Paper 12- Company Accounts & Audit

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

Section – A (Company Accounts)

Answer Question No. 1 and any three from Question Nos. 2,3,4 and 5.

1. (a) Choose the correct answer from the given four alternatives: [6x1=6]

(i) Which of the following is an objective of a Bank's book-keeping system?
(a) to keep up-to-date detailed ledgers
(b) to balance the trial balance every day
(c) to keep all control accounts in agreement with the detailed ledgers
(d) All of the above

(ii) A non-cancellable lease is a lease that is cancellable only:
(a) upon the occurrence of some remote contingency
(b) with the permission of the lessor
(c) if the lessee enters into a new lease for the same or an equivalent asset with the same lessor
(d) All of the above

(iii) As per AS-17, the revenue of the reportable segment must have at least the following percentage of total revenue of the enterprise:
(a) 60%
(b) 75%
(c) 80%
(d) 90%

(iv) Short-Term Borrowings will include all Loans within a period of ______ months from the date of the loan.
(a) 6
(b) 12
(c) 24
(d) 36

(v) On redemption of Debentures, the amount lying in the Debenture Redemption Reserve, which is no longer necessary to be retained, should be transferred to
(a) Revaluation Reserve
(b) Securities Premium A/c
(c) Capital Reserve
(d) General Reserve

(vi) In case of Electricity Company, balance of Security Deposit a/c at the end of the accounting period should be disclosed as a _____________in the Balance Sheet.
(a) Non-current asset
(b) Non-current liability
(c) Current asset
(d) Current liability

Answer:

(i) (d)
(ii) (d)
(iii) (b)

(iv) (b)
(v) (d)
(vi) (b)

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

	Column 'A'		Column 'B'
1.	**Section 68**	**A.**	**Rollover**
2.	**Section 55**	**B.**	**Power of company to purchase its own securities.**
3.	**Issue of new debentures in the place of old ones.**	**C.**	**Guaranteed Residual Value (GRV)**
4.	**AS 19**	**D.**	**Issue and redemption of preference shares**

Answer:

	Column 'A'		Column 'B'
1.	Section 68	**B.**	Power of company to purchase its own securities.
2.	Section 55	**D.**	Issue and redemption of preference shares
3.	Issue of new debentures in the place of old ones.	**A.**	Rollover
4.	AS 19	**C.**	Guaranteed Residual Value(GRV)

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

(i) Bonus paid in the end along with the policy amount is called Reversionary Bonus.
(ii) Related party transactions means a transfer of resource or obligations between related parties against a price.
(iii) Unmarked applications are those applications which bear the stamp of an underwriter.
(iv) Interest income in case of a Finance Company is not treated as a part of revenue from Operation.

Answer:

(i) True;
(ii) False;
(iii) False;
(iv) False.

Answer any three questions out of the following four questions [3×12=36]

2. (a) XYZ Ltd. has the following capital structure on of 31st March 2015

Particulars	₹ in Crores
a. Equity Share capital (Shares of ₹10 each)	**300**
b. Reserves:	
General reserve	**270**
Security Premium	**100**
Profit and Loss A/c	**50**

Export Reserve (Statutory Reserve)	**80**
c. Loan Funds	**800**

The shareholders have on recommendation of Board of Directors approved vide special resolution at their meeting on 10th April 2015 a proposal to buy back maximum permissible equity shares considering the huge cash surplus following A/c of one of its divisions.
The market price was hovering in the range of ₹ 25 and in order to induce existing shareholders to offer their shares for buy back, it was decided to offer a price of 20% above market.
Advice the company on maximum number of shares that can be bought back and record journal entries for the same assuming the buyback has been completed in full within the next 3 months. If borrowed funds were ₹1200 crores, and 1500 crores respectively would your answer change? [8]

Answer:
Maximum shares that can be bought back

		Situation I	**Situation II**	**Situation III**
a.	Shares outstanding test (WN#1)	7.5	7.5	7.5
b.	Resources test (WN#2)	6	6	6
c.	Debt Equity ratio test (WN#3)	10.68	3	-
d.	Maximum number of shares for buyback-LEAST of the above	6	3	-

	Particulars	Situation I		Situation II	
		Debit	Credit	Debit	Credit
a.	Shares bought back A/c Dr.	180		90	
	To Bank A/c		180		90
	[Being purchase of shares from public]				
b.	Share capital A/c Dr.	60		30	
	Security premium A/c Dr.	100		60	
	General reserve A/c (balancing figure) Dr.	20		--	
	To Shares bought back A/c		180		90
	[Being cancellation of shares bought on buy back]				
c.	General reserves A/c Dr.	60		30	
	To Capital redemption reserve A/c		60		30
	[Being transfer of reserves to capital redemption reserve to the extent capital is redeemed]				

Note: Under situation III, the company does not qualify the debt equity ratio test. Therefore the company cannot perform the buyback of shares.

Working Notes:

WN # 1: Shares outstanding test

Particulars	**Amount**
a. No. of shares outstanding	30 crores

b. 25% of shares outstanding	7.5 crores

WN # 2: Resources test

Particulars	**Amount(₹)**
a. Paid up capital	300
b. Free reserves [270+100+50]	420
c. Shareholders fund (a+b)	720
d. 25% of shareholders fund	180
e. Buyback price per share	30
f. Number of shares that can be bought back	6 crores

WN # 3: Debt Equity ratio test: **(₹ in Crores)**

	Particulars	**Situation I**	**Situation II**	**Situation III**
a.	Borrowed Funds	800	1200	1500
b.	Minimum equity to be maintained after buy back in the ratio 2:1	400	600	750
c.	Present equity	720	720	720
d.	Maximum possible dilution in equity	320	120	---
e.	Maximum shares that can be bought back @ ₹30/- per share	10.67	4	---

Alternatively: Let no. of shares bought back be x @ ₹ 30

Max ratio of Debt/Proprietors Fund = 2

I

$$\frac{800}{720-10x-30x}=2$$

or, x= 8

II

$$\frac{1200}{720-10x-30x}=2$$

or, x= 3

III

$$\frac{1500}{720-10x-30x}=2$$

or,x = -x, so not possible.

(b) Information relating to five segments of X Ltd. is as under: (₹ in lakhs)

Segments	**P**	**Q**	**R**	**S**	**T**	**Total**
Segment Revenue	**150**	**450**	**300**	**150**	**450**	**1500**
Segment Result	**60**	**(90)**	**135**	**15**	**(45)**	**75**
Segment Assets	**67.5**	**82.5**	**210**	**30**	**60**	**450**

As a cost accountant of this company management wishes to know from you which company need to be reported as per AS-17. [4]

Answer:

Particulars	**P**	**Q**	**R**	**S**	**T**	**Total**
1.Segment Revenue	150	450	300	150	450	1500
2.% of Segment Revenue	10%	30%	20%	10%	30%	

3.Segment Result Profit Loss	60	(90)	135	15	(45)	210 (135)
4.% of segment Result, absolute amount of profit/loss whichever is higher, i.e. as a % of 210	28.57%	42.88%	64.29%	7.14%	21.43%	
5.Segment Assets	67.5	82.5	210	30	60	450
6.% of Segment Assets	15%	18.33%	46.67%	6.66%	13.33%	
Reportable Segment	Yes	Yes	Yes	Yes	Yes	
Criteria satisfied	Revenue, Result& Assets	Revenue, Result& Assets	Revenue, Result& Assets	Revenue	Revenue, Result& Assets	

3. (a) T Ltd. gives you the following information for the year ended 31st March,2019:

(i) Tax paid during the year amounts to ₹ 225,000.
(ii) Closing inventory was higher than opening inventory by ₹ 75,000.
(iii) Cost of goods sold was 75% of sales.
(iv) Sales for the year ₹ 72,00,000. The company sold goods for cash only.
(v) Closing Trade payables exceed Opening Trade payables by ₹ 1,50,000.
(vi) Amounts paid to Trade payables during the year ₹ 53,25,000.
(vii)Administrative and Selling expenses paid ₹ 5,40,000.
(viii) One new machinery was acquired during the year for ₹ 9,00,000.
(ix) Dividend paid during the year -₹ 1,80,000.
(x) Cash in hand and of bank at the end ₹ 105,000.
(xi) Cash in hand and at bank at the beginning ₹ 75,000.
Prepare Cash Flow Statement as per Accounting Standard 3. [6]

Answer:

Cash Flow Statement of T Ltd. for the year ending 31st March, 2019

Particulars	₹	₹
Cash flow from operating activities:		
Cash receipt from customers(sales)	72,00,000	
Cash paid to suppliers and expenses (53,25,000+5,40,000)	(58,65,000)	
Cash flow from operations	13,35,000	
Less: Tax paid	(225,000)	
Net cash from operating activities		1,110,000
Cash flow from investing activities		
Purchase of fixed assets	(9,00,000)	
Net cash used in investing activities		(9,00,000)
Cash flow from financing activities:		
Dividend Paid	(1,80,000)	

Net cash from financing activities		(1,80,000)
Net Increase in cash and cash equivalents		30,000
Cash and cash equivalents at the beginning of the year		75,000
Cash and cash equivalents at the end of the year		1,05,000

(b) From the following information calculate Depreciation and Advance against Depreciation as per Regulation 21 of the Central Electricity Regulatory Commission (Terms and Conditions of Tariff) Regulations,2004.
Date of Commercial Operation of COD=1st April 2010
Approved opening Capital cost as on 1st April 2010= 3,75,000
Weighted Average Rate of Depreciation: 3.5%
Details of allowed Additional Capital Expenditure. Repayment of Loan and Weighted Average Rate of Interest on Loan is as follows:

	1st year	2nd year	3rd year	4th year
Additional Capital Expenditure(Allowed)	**25,000**	**7,500**	**5,000**	**5,000**
Repayment of Loan	**20,000**	**25,000**	**25,000**	**27,500**
Weighted Average Rate of Interest on Loan	**7.4**	**7.5**	**7.6**	**7.5**

[6]

Answer:

Computation of Depreciation

Particulars	1st year	2nd year	3rd year	4th year
A. Opening Capital Cost	3,75,000	4,00,000	4,07,500	4,12,500
B. Additional Capital Cost	25,000	7,500	5,000	5,000
C. Closing Capital Cost(A+B)	4,00,000	4,07,500	4,12,500	4,17,500
D. Average Capital Cost[(A+C)/2]	3,87,500	4,03,750	4,10,000	4,15,000
E. Weighted Average Rate of Dep.	3.5%	3.5%	3.5%	3.5%
F. Annualized Depreciation (D x E)	13,562.5	14,131.25	14,350	14,525
G. Advance Against Depreciation (AAD)	6,437.5	10,868.75	10,650	12,975
H. Total Depreciation (including AAD) for Tariff (F+G)	20,000	25,000	25,000	27,500

Computation of Advance Against Depreciation (AAD)

Particulars	1st year	2nd year	3rd year	4th year
A. Repayment of Loan (10% of Loan Amount)	20,000	25,000	25,000	27,500
B. Depreciation (Excluding AAD)	13,562.5	14,131.25	14,350	14,525
C. Difference between A&B (A-B)	6,437.5	10,868.75	10,650	12,975
D. Cumulative Repayment of Loan	20,000	45,000	70,000	97,500
E. Cumulative Depreciation (Excluding AAD) at the beg.	13,562.5	27,693.75	42,043.75	56,568.75
F. Difference between D&E(D-E)	6,437.5	17,306.25	27,956.25	40,931.25

G. Advance Against Depreciation (AAD) (Minimum of C&F)	6,437.5	10,868.75	10,650	12,975

4. XYZ Ltd. have authorised capital of ₹ 50 lakhs divided into 5,00,000 equity shares of ₹ 10 each. Their books show the following balances as on 31st March, 2019:

	₹
Opening Stock	**760,000**
Discounts & Rebates	**5000**
Carriage Inwards	**32500**
Patterns	**500000**
Rates, Taxes and Insurance	**27500**
Furniture & Fixtures	**150,000**
Purchases	**6,16,250**
Wages	**11,68,000**
Freehold Land	**12,50,000**
Plant & Machinery	**4,00,000**
Engineering Tools	**1,50,000**
Goodwill	**3,75,000**
Sundry Debtors	**2,42,000**
Bills Receivables	**1,34,500**
Advertisement	**22500**
Commission & Brokerage	**32000**
Business Expenses	**42000**
Bank Current Account	**20000**
Cash in Hand	**8000**
Debenture Interest Paid	**10,000**
Interest on Bank Overdraft	**45,500**
Preliminary Expenses	**15,000**
Calls in Arrear@2 per share	**10,000**
Equity Share Capital (2,00,000 shares of ₹10 each)	**20,00,000**
8% Debentures (repayable after 10 years)	**5,00,000**
Bank Overdraft	**7,57,000**
Sundry Creditors (for goods)	**2,40,500**
Sales	**26,16,650**
Rent (Cr.)	**45,000**
Transfer Fees received	**10,000**
Profit & Loss A/c(Cr.)	**67,000**
Repairs to Building	**31,000**
Bad Debts	**12750**

1. The stock (valued at cost or market value, whichever is lower) as on 31st March,2019 was ₹ 708000.
2. Outstanding liabilities for wages ₹32,000 and business expenses ₹12,000.
3. Dividend declared @ 12% on paid up capital.
4. Depreciation: Plant and Machinery @ 5%, Engineering Tools @ 20%, Patterns @ 10% and Furniture & Fixtures @10%.
5.Provide 5% on debtors as doubtful debts after writing off ₹ 9000 as bad debts. Write off preliminary expenses fully.
6. Create Debenture Redemption Reserve @ 10% of Debentures.
7.Transfer to General Reserve @ 2.5 %.
8. Provide for Income Tax @ 30 %. Dividend Distribution Tax Rate @ 20%.
Required: Prepare a Statement of Profit & Loss for the year ended 31st March 2019. [12]

Answer:

XYZ LTD.
PROFIT AND LOSS STATEMENT FOR THE YEAR ENDED 31ST MARCH, 2019

Particulars	Note No.	₹
I. Revenue from Operations		26,16,650
II.Other Income	1	55,000
III.Total Revenue[I+II}		26,71,650
IV.Expenses:		
Cost of Purchases		61,6250
Changes in Inventories [7,60,000-7,08,000]		52,000
Employee Benefits Expenses [1168000+32000]		12,00,000
Finance Costs [40,000+45500]		85,500
Depreciation and Amortization Expense		11,5000
Other Expenses	2	2,52,900
Total Expenses		23,21,650
V. Profit before Tax (III-IV)		3,50,000
VI. Tax Expense@30%:		1,05,000
VI. Profit for the period		2,45,000
Basic Earnings per Equity Share=2,45,000/2,00,000=1.225		

Notes to Accounts:

1. OTHER INCOME

Miscellaneous Income (Transfer fees)	10,000
Rental Income	45,000
	55,000

2. OTHER EXPENSES

Carriage Inward	32,500
Discount & Rebates	5,000
Advertisement	22,500
Rates, Taxes and Insurance	27,500
Repairs to Building	31,000
Preliminary Expenses	15,000
Commission & Brokerage	32,000
Miscellaneous Expenses[42,000+12,000]	54,000
Bad Debts[12750+9,000]	21,750
Provision for Doubtful Debts [5% of (242000-9000)]	11,650
	2,52,900

5. Write short note (any three): **[3×4=12]**

(a) Disclosure requirements under AS-11

(b) Issue of Sweat Equity Shares

(c) Re-insurance

(d) Money received against Share Warrants

Answer:

(a) Disclosure requirements under AS-11

As per AS-11 an enterprise should disclose:

(i) The amount of exchange difference included in the net profit or loss for the period.
(ii) The amount of exchange difference adjusted in the carrying amount of fixed assets during the accounting period.
(iii) The amount of exchange difference in respect of forward contracts to be recognized in the profit/ loss for one or more subsequent accounting period.
(iv) Foreign currency risk management policy.

(b) Issue of Sweat Equity Shares

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

(1) the issue is authorised by a special resolution passed by the company;
(2) the resolution specifies the number of shares, the current market price, consideration, if any, and the class or classes of directors or employees to whom such equity shares are to be issued;
(3) not less than one year has, at the date of such issue, elapsed since the date on which the company had commenced business; and
(4) where the equity shares of the company are listed on a recognised stock exchange, the sweat equity shares are issued in accordance with the regulations made by the Securities and Exchange Board in this behalf and if they are not so listed, the sweat equity shares are issued in accordance with such rules as may be prescribed.

The rights, limitations, restrictions and provisions as are for the time being applicable to equity shares shall be applicable to the sweat equity shares issued under this section and the holders of such shares shall rank pari passu with other equity shareholders.

(c) Re-insurance

Sometimes the insurer considers a particular risk too much for his capacity and may re-insure a part of the risk with some other insurer. Such an arrangement between two insurers is referred to as reinsurance.

In such a case the first insurer cannot retain all the premium on the policy for himself. Depending on the share of risk undertaken by the second insurer, proportionate premium must be ceded by the first insurer. Likewise if such a policy matures, the claim will have to be shared by both the insurers in the agreed ratio. These adjustments will have to be shown in the accounts of both the insurers.

In the accounts of the first insurer amount of claim recovered from the second insurer has to be deducted from the total claim payable by him. Similarly, the premium ceded to the second insurer has to be deducted from the total premium received. In the accounts of the second insurer, claims paid include claims paid on account of Re-insurance and premiums received include premium received on re- insurance business

(d) Money received against Share Warrants

As per Sch. III Disclosure Requirements, it is to be shown as a separate line item on the face of Balance Sheet.

- In case of Listed Companies, Share warrants are issued to Promoters & others in terms of the Guidelines for Preferential Issues viz. SEBI (Issue of Capital and Disclosure Requirements), Guidelines, 2009.
- Effectively, Share Warrants are amounts which would ultimately form part of the Shareholder's Funds. Since Shares are yet to be allotted against the same, these are not reflected as part of Share Capital, but as a separate line – item.

Section – B (Auditing)

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

6. (a) Choose the correct answer from the given four alternatives: [6x1=6]

(i) Statutory Auditor is appointed by the shareholder in the
(a) General Meeting
(b)Statutory Meeting
(c) EGM
(d)Board Meeting

(ii) A Cost Auditor submits his report to
(a) Board of Directors
(b) Government
(c) Shareholders
(d) Statutory Auditor

(iii) An audit committee should have ______ directors.
(a) 3
(b) 2
(c) 1
(d) 4

(iv) Any fraud to involve an amount of _______ is to be reported to the Central government.
(a) 5 crore or above
(b) 100 crore or above
(c) 1 crore or above
(d) 10 crore or above

(v) Form for Secretarial Audit Report is-
(a)MR-2
(b)MR-3
(c)MR-4
(d)MR-5

(vi) Preventive Controls is a type of __________
(a) Internal Control
(b) Detective Control
(c) Verification
(d) None of the above

Answer:

(i) — (a)
(ii) — (a)

(iii) — (a)
(iv) — (c)
(v) — (b)
(vi) — (a)

b) Match the following: [4x1=4]

	Column 'A'		Column 'B'
1.	**Analysis of significant ratios and trends**	A.	**Power of company to Purchase its Own Securities.**
2.	**SA 300**	B.	**Verification**
3.	**Section 68 of the Co. Act 2013**	C.	**Permanent Audit File**
4.	**Proving the Truth**	D.	**Audit Planning**

Answer:

	Column 'A'		Column 'B'
1.	Analysis of significant ratios and trends	**C.**	Permanent Audit File
2.	SA 300	**D.**	Audit Planning
3.	Section 68 of the Co. Act 2013	**A.**	Power of company to Purchase its Own Securities.
4.	Proving the Truth	**B.**	Verification

(c) Say True or False for the following question: [4×1=4]

(i) Cut off procedures are generally applied to trading transactions.
(ii) The primary objective of the audit is for detecting frauds and error in the books of accounts and financial records of the clients business.
(iii) If the debentures are issued as collateral security to the banks or creditors then auditor needs to ensure that such issue is approved by debenture trustee.
(iv) Company Secretaries are eligible to conduct Cost Audit having valid certificate of practice.

Answer:

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

Answer any three questions out of the following four questions [3×12=36]

7. (a) What is an 'Audit Engagement Letter'? What are the points to be covered in every audit engagement letter? [2+6=8]

Answer:

Audit Engagement letter is given by Auditor to Company, explaining scope of work duties & responsibilities of Auditor and that of management of Company. It specifies limits of Liability of Auditor. It avoids misunderstanding confusion, dispute between client & Auditor at a later stage. Audit engagement letter confirms acceptance of Audit by Auditor, documentation objective & scope of Audit & Other work and the extent of his responsibilities to client the forms of report to be given by him.

Every engagement letter as per ICAI should cover following points: -
(a) Objective & scope of engagement
(b) Management responsibility
(c) Existence of inherent limitations
(d) Need for use of Internal Auditor
(e) Management confirmation letter
(f) Restrictions & limitations of Auditor liabilities
(g) Basis of computation of Audit fees
(h) Billing arrangement
(i) Form of report & Other communications of engagement
(j) Validity of report
(k) Limits on submission of report to other authorities

(b) What are the techniques for evaluation of Internal control system? [4]

Answer:

Techniques for Evaluation of Internal Control System :

i. **Narrative Record**: It is a complete and exhaustive description of the system. It is appropriate in circumstances where a formal control system is lacking, like in the case of small businesses. Gaps in the control system are difficult to identify using a narrative record.
ii. **Check List:** It is a series of instructions that a member of the audit staff is required to follow. They have to be signed/ initialed by the audit assistant as proof for having followed the instructions given. A specific statement is required for every weakness area.
iii. **Flow Chart:** It is a pictorial representation of the internal control system depicting its various elements such as operations, processes and controls, which help in giving a concise and comprehensive view of the organization's working to the auditor. A complete flow chart would depict the process of raising documents, personnel involved in doing so, the flow of documents through various departments, maintenance of records, flow of goods and consideration, and dealing with results.
The internal control evaluation process becomes easier through a flow chart as a broad picture of all the controls involved can be gauged in a glimpse.
iv. **Internal Control Questionnaire:** This is the most widely used method for collecting information regarding the internal control system and involves asking questions to various people at different levels in the organization. The questionnaire is in a pre-designed format to ensure collection of complete and all relevant information. The questions are formed in a manner that would facilitate obtaining full information through answers in "Yes" or "No''.

8. (a) Discuss the procedure for appointment of first auditor of a company. [4]

Answer:

The first auditor of a company, other than a Government company, shall be appointed by the Board of Directors within thirty days from the date of registration of the company and in the case of failure of the Board to appoint such auditor, it shall inform the members of the company, who shall within ninety days at an extraordinary general meeting appoint such auditor and such auditor shall hold office till the conclusion of the first annual general meeting.

In the case of a Government company or any other company owned or controlled, directly or indirectly, by the Central Government, or by any State Government, or Governments, or partly by the Central Government and partly by one or more State Governments, the first auditor shall be appointed by the Comptroller and Auditor-General of India within sixty days from the date of registration of the company and in case the Comptroller and Auditor-General of India does not appoint such auditor within the said period, the Board of Directors of the company shall appoint such auditor within the next thirty days; and in the case of failure of the Board to appoint such auditor within the next thirty days, it shall inform the members of the company who shall appoint such auditor within the sixty days at an extraordinary general meeting, who shall hold office till the conclusion of the first annual general meeting.

(b) Discuss the duty of an auditor to report certain matters in the audit report u/s 143(3). [8]

Answer:

Rule 11: Other Matters to be Included in Auditors Report
The auditor's report shall also include their views and comments on the following matters, namely:-
(a) whether the company has disclosed the impact, if any, of pending litigations on its financial position in its financial statement;
(b) whether the company has made provision, as required under any law or accounting standards, for material foreseeable losses, if any, on long term contracts including derivative contracts;
(c) whether there has been any delay in transferring amounts, required to be transferred, to the Investor Education and Protection Fund by the company.
(d) whether the company had provided requisite disclosures in its financial statements as to holdings as well as dealings in Specified Bank Notes during the period from 8th November, 2016 to 30th December, 2016 and if so, whether these are in accordance with the books of accounts maintained by the company.

The auditor's report shall also state—

(a) whether he has sought and obtained all the information and explanations which to the best of his knowledge and belief were necessary for the purpose of his audit and if not, the details thereof and the effect of such information on the financial statements;
(b) whether, in his opinion, proper books of account as required by law have been kept by the company so far as appears from his examination of those books and proper returns adequate for the purposes of his audit have been received from branches not visited by him;
(c) whether the report on the accounts of any branch office of the company audited under subsection (8) by a person other than the company's auditor has been sent to him under the proviso to that sub-section and the manner in which he has dealt with it in preparing his report;
(d) whether the company's balance sheet and profit and loss account dealt with in the report are in agreement with the books of account and returns;
(e) whether, in his opinion, the financial statements comply with the accounting standards;
(f) the observations or comments of the auditors on financial transactions or matters which have any adverse effect on the functioning of the company;
(g) whether any director is disqualified from being appointed as a director under sub-section (2) of section 164;
(h) any qualification, reservation or adverse remark relating to the maintenance of accounts and other matters connected therewith;
(i) whether the company has adequate internal financial controls with reference to financial statements in place and the operating effectiveness of such controls;
(j) such other matters as may be prescribed.

9(a) The Companies Act, 2013 has introduced provision regarding rotation of auditors. Is the provision of rotation of auditors applicable to cost auditors also? [6]

Answer:

The provisions for maintenance of cost accounting records and cost audit are governed by Section 148 of the Companies Act, 2013. The provisions of Section 148 clearly states that no person appointed under Section 139 as an auditor of the company shall be appointed for conducting audit of cost records of the company. Section 148 also provides that qualifications, disqualifications, rights, duties and obligations applicable to auditors (financial) shall apply to a cost auditor appointed under this section. The eligibility, qualifications and disqualifications are provided in Section 141 of the Act and powers and duties are provided in Section 143. Section 143(14) specifically states that the provisions of Section 143 shall mutatis mutandis apply to a cost auditor appointed under Section 148. There are no other provisions governing the appointment of a cost auditor.
Section 139(3) of the Act, applicable to appointment of auditors (financial), and Rule 6 of Companies (Audit and Auditors) Rules, 2014 deals with the provision of rotation of auditors and these provisions are applicable only to appointment of auditors (financial). The Act does not provide for rotation in case of appointment of cost auditors and the same is not applicable to a cost auditor. It may, however, be noted that though there is no statutory provision for rotation of cost auditors, individual companies may do so as a part of their policy, as is the practice with Public Sector Undertakings.

(b) Under what circumstances should an auditor express an adverse opinion or disclaimer of opinion? [6]

Answer:

An Adverse or Negative Report is given when the Auditor concludes that based on his examination, he does not agree with the affirmations made in the Financial Statements / Financial Report.
The Auditor states that the Financial Statements do not present a true and fair view of the state of affairs and the working results of the organisation.
The Auditor should state the reasons for issuing such a report. An Adverse Opinion should be expressed when the effect of a disagreement is so material and pervasive to the Financial Statements, that the Auditor concludes that a qualification of the report is not adequate to disclose the misleading or incomplete nature of the Financial Statements.
A Disclaimer of Opinion Report is given when the Auditor is unable to form an overall opinion about the matters contained in the Financial Statements. A Disclaimer of Opinion should be expressed when the possible effect of a limitation on scope is so material and pervasive that the Auditor has not been able to obtain sufficient appropriate audit evidence and is, accordingly, unable to express an opinion on the Financial Statements.
It may happen in situations such as -- (a) when books of account of the Company seized by Income Tax Authorities, (b) when it is not possible for the Auditor to obtain certain information or (c) when scope of audit work is restricted.
The Auditor will state in his Report that he is unable to term an opinion on the Financial Statements. Such Report is called as "Disclaimer of Opinion Report".

10. Write short notes (Any three) (3x4=12)

(a) Declaration of dividend by a company u/s 123.
(b) Features of Inventories that have impact on related audit procedures.
(c) Audit of Co-operative Society
(d) Audit of Issue of Bonus Shares.

Answer:

(a) Declaration of dividend by a company u/s 123.

No dividend shall be declared or paid by a company for any financial year except—

● out of the profits of the company for that year arrived at after providing for depreciation in accordance with the provisions of sub-section (2), or out of the profits of the company for any previous financial year or years arrived at after providing for depreciation in accordance with the provisions of that sub-section and remaining undistributed, or out of both; or
● out of money provided by the Central Government or a State Government for the payment of dividend by the company in pursuance of a guarantee given by that Government.
Provided that a company may, before the declaration of any dividend in any financial year, transfer such percent-age of its profits for that financial year as it may consider appropriate to the reserves of the company.
Provided further that where, owing to inadequacy or absence of profits in any financial year, any company proposes to declare dividend out of the accumulated profits earned by it in previous years and transferred by the company to the reserves, such declaration of dividend shall not be made except in accordance with such rules as may be prescribed in this behalf.
Provided also that no dividend shall be declared or paid by a company from its reserves other than free reserves.
Provided also that no company shall declare dividend unless carried over previous losses and depreciation not pro-vided in previous year or years are set off against profit of the company for the current year.
For the purposes of clause (a) of sub-section (1), depreciation shall be provided in accordance with the provisions of Schedule II.

(b) Features of Inventories that have impact on related audit procedures.

The following features of inventories have an impact on the related audit procedures:

- By their very nature, inventories normally turn over rapidly.
- Inventories are susceptible to obsolescence and spoilage. Further, some of the items of inventory may be slow-moving while others may follow a seasonal pattern of movement.
- Inventories are normally movable in nature, although there may be some instances of immovable inventories also, e.g., in the case of an entity dealing in real-estate.
- All the items of inventory may not be located at one place but may be held at different locations such as factories and warehouses, or with third parties such as selling agents.
- The individual items of inventory may not be significant in value, but taken together, they normally constitute a significant proportion of total assets and current assets of manufacturing, trading and certain service entities.
- Physical condition (e.g., stage of completion of work-in-process in certain industries) and existence of certain items of inventories may be difficult to determine.
- Valuation of inventories may involve varying degrees of estimation, including expert opinions, e.g., in the case of jewelry.

(c) Audit of Co-operative Society

In general while conducting audit of Co-operative society the auditor need to look into the followings:

(i) The auditor should carefully go through the bye-laws of the society and see that they are being observed both in letter and spirit.
(ii) He should examine the Register of Members of the society and individual shareholdings.
(iii) He should test-check the internal check and control system operated by the society and model his audit examination based on its strengths and weaknesses.

Audit of income: He should carefully vouch the receipt of cash. Cash receipts on account of share capital should be vouched with the Register of Members. Cash received against sales should be vouched with the cash memos and invoices issued to customers as also Sales Account. Receipt of cash in respect of payment of interest and repayment of loans advanced by the society should be vouched with the loan agreements. Cash received from members towards construction of houses or their maintenance, should be vouched with the Register of Members, demands made by the society from time to time, and money receipts.

Audit of Expenditure:

- He should vouch all expenditure with reference to authorisation from the Managing Committee, particularly in the case of large capital expenditure, as also the bills received from individual parties, the money receipts obtained from them, and entries in the Bank Pass Book along with counter-foils of cheques.
- He should vouch the payment of loans from the loan agreements entered into with borrower members.
- He should vouch establishment expenses with reference to the resolutions of the Managing Committee, agreements with the persons concerned, and money receipts obtained from them.

Other aspects points:

- He should appropriately classify overdue debts for a period from six months to five years and more, and report them to the members, with a note regarding the effects these might have on the financial position of the society. He should also put a note regarding the probability of recovery of such debts.
- Similarly, he should make a special reference to the overdue amount of interest from members. Generally, interest on overdue debts should not be credited to Interest Account but to the Overdue Interest Reserve Account.
- Writing off of bad debts should be after prior authorisation from the Managing Committee of the society. According to the Maharashtra Co-operative Societies Rules, a bad debt can be written off only when it is certified to be irrecoverable by the auditor. This casts a special obligation on the auditor to ascertain whether the debt in question was created within the Rules of the society, and whether it has now really become bad and irrecoverable.

(d) Audit of Issue of Bonus Shares.

Issue of Bonus Shares [Section 63] –

The auditor shall-

- Confirm that issue of Bonus Share was authorized by articles.
- Verify the minutes of the Board meeting and ordinary resolution passed in the general meeting in which the approval of members is obtained.
- Check that the company has issue fully paid-up bonus shares to its members only.
- Confirm that the issue of bonus shares shall not be made by capitalising reserves created by the revaluation of assets.
- Check whether the company has made any default in payment of interest or principal in respect of fixed deposits or debt securities issued by it.
- Check whether the company has made any default in payment of statutory dues of the employees, such as, contribution to provident fund, gratuity and bonus.
- Whether the partly paid-up shares are made fully paid-up.
- Check whether the bonus shares shall not be issued in lieu of dividend.