. It is the abstract of receipts and payments made up to a date within 7 days of the report.

Section B

II. Answer any three of the following **[3 × 15 = 45]**

4.

(a) As per AS – 12 Accounting for Government Grants when govt. grant is received for a specific purpose, it should be utilized for the same. So the grant received for setting up a factory is not available for distribution.

In the second case even if the company has not spent money for the acquisition of land, land should be recorded in the books at a nominal value. So the treatment of both grants is incorrect as per AS – 12.

(b) Theoretical ex-right price

(F.V of all o/s shares immediately prior to exercise of right + total amount received on exercise of rights) /(No. of shares o/s prior exercise of rights + No. of shares issued in exercise)

$$\Rightarrow \frac{(2,00,000 \times 40) + (2,00,000 \times 25)}{(2,00,000 + 2,00,000)}$$

$$\Rightarrow \frac{80,00,000 + 50,00,000}{4,00,000} = 32.50$$

Adjust factor $\frac{\text{F.V per share immediately prior to exercise of rights}}{\text{Theoritical ex - right price}}$

$$\Rightarrow \frac{40}{32.50} = 1.23$$

Calculation of EPS

	31/3/2011	31/3/2012
Basic EPS(given)	₹2.50	
EPS restated for 2011 for right issue $\frac{2,50,000}{2,00,000 \times 1.23}$	$\frac{2,50,000}{2,46,000}$	
	₹1.02	
for 2012		
$\frac{3,00,000}{(2,00,000 \times 1.23 \times \frac{6M}{12M}) + (2,00,000 \times \frac{6M}{12M})}$		
$\Rightarrow \frac{3,00,000}{1,23,000 + 1,00,000}$		₹1.35

5.

(a) **Journal Entries**

Date	Particulars	Dr. (₹)	Cr.(₹)
1/7/2013	Own Debenture A/c Dr. Interest on Debenture A/c Dr. To, Bank A/c (Being 1,000 own debentures purchased @ ₹97 cum interest immediately cancellation)	95,000 2,000	 97,000
01/7/2013	8% Debenture A/c Dr. To Own debenture A/c To Capital Reserve A/c (Being the profit on cancellation of debenture transfer)	1,00,000	 95,000 5,000
30/09/2013	Int. on debenture A/c Dr.	36,000	

	$(9000 \times 100 \times 8\% \times \frac{6m}{12m})$ To Debenture holder A/c (Being the interest on due to Debenture holders)		36,000
30/09/2013	Debenture holder A/c Dr. To Bank A/c (Being the interest paid)	36,000	36,000
29/02/2014	Own debenture A/c Dr. Int. on debenture A/c Dr. $(1{,}800 \times 100 \times 8\% \times \frac{5m}{12m})$ To bank A/c (Being 1800 debentures @ 99 purchased for ex. Interest for immediate cancellation)	1,78,200 6,000	1,84,200
29/02/2014	8% Debenture A/c Dr. To Own debenture A/c To Capital Reserve A/c (Being profit on cancellation transfer to Capital Reserve)	1,80,000	1,78,200 1,800
31/03/2014	Int. on debenture A/c Dr. $(7200 \times 100 \times 8\% \times \frac{6m}{12m})$ To Debenture holder A/c (Being the interest due to debenture holder)	28,800	28,800
31/03/2014	Debenture holder A/c Dr. To Bank A/c (Being the Interest paid)	28,800	28,800
31/03/2014	Profit and loss A/c Dr. To interest on debt A/c (Being the total interest on debenture charged to Profit and Loss A/c).	72,800	72,800

(b) As per AS 11 changes in foreign currency rates, a foreign currency transaction should be recorded on initial recognition in the reporting currency by applying the foreign currency exchange rate between the reporting currency and the foreign currency at the date of transaction as 31/3/2013. Borrowings will be recorded ₹1,28,00,000 (2,00,000 US$ x ₹64).

At each Balance sheet date foreign currency monetary items should be reported using the closing value on 31/3/2014 borrowings will be recorded at ₹1,29,00,000 (2,00,000 x ₹64.5)
The exchange difference of ₹1,00,000 is arising because of the transaction has been reported at different rate (₹64.50 per US$) from the rate initially recorded (₹64 per US$) this difference is taken to Profit & Loss A/c.
When the loan is closed, the liability will be higher by ₹2,50,000 i.e. [(₹65.75 – ₹64.50) x 2,00,000 US$] the exchange difference of ₹2,50,000 is arising because the transaction has been settled at an exchange rate (₹65.75 = 1 US$) different from the rate at which reported in the last financial statements (₹64.50 = 1 US$). This difference is also taken to Profit and Loss A/c.

6. (a) Business segment:

Segment based on product / services (or) related products those are plane to different risks and returns.

Factors for identification:

Nature of product / service
Nature of production process
Type (or) class of customer's
Marketing and distribution technique
Nature of regularity environment

Geographical segment:

Segment based on operation in different geographical areas those are plane to different risk and returns.

Factors for identification:

Similarity of economic and political condition's, relationship between operation's in different geographical area.
Proximity and risk of operations, exchange regularity and currency risk.

(b) Liquidators Final Statement

Receipt's	Amount	Payment's	Amount
Cash at bank	60,000	Liquidation exp	4,600
Plant & Machinery	3,60,000	Liquidator Rem. (1,000+29,400)	30,400
Stock	1,20,000	Pay to Pref cr's	30,000
Sundry debtors	1,60,000	Pay to debenture holder (2,00,000+10,000+5,000) #10,000 – Interest # 5,000 – Outstanding Interest	2,15,000
Surplus in pledged asset's (3,40,000-90,000-10,000) #10,000 – Interest	2,40,000	Payment to unsecured Cr's	3,70,000
		Pay to P.S.H – 2,00,000 + Preference dividend 40,000	2,40,000
		Pay to ESH (6,000@2.50 + 2,000@17.50)	50,000
	9,40,000		9,40,000

Working notes:

Total receipts	9,40,000 (before calls)
Total Payments	8,89,000 (before ESH)
Surplus	51,000
(-) Liquidation Rem. (51,000 x 2/102)	1,000
	50,000
(+) national calls (6,000 @ 15)	90,000

Total surplus	1,40,000

Surplus per ES = 1,40,000/8,000 ES = 17.5

7. (a) Computation of Intrinsic value —

Particulars	A Ltd. (₹)	B Ltd. (₹)
Goodwill	75,000	50,000
Building	1,95,000	1,75,000
Debtors	2,86,900	1,72,900
Stock	91,500	90,750
Cash at bank	98,000	1,09,590
	7,46,400	5,98,240
(-) Sundry creditors	44,400	58,200
Net assets	7,02,000	5,40,040
Number of Equity shares	54,000	40,330
I.V per equity share	7,02,000 / 54,000	5,40,040 / 40,330
	13.00	13.39

No of Equity share to be issued —
Total purchase consideration 5,40,040
Intrinsic Value per Equity Share of A Ltd ₹13.33
∴ No of Equity share to be issued ₹5,40,040/₹13.33 = 41541.538

(b) In the books of ABC Company
Journal Entries

Particulars	Dr.(₹)	Cr.(₹)
Preference Share Capital A/c Dr. (25,000 pref. share @ ₹10) To Capital Reduction A/c To Preference Capital A/c (25,000 pref. share @ ₹5) (Being the each preference share value is reduced by ₹5 each)	2,50,000	 1,25,000 1,25,000
Equity Share Capital A/c Dr. (25,000 equity share @₹10) To Capital Reduction A/c (25,000 equity share @ ₹5) To Equity Share Capital A/c (25,000 equity share @ ₹5) (Being the Equity share is reduced by ₹ 5 each)	2,50,000	 1,25,000 1,25,000
Capital Reduction A/c Dr. To Profit & loss A/c To Stock A/c (1,34,000 x 10%) To Debtors (B/d)A/c (56,000 x 10%) To Patents (B/f)A/c (Being the Capital Reduction A/c balance is used to write off various items)	2,50,000	 2,15,000 13,400 5,600 16,000

Balance Sheet of ABC Company and reduced as at….

Particulars	Note no.	Amount (₹)
I. Equity and Liabilities		

	(i) Shareholders' Funds		
	Share Capital	1	2,50,000
	Reserves and Surplus	-	-
	(ii) Non- Current Liabilities		
	Long term Borrowings	-	-
	(iii) Current Liabilities	-	76,000
	Total		3,26,000
II.	Assets		
	(i) Non-current Assets		
	Fixed Assets – Intangible Assets	-	1,54,900
	(ii) Current Assets		
	Inventories	-	1,20,600
	Trade Receivables – Debtors	-	50,400
	Cash and cash equivalents	-	100
	Total		3,26,000

Note: 1

Share capital

Equity Share Capital (25,000 Equity Shares @ ₹5)	=	₹1,25,000
Preference Share Capital (25,000 Equity Shares @ ₹5)	=	₹1,25,000
		₹ 2,50,000

Section C

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

8. (a) Plant and Machinery:

As in case of Industrial concern out of total assets 20% to 50% cost is that of plant and machinery and hence the auditor is required to take much more precaution while verifying the plant and machinery and for this he should give attention to the following points.

I. He should get the detailed list of all plant and machineries and asset wise accumulated depreciation.
II. He should take the opening balance in the plant and machinery register with the help of year audited Balance Sheet.
III. He should verify quotation's Invoices, cost's etc in connection with purpose of plant and machinery of there are sales of plant and machinery in audit period he should verify the … to that effect. He should checks the Board Resolution authorizing purchase of plant and machinery.
IV. If any machinery is disposed off and sold as scrap during the audit period, he should check the authorization and values report in that connection.
V. He should check the rates and calculation of depreciation and ensure these are according to the provision of section 123 of the Companies Act, 2013
VI. He should check whether the related expenses incurred at the time of purchase of machinery are dully capitalized.
VII. He should check whether proper accounting or income earned (or) loss suffered during sale the audit period done.
VIII. If any machine is manufactured by client itself, auditor should verify that capitalization of material, labour and other expenses is properly done.
IX. He should obtain from the company management certificate about the verification of all items' as required under CARO [Sec -143].
X. He should scan the plant register and physical inspect some of the major plants by visiting to the works.

XI. He should finally ensure appropriate disclosure of all information on the B/S as required by the Companies Act.
XII. He should obtain a certificate from the local auditor to the effect, of plant and machinery is kept abroad at distant place.

Investments:

I. Insist on a schedule of Investments, when number of investments held by the auditor 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 sale custody.
VI. Examine the transfer deed, broker's contract note if certificate of investments is not received up to 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. 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 client.
XI. See that regarding the investments in subsidiaries disclosure requirements of Section 133 are complied with.
XII. See that the investments made by the company are not contrary to the provisions of Sec 186 of the Indian Companies Act 2013.
XIII. In case of application money paid for shares which are still to be quoted, the fact is to be specifically disclosed in Balance Sheet.
XIV. Confirm the uncalled amount on party paid share held as investment is shown as contingent liability in Balance Sheet.
XV. The auditor has to report, as per Section 143 of the Companies Act. Whether any share debentures sold at price lower than their coat, in the case of finance company whether proper records of investments are kept.
XVI. While auditing the investments the auditor should keep in mind the provision's of AS 13.

(b) Teeming and landing is a commonly followed method of misappropriation of cash by concealing cash shortages and covering them through recoveries from another customers. It is not uncommon in case of cash collections if the internal check and internal control on cash transactions are not proper. E.g. a sales man recovers ₹20,000 from customers M and misappropriates the same. But to conceal the misappropriation he declares ₹20,000 received later from another customer P as received from M so that the balance of M confirms to the client's debtor list, and so on for recovery from N of same amount declared as from P.
Teeming and landing may not amount to fraud, but negligence on the part of the management and weaknesses in internal control (or) internal check may lead to substantial amount being misappropriated by the cashier. This may result in huge loss if he is not in a position to clear the debts when caught.
The auditor has to follow the following procedure for timely detection of teeming and landing.

- Ascertain if the cash memos are consecutively numbered, and the dates, name and amount as per the daily summary reconcile with relevant cash receipts records.
- Reconcile individual cash amounts as per receipts with records in the rough cash book.
- Reconcile the receipts as recorded in a rough cash book, main cash book, pre-numbered cash memos, with counterfoils of the pay in slip.
- Ensure whether cash receipts are deposited in the bank on timely basis.
- Examine the debtors ledger especially entries showing part payments to satisfy that the debtors concerned here indeed made part payments.
- Confirmations may be obtained from the debtors from time to time.

9. (a) Qualified report and Adverse report:

Qualified Report	Adverse Report
1. A qualified Audit Report is one an auditor gives an opinion subject to certain reservations.	An Adverse Report is given when he concludes that based on his examination, he does not agree with the affirmations made in the financial statements.
2. The auditor's reservation is generally stated as "subject to the above, he report that the B/S show's a true and fair view.	The auditor states that the financial statements do not present the true and fair view of the state of affairs and working results of the organization.
3. The accounts present a true and fair view subject to certain reservations.	The accounts do not present a true and fair view of the whole.
4. A qualification is made in the audit report when the auditor has reservation on specific items of material nature.	An adverse report is given when the auditor has his reservations on true and fair view presented by the financial statements.

(b) The following are the main principles of an effective Internal Control System.

I. Clearly and precisely define the authorities, duties and responsibilities of the staff.

II. The work should be divided among the staff depending on their capacity as well as capability. Ensure that there is no overlapping (or) duplication of work at any level.

III. Division of work should be such that no single individual is allowed to perform any work single handed from beginning to end.

IV. Regular rotation of employees should be followed. This would ensure not only the prevention of errors and frauds but also broaden their work experience. The enterprise can also consider granting leaves to the employees at regular internal. This would ensure that the true fraud (or) error committed by anyone could be decided by his substitute during his absence (or) his leave period.

V. Instruction manuals should be clear. The employees should be given clear cut instructions so that the work can be performed in a timely manner and efficient manner.

VI. There should be a self balancing system of accounting providing for control of subsidiary ledgers through an account in the general ledger.

VII. Perpetual system of maintaining inventory should be implemented so as to ensure continuous accountability.

VIII. Use of mechanical and electronic equipment such as a cash register, calculators, computers etc should be encouraged.

IX. Correspondence with Dr's and Cr's should be under the charge of a responsible person.

X. Verification and valuation of stock, sales, payment of wages, fixed assets etc should be under strict vigilance and control.

10. (a) Every auditor of a company shall have a right of access of 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 namely.

a. Whether loans and advances made by the company on the basis of security have been properly secured and whether the terms on which they have been made are prejudicial to the interest of the company (or) its numbers.
b. Whether transactions of the company which are represented merely by book entries are prejudicial to the interest of the company.
c. Where the company not being an investment company (or) a banking company, whether so much of the assets of the company as consist of shares, debentures and other securities have been sold at a price less than that at which they were purchased by the company.
d. Whether the loan's and advances made by the company have been shown as deposits.
e. Whether personal expenses have been charged to revenue account.
f. Where it is rated in the books and documents of the company that any shares have been quoted for cash, whether cash has actually been received in respect of such allotment and if no cash has actually been so received , whether the position as stated in the accounts books and the balance sheet is correct, regular and not misleading.

Provided that the auditor of a company which is a holding company shall also have the right of access to the records of all its subsidiaries is so far as it relates to the consolidation of its financial statements with that of its subsidiaries.

(b) Difference between Statutory audit and Internal audit as follows:

Statutory audit	Internal audit
• Mandatory and prescribed by different statutes like for Companies, Co-operative societies, Nationalized bank, and Banking and Insurance Company.	Generally not mandatory. They are discretionary for management of Sole proprietors, Partnership and others.
• Statutory audit is conducted with the objective of ensuring truth fullness and fairness of the financial statements of entity.	Internal audit is conducted with objective of review of internal controls, checks and financial (or) non financial operations of the Organization.
• Scope is prescribed by governing law.	Scope is decided by the management and auditor and documented through the letter of engagement.
• The auditor is an independent person and is appointed by the Board of Directors /Share holders /Central govt. The audit is conducted on behalf of the share holders / govt. as the case may be.	Internal can be conducted by any independent agency (or) by the employees of the enterprise. It is conducted on behalf of management.
• To ascertain after critical examination of evidences and records whether financial statements are true and fair and no misrepresentation is made there in. To express an independent person opinion there on about the state of health of the entity.	To ensure that the inter control are working efficiently and are in place. To check the accuracy and completeness of records and early detection of errors. Proprietary oriented approach.

Compliance oriented approach.	
• A qualified CA in whole time practice (or) a firm of CA's in practice can be a statutory auditor.	No qualification is prescribed.
• Term ends at the conclusion of next AGM (annual general meeting) however the auditor can be reappointed if not disqualified.	The term is generally mutually decided.
• Report share holder's / owner's in a format prescribed under law.	Report to the management no prescribed format.