Paper – 12: Company Accounts and Audit

The following table lists the learning objectives and the verbs that appear in the syllabus learning aims and examination questions:

	Learning objectives	Verbs used	Definition
LEVEL B	KNOWLEDGE What you are expected to know	List	Make a list of
		State	Express, fully or clearly, the details/facts
		Define	Give the exact meaning of
	COMPREHENSION What you are expected to understand	Describe	Communicate the key features of
		Distinguish	Highlight the differences between
		Explain	Make clear or intelligible/ state the meaning or purpose of
		Identity	Recognize, establish or select after consideration
		Illustrate	Use an example to describe or explain something
	APPLICATION How you are expected to apply your knowledge	Apply	Put to practical use
		Calculate	Ascertain or reckon mathematically
		Demonstrate	Prove with certainty or exhibit by practical means
		Prepare	Make or get ready for use
		Reconcile	Make or prove consistent/ compatible
		Solve	Find an answer to
		Tabulate	Arrange in a table
	ANALYSIS How you are expected to analyse the detail of what you have learned	Analyse	Examine in detail the structure of
		Categorise	Place into a defined class or division
		Compare and contrast	Show the similarities and/or differences between
		Construct	Build up or compile
		Prioritise	Place in order of priority or sequence for action
		Produce	Create or bring into existence

Paper – 12: Company Accounts and Audit

Full Marks: 100 **Time Allowed: 3 Hours**

This paper contains 4 questions. All questions are compulsory, subject to instruction provided against each question. All workings must form part of your answer. Assumptions, if any, must be clearly indicated.

A. Answer all questions: **[2×10=20]**

(i) An asset does not meet the requirements of environment laws which have been recently enacted. The asset has to be destroyed as per the law. The asset is carried in the Balance Sheet at the year end at ₹ 6,00,000. The estimated cost of destroying the asset is ₹ 60,000. How is the asset to be accounted for?

Answer:

Fixed assets should be eliminated from the Financial Statements on disposal, or when no further benefit is expected from its use or disposal. So, the fixed asset should be eliminated from the Financial statements, as it is proposed to be destroyed as per law.

Cost of destroying the asset of ₹ 60,000 should be accounted for as and when incurred. A provision for the same should not be created since it is an obligation from a future event i.e., destruction of the asset.

(ii) XYZ Ltd. took over assets of ₹ 230 lakh and liabilities of ₹ 30 lakh of PQR Ltd. for the purchase consideration of ₹ 220 lakh. XYZ Ltd. paid the purchase consideration issuing equity shares of ₹ 100 each at 10% premium. Give journal entries in the books of the XYZ Ltd.

Answer:

Journal Entries
In the books of XYZ Ltd.

Date	Particulars		Dr. (₹ in lakh)	Cr.(₹ in lakh)
	Sundry Assets A/c	Dr.	230	
	Goodwill A/c	Dr.	20	
	To, Liabilities A/c			30
	To PQR Ltd. A/c			220
	(Being purchase of assets and liabilities of company)			
	PQR Ltd. A/c	Dr.	220	
	To, Equity Share Capital A/c			200
	To Securities Premium A/c			20
	(Being issue of equity shares of XYZ Ltd. at 10% premium)			

(iii) Differentiate between Reporting Currency and Foreign Currency .

Answer:

Difference between Reporting Currency and Foreign Currency:

Particulars	Reporting Currency	Foreign Currency
Meaning	It is the currency used in presenting the Financial Statements.	It is a currency other than the Reporting Currency of an enterprise.
Example	Indian Rupees is the Reporting Currency for an Indian Company.	Any currency other than Indian Rupees is a foreign Currency for an Indian Company.

(iv) List the matters to be disclosed when there is a change in classification as per AS – 11.

Answer:

When there is a change in the classification of a significant Foreign Operation, an enterprise should disclose –

(a) Nature of the change in classification.
(b) Reason for the change,
(c) Impact of the change in classification on Shareholders' Funds, and
(d) Impact on Net Profit or Loss for each prior period presented, had the change in classification occurred at the beginning of the earliest period presented.

(v) A Company has its Share Capital divided into Equity Shares of ₹10 each. On 01.10.2013, it granted 20,000 Employees' Stock Option at ₹ 50 per Share, when Market Price was ₹ 120 per share. The Options were to be exercised between 10.12.2013 and 31.03.2014. Employees exercised their options for ₹16,000 Shares only, and the remaining options lapsed. The Company closes its books on 31st March every year. Show Journal Entry (with narration) as would appear in the Company's books upto 31.03.2014.

Answer:

Journal Entry for ESOP

Particulars		Dr. (₹)	Cr.(₹)
Bank A/c (16,000 Shares × ₹ 50)	Dr.	8,00,000	
Employees' Compensation Expense A/c (16,000 Shares × ₹ (120-50) i.e. 70)	Dr.	11,20,000	
To Equity Share Capital A/c (16,000 Shares × ₹ 10)			1,60,000
To Securities Premium A/c [16,000 Shares × ₹ (120 – 10)]			17,60,000
(Being 16,000 Shares allotted to Employees under ESOP at a Premium of ₹ 110 per share)			

(vi) Treatment of Non-cash transactions as per AS – 3 — discuss.

Answer:

Treatment of Non- Cash transactions as per AS – 3:

- Investing and financing transactions that do not require the use of Cash or Cash Equivalents should be excluded from a Cash Flow Statement.

- Such transactions should be disclosed elsewhere in the Financial Statements, in way that provides all the relevant information about these investing and financing activities.

(vii) State the duties and powers of the company's auditor with reference to the audit of the branch and the branch auditor.

Answer:

Duties and Powers of the company's auditor with reference to the audit of the branch and the branch auditor —

(1) For the purposes of sub-section (8) of section 143, the duties and powers of the company's auditor with reference to the audit of the branch and the branch auditor, if any, shall be as contained in sub-sections (1) to (4) of section 143.
(2) The branch auditor shall submit his report to the company's auditor.
(3) The provisions of sub-section (12) of section 143 read with rule 12 hereunder regarding reporting of fraud by the auditor shall also extend to such branch auditor to the extent in relates to the concerned branch.

(viii) A Statutory auditor cannot be appointed as a Cost Auditor — Comment.

Answer:

Statutory auditor appointed under section 139 of the 2013 Act cannot be appointed to audit cost records - first proviso to section 148(3) of the 2013 Act.

(ix) List the Objectives of quality control procedures to be adopted by an audit firm.

Answer:

The objective of the auditor is to implement quality control procedures at the engagement level that provide the auditor with reasonable assurance that:
(a) The audit complies with professional standards and regulatory and legal requirements; and
(b) The auditor's report issued is appropriate in the circumstances.

(x) Discuss — Cost Auditing Standards as per the Companies Act,2013.

Answer:

"Cost Auditing Standards" mean such standards as are issued by the Institute of Cost Accountants of India, constituted under the Cost and Works Accountants Act, 1959, with the approval of the Central Government - Explanation to section 148(3) of the Companies Act ,2013.

2. (Answer any 2 questions)

(a) (i) Anand Ltd availed a lease from Sukh Ltd. The terms and conditions of the Lease are as under:

- **Lease Period is 3 years, in the beginning of the year 2012, for equipment costing ₹ 10,00,000 and has an expected useful life of 5 years.**
- **The Fair Market Value is also ₹ 10,00,000.**
- **The property reverts back to the lessor on termination of the lease.**

- **The Unguaranteed Residual Value is estimated at ₹ 1,00,000 at the end of the year 2014.**
- **3 equal annual payments are made at the end of the each year.**

Consider IRR = 10%. Present Value of ₹ 1 due at the end of 3rd year at 10% rate of interest is ₹ 0.7513. present Value of annuity of ₹ 1 due at the end of 3rd year at 10% IRR is ₹ 2.4868.

State whether the Lease constitutes Finance Lease, and also calculate Unearned Finance Income. [6]

Answer:

1. Finance vs. Operating Lease

Particulars	₹
(a) Present Value of Unguaranteed Residual Value (URV) ₹ 1,00,000 × 0.7513	75,310
(b) Present value of lease Payments (PV of MLP) ₹ 10,00,000 – ₹ 75,310	9,24,870
(c) % of PV of MLP to Fair Value $\frac{₹9,24,870}{₹10,00,000}$	92.49%

The Lease Term is 60%, 3/5th of the Asset's Useful Life. Also, the Present value of Lease Payments is around 92% of the Fair Value, constituting substantial portion of the Fair Value. Therefore, the Lease is a Finance lease.

2. Computation of Unearned Finance Income

Particulars	₹
Annual Lease Payments = $\frac{\text{PV of Lease Payments}}{\text{Annuity Factor for 3 years at 10\%}} = \frac{₹9,24,870}{2.4868}$	3,71,912 p.a.
Total Lease Rentals for the Lease Period = ₹ 3,71,912 p.a. × 3 years = MLP	11,15,736
Residual Value	1,00,000
Gross Investment in the Lease	12,15,736
Less: Present Value of MLP & URV = (9,24,690 + 75,310) (see note)	(10,00,000)
Unearned Finance Income	2,15,736

Note: PV of MLP & URV equals the Fair Value / Cost of Equipment at the inception of the lease = ₹ 10,00,000.

(ii) A Ltd. has not included in the Balance Sheet as on 31.03.2014, a sum of ₹ 1.50 Crores being amount in the arrears of Salaries and Wages payable to the Staff for the last 2 years as a result of successful negotiations which were going on during the last 18 months and concluded on 30.04.2014. The Auditor wants to sign the said Balance Sheet and give the audit report on 31.05.2014. The Auditor came to know the result to the negotiations on 15.05.2014 — Comment. [2]

Answer:

- The obligation requires a Provision for Outstanding Expenses under AS – 29.
- The facts have become known to the Auditor before the date of issue of the Audit Report and before the date the Financial Statements are issued, under SA-560.

The Auditor should require the Management to create provision for ₹ 1.50 Crores. If not done, he should qualify his Audit Report.

(b) A Steel Manufacturing Company has a turnover of ₹ 45 Crores and Net Pre-Tax Profit of ₹ 6 Crores. The Company's financial year ends on 31st March. The Company's policy is to treat Grants received in respect of Fixed Assets as Deferred Income and to deduct all Grants identified as relating to specific revenue expenditure against that expenditure. All other

Grants recognized are credited to P&L Account. Discuss the following situations –

(i) During the year, the Company received a Grant from the Defence Department of Government of India for ₹ 3,00,000 towards the cost of new equipment. The equipment has an estimated useful economic life of 10 years and cost ₹ 7,00,000. The Company policy is to depreciate all depreciable Fixed Assets by the Straight Line Method.

(ii) During the year, the Company spent ₹ 70,000 on training, in respect of which it is due to receive Government Grant of 50%. The grant formalities have been completed but payment is not expected until mid – June of the next year.

(iii) In October, a Grant of ₹ 40,000 was receive from the Government in recognition of the high quality that the Company's production had maintained over the five years, which had ended on 31st March, the previous accounting year. [8]

Answer:

Situation i: The Government Grant has been received relating to specific Fixed Assets. There are two methods for dealing with the grant in the books –

	Particulars	Assets Cost Reduction Method	Deferred Income Method
1	Original Cost of Equipment	₹ 7,00,000	₹ 7,00,000
2	Specific Grant Received	₹ 3,00,000 (reduced from Cost)	₹ 3,00,000 (treated as Deferred Income)
3	Depreciable Value (1) – (2)	₹ 4,00,000	₹ 7,00,000
4	Useful Life of Machinery	10 years	10 years
5	Depreciation provided p.a. (3) ÷ (4)	₹ 40,000	₹ 70,000
6	Other Income Credited to P&L A/c every year	Not Applicable	₹ 30,000

Note:
The balance in the Deferred Income Account shall be shown in the Balance Sheet separately with a description, as 'Deferred Government Grants', under the appropriate head.

Situation ii: The Government Grant to be received can be shown either as income or as deduction from Training Expenses. As the Grant has not been received till the year end, it has to be shown as Receivable.

Situation iii: This is not a Grant related to specific Fixed Asset or for conditions to be complied in future. This Grant should be credited to P&L Account in the year of receipt only.

(c) (i) Ranashankara Ltd acquired a know-how on 1st April 2000 for ₹ 72 Lakhs and amortises the same using Straight Line Method for 18 years. AS – 26 is applicable to the company from 1st April 2003. Give the accounting treatment for the above under AS – 26. [5]

Answer:

A. Amortisation Period for Knowhow = 10 years from 1st April 2000.
The amortization period has not expired when AS – 26 is applicable for the Enterprise.

The amounting treatment is given below:

B. If AS – 26 were applicable from the beginning:

(a)	Amortisation Amount as per AS – 26 (as if applicable from the beginning)	₹ 7.20 lakhs p.a.
(b)	Accumulated Amortisation upto 31st 2003 (for 3 years) = ₹ 7.20 × 3	₹ 21.60 lakhs.
(c)	Carrying Amount of Knowhow on 1st April 2003 as per AS – 26 = ₹ 72 – ₹ 21.60	₹ 50.40 lakhs

C. Amortisation Amount as per Company Policy:

(a)	Amortisation Amount	₹ 4.00 lakhs p.a.
(b)	Accumulated Amortisation upto 31st 2003 (for 3 years) = ₹ 4.00 × 3	₹ 12.00 lakhs.
(c)	Carrying Amount of Knowhow on 1st April 2003 as per Books = ₹ 72 – ₹ 12	₹ 60.00 lakhs

D. The Carrying Amount of Knowhow should be adjusted to ₹ 50.40 lakhs (from ₹ 60.00 lakhs) by the following entry –

Particulars	Amount (₹)	Amount (₹)
P & L A/c or Revenue Reserve A/c Dr. To Knowhow A/c	₹ 9.60 lakhs	 ₹ 9.60 lakhs

E. The balance Carrying Amount of ₹ 50.40 Lakhs should be amortised over the balance Useful Life (1 years) at ₹ 7.20 lakhs per annum from Financial Year 2003-2004.

(c)(ii) As on 31.03.2014, the Equity share Capital of AB Ltd. is ₹10 Crores divided into Shares of ₹10 each. During the financial year 2014-2015, it has issued Bonus Shares in the ratio of 1:1. The Net Profit after Tax for the years 31.03.2014 and 31.03.2015 are ₹8.50 Crores and ₹11.50 Crores respectively. EPS disclosed in the accounts for two years in ₹8.50 and ₹5.75 respectively. Comment on the above. [3]

Answer:

Step	Particulars
1	Number of Shares at period beginning, on 31.03.2014 = ₹10 Crores ÷ ₹10 = 1 Crore Shares = 100 Lakh Shares
2	Bonus Shares in the ratio 1:1 = 100 Lakh Shares. So, Total Number of Equity Shares Outstanding, i.e. Step 1 + Bonus = Given 100 Lakh + Bonus 100 Lakh = 200 Lakh Shares.
3	Basic EPS for Current Year = $\frac{\text{Net Profit for the year}}{\text{Total Shares as per Step 2}} = \frac{₹1,150 \text{ Lakhs}}{200 \text{ Lakh Shares}} = ₹5.75$
4	Adjusted Basic EPS for the previous year

	$= \frac{\text{Net Profit for the previous year}}{\text{Total Shares as per Step 2}} = \frac{₹850 \text{ Lakhs}}{200 \text{ Lakh Shares}} = ₹4.25$

3. (Answer any 2 questions)

(a) (i) ABC Ltd. came out with an issue of 45,00,000 Equity Shares of ₹ 10 each at a Premium of ₹ 2 per Share. The Promoters took 20% of the issue and the balance was offered to the public. The issue was equally underwritten by A. B and C.

Each Underwriter took Firm Underwriting of 1,00,000 Shares each. Subscriptions for 31,00,000 Equity Shares were received with Marked Forms for the Underwriters as given below (i) A – 7,25,000, (ii) B – 8,40,000 (iii) C – 13,10,000, (iv) Total – 28,75,000.

The Underwriters are eligible for a commission of 5% on Face Value of Shares. The entire amount towards Shares subscription has to be paid along with application. You are required to:

- **Compute the Underwriters' Liability (Number of Shares),**
- **Compute the amounts payable or due to Underwrites, and**
- **Pass necessary Journal Entries in the books of the Company relating to Underwriting. [12]**

Answer:

When Benefit of Firm Underwriting is given to Underwriters —

A. Underwriters' Liability

Particulars	A	B	C	Total
Gross Liability	12,00,000	12,00,000	12,00,000	36,00,000
Less: Marked Applications	(7,25,000)	(8,40,000)	(13,10,000)	(28,75,000)
Less: Unmarked Applications	(75,000)	(75,000)	(75,000)	(2,25,000)
Less: Firm Underwriting	(1,00,000)	(1,00,000)	(1,00,000)	(3,00,000)
Net Liability under the Contract	3,00,000	1,85,000	(2,85,000)	2,00,000
Adjust: Surplus of C transferred to A & B	(1,42,500)	(1,42,500)	2,85,000)	Nil
Balance to be Underwritten	1,57,500	42,500	---	2,00,000
Add: Firm Underwriting	1,00,000	1,00,000	1,00,000	3,00,000
Total Liability=Shares to be taken up by Underwriters	2,57,500	1,42,500	1,00,000	5,00,000
Amount Due to Company at ₹ 12 per Share (₹)	30,90,000	17,10,000	12,00,000	60,00,000
Less: Commission due to Underwriters (₹)	(6,00,000)	(6,00,000)	(6,00,000)	(18,00,000)
(Amount due)/Payable to Underwriters	24,90,000	11,10,000	6,00,000	42,00,000

Note: Unmarked Applications = Total Applications received – Marked Applications = 31,00,000 – 28,75,000 = 2,25,000

B. Journal Entries in the books of the Company

	Particulars		**Dr. (₹)**	**Cr.(₹)**
1.	Underwriting Commission A/c	Dr.	18,00,000	
	To, A A/c			6,00,000
	To B A/c			6,00,000

	To C A/c (Being Underwriting Commission on the Shares underwritten)		6,00,000
2.	A A/c Dr. B A/c Dr. C A/c Dr. To, Share Capital A/c [(2,57,500 + 1,42,500 + 1,00,000) × ₹ 10] To Securities Premium A/c (Being Shares including Firm Underwriting Shares allotted to Underwriters)	30,90,000 17,10,000 12,00,000	 50,00,000 10,00,000
3.	Bank A/c Dr. To, A A/c To B A/c To C A/c (Being receipt of balance amount payable after Commission due to Underwriters)	42,00,000	 24,90,000 11,10,000 6,00,000

(ii) ABC Ltd. agreed to absorb Moon Limited on 31st March 2015 whose summarized Balance Sheet stood as follows:

Equity and Liabilities	₹	Assets	₹
Share capital		**Fixed Assets**	**10,50,000**
1,20,000 Shares of no each fully paid up	**12,00,000**	**Investments**	**-**
Reserves & Surplus		**Current Assets,**	
General reserve	**1,50,000**	**Loans and Advances**	
Secured Loan	**-**	**Stock in Trade**	**1,50,000**
Unsecured Loan	**-**	**Sundry Debtors**	**3,00,000**
Current Liabilities & Provisions			
Sundry Creditors	**1,50,000**		
	15,00,000		**15,00,000**

The consideration was agreed to be paid as follows:

(a) A payment in cash of ₹5 per share in Moon Ltd. and

(b) The issue of shares of ₹10 each in ABC Ltd. on the basis of two equity shares (valued at ₹15) and one 10% cumulative preference share (valued at ₹10) for every five shares held in Moon Ltd.

The whole of the share capital consists of shareholdings in exact multiple of five except the following holding:

P	**174**	
Q	**114**	
R	**108**	
S	**42**	
Other Individuals	**12**	**(Twelve members holding one share each)**

It was agreed that ABC Ltd. will pay in cash for fractional shares equivalent at agreed value of shares in Moon Ltd. i.e. ₹65 for five shares of ₹50 paid.

Compute the total number of Non-exchangeable shares. [4]

Answer:

Computation of total number of Non-exchangeable shares —

	Holding of shares (A)	Exchangeable in nearest multiple of five (B)	Exchange in equity shares (C) = (B)/5x2	Exchange in Preference shares (D) = (B)/5x1	Non-exchangeable Shars (E)=(A)-(B)
p	174	170	68	34	4
Q	114	110	44	22	4
R	108	105	42	21	3
S	42	40	16	8	2
Other individuals	12	-	-	-	12
	450	425	170	85	25

(b) Santanu Ltd. had decided to reconstruct the Balance Sheet since it had accumulated huge losses. The following is the Balance sheet of the Company on 31st March before reconstruction:

(₹ in '000)

Liabilities	₹	Assets	₹
Shareholders' Funds:		**Non-Current Assets:**	
Share Capital		**Tangible Assets**	
50,000 Equity Shares of ₹50 each	**2,500**	**Fixed Assets**	**1,000**
1,00,000 Equity Shares of ₹50 each ₹40 paid up	**4,000**	**Building**	**1,000**
		Plant	**2,500**
		Computers	
Reserves and Surplus			
Profit & Loss Account	**2,000**	**Intangible Assets**	
Non-Current Liabilities:		**Goodwill**	**2,000**
12% First Debentures	**5,00**		
12% Second Debentures	**1,000**		
Current Liabilities:	**500**		
Total	**8,500**	**Total**	**8,500**

The following is the interest of 2 individuals, Mr. N and Mr. D in the Company –

Particulars	Mr. N	Mr. D
12% First Debentures	**3,00,000**	**2,00,000**
12% Second Debentures	**7,00,000**	**3,00,000**
Sundry Creditors	**2,00,000**	**1,00,000**
Total of above	**12,00,000**	**6,00,000**
Fully paid up ₹ 50 Shares	**3,00,000**	**2,00,000**
Partly paid up Shares (₹ 40 paid up)	**5,00,000**	**5,00,000**

The following scheme of Reconstruction is approved by all parties interested and also by the Court:

i. **Uncalled Capital is to be called up in full and such shares and the other fully paid up shares be converted into Equity Shares of ₹ 20 each.**
ii. **Mr. N is to cancel ₹ 7,00,000 of his total debt (other than Share Amount) and to pay ₹ 2 lakhs to the Company and to received new 14% First Debentures for the balance amount.**
iii. **Mr. D is to cancel ₹ 3,00,000 of his total debt (other than Equity Shares) and to accept new 14% First Debentures for the balance.**
iv. **The amount thus rendered available by the scheme shall be utilized in writing off of Goodwill, Profit and Loss A/c and the balance to write off the value of Computers.**

You are required to draw the Journal Entries to record the same and show the Balance Sheet of the reconstructed Company. [16]

Answer:

Note: Since only Shareholders are involved, are involved, the word "Capital Reduction" A/c is used in this Illustration. Alternatively, the term "Reconstruction" A/c may also be used.

A. Journal Entries in the books of Santanu Ltd.

	Particulars		Dr. (₹)	Cr.(₹)
1.	Bank A/c	Dr.	10,00,000	
	To, Equity Share Capital A/c			10,00,000
	(Being the balance of ₹ 10 per Share on 1,00,000 Equity Shares called up and received as per approved reconstruction scheme)			
2.	Equity Share Capital (₹ 50) A/c	Dr.	75,00,000	
	To Equity Share Capital (₹ 20) A/c			30,00,000
	To Reconstruction A/c			45,00,000
	(Being the reduction of Equity Shares of ₹ 50 each to Shares of ₹ 20 each, as per approved reconstruction scheme)			
3.	12% First Debentures A/c	Dr.	3,00,000	
	12% Second Debentures A/c	Dr.	7,00,000	
	Sundry Creditors A/c	Dr.	2,00,000	
	To, Mr. N A/c			12,00,000
	(Being the total amount due to Mr. N, transferred to his account)			
4.	Bank A/c	Dr.	2,00,000	
	To, Mr. N A/c			2,00,000
	(Being amount received from Mr. N under Reconstruction Scheme)			
5.	12% First Debentures A/c	Dr.	2,00,000	
	12% Second Debentures A/c	Dr.	3,00,000	
	Sundry Creditors A/c	Dr.	1,00,000	
	To, Mr. D A/c			6,00,000
	(Being the total amount due to Mr. D, transferred to his account)			
6.	Mr. D A/c	Dr.	14,00,000	
	To 14% First Debentures A/c			7,00,000
	To Reconstruction A/c			7,00,000
	(Being cancellation of ₹ 7,00,000 out of total debt due to Nandi, and issue of 14% First Debentures for the balance amount as per approved reconstruction scheme)			
7.	Mr. D A/c	Dr.	6,00,000	

	To 14% First Debentures A/c To Reconstruction A/c (Being cancellation of ₹ 3,00,000 out of total debt due to Nandi, and issue of 14% First Debentures for the balance amount as per approved reconstruction scheme)		3,00,000 3,00,000
8.	Reconstruction A/c Dr. To Goodwill A/c To Profit and Loss A/c To Computers A/c (balancing figure) (Being Goodwill, Profit and Loss Account written off out of Reconstruction A/c and the balance for writing off Computers)(see WN 2)	55,00,000	 20,00,000 20,00,000 15,00,000

B. Reconstruction Account

Particulars	₹	Particulars	₹
To Goodwill A/c (written off)	20,00,000	By Equity Share Capital A/c (Reduction of Capital)	45,00,000
To P&L A/c (written off)	20,00,000	By Nandi A/c (Cancellation of Debt)	7,00,000
To Computers (balancing figure)	15,00,000	By Dundi A/c (Cancellation of Debt)	3,00,000
Total	55,00,000	Total	55,00,000

C. Balance Sheet of Santanu Ltd. (and Reduced) as at 31st March (after reconstruction)

	Particulars as at 31st March	Note	This Year	Prev. Yr.
I	Equity and liabilities:			
(1)	Shareholders' Funds: - Share Capital	1	30,00,000	
(2)	Non-Current Liabilities: Long Term Borrowings: 14% Debentures		10,00,000	
(3)	Current Liabilities:			
	Trade Payables – Sundry Creditors (5,00,000 – 2,00,000 – 1,00,000)		2,00,000	
	Total		42,00,000	
II	Assets			
(1)	Non-Current Assets - Fixed Assets: Tangible Assets	2	30,00,000	
(2)	Current Assets:			
	Cash and Cash Equivalents – (10,00,000 + 2,00,000)		12,00,000	
	Total		42,00,000	

Note 1: Share Capital

Particulars	This Year	Previous Year
Authorized: ……………………. Equity Shares of ……… each		
Issued, Subscribed & Paid up: 1,50,000 Equity Shares of ₹ 20 each	30,00,000	

Note 2: Tangible Assets

Particulars	This Year	Previous Year
(a) Building	10,00,000	
(b) Plant	10,00,000	
(c) Computers (Cost 25,00,000 – Cancelled Under Reconstruction Scheme 15,00,000)	10,00,000	
Total	30,00,000	

(c) (i) Mr. Sen of Moon Light Limited has collected the following information for the preparation of cash flow statement for the year ended 30.06.2014 :

	(₹ in lakhs)
Net Profit	**90,000**
Dividend (including dividend tax) paid	**25,605**
Provision for Income-tax	**18,000**
Income tax paid during the year	**12,744**
Loss on sale of assets (net)	**120**
Book value of the assets sold	**555**
Depreciation charged to Profit & Loss Account	**60,000**
Amortisation of Capital grant	**30**
Profit on sale of Investments	**300**
Carrying amount of Investment sold	**83,295**
Interest income on investments	**7,530**
Interest expenses	**30,000**
Interest paid during the year	**31,560**
Increase in Working Capital (excluding Cash & Bank balance)	**1,68,225**
Purchase of fixed assets	**43,680**
Investment in joint venture	**11,550**
Expenditure on construction work in progress	**1,04,220**
Proceeds from calls in arrear	**6**
Receipt of grant for capital projects	**36**
Proceeds from long-term borrowings	**77,935**
Proceeds from short-term borrowings	**61,730**
Opening cash and Bank balance	**15,009**
Closing cash and Bank balance	**38,952**

Required :

Prepare the Cash Flow statements for the year in accordance with AS-3 on Cash Flow statements issued by the Institute of Chartered Accountants of India (Make necessary assumptions). [12]

Answer :

Cash Flow Statement for the year ended 30-06-2014

(₹ in Lakhs)

Cash Flow from Operating Activities		
Net Profit before Taxation (90,000 + 18,000)	1,08,000	
Adjustments for :		
Depreciation	60,000	
Loss on sale of assets (Net)	120	
Amortisation of capital grant	(30)	

Profit on sale of investments	(300)	
Interest income on investments	(7,530)	
Interest expenses	30,000	
Operating profit before working capital changes	1,90,260	
Changes in working capital (excluding cash and bank balance)	(1,68,225)	
Cash generated from operations	22,035	
Income taxes paid	(12,744)	
Net cash used in operating activities		9,291
Cash flows from investing activities		
Sale of assets (555-120)	435	
Sale of investments (83,295 + 300)	83,595	
Investment income on investments	7,530	
Purchase of fixed assets	(43,680)	
Investment in joint venture	(11,550)	
Expenditure on construction work-in-progress	(1,04,220)	
Net cash used in investing activities		(67,890)
Cash flows from financing Activities		
Proceeds from calls in arrear	6	
Receipts of grant for capital projects	36	
Proceeds from long-term borrowings	77,935	
Proceeds from short-term borrowings	61,730	
Interest paid	(31,560)	
Dividend (including dividend tax) paid	(25,605)	
Net cash provided by financing activities		82,542
Net increase in cash and cash equivalents		23,943
Add : Cash and cash equivalents at the beginning of the period		15,009
Cash and cash equivalents at the end of the period		38,952

Note: It is assumed that interest income on investments ₹ 7,530 has been received during the year.

(ii) The Chief Accountant of BHD Ltd. gives the following data regarding its six segments:

Particulars	M	N	O	P	Q	R	Total
Segment Assets	50	25	10	5	5	5	100
Segment Results	-50	-140	80	10	-10	10	-100
Segment Revenue	200	320	200	90	90	100	1000

Determine the reportable segments as per AS – 17. [4]

Answer:

As per AS -17 a business segment or a geographical segment should be identified as a reportable segment if:

Its revenue from sales to external customers and from other transactions with other segments is 10% or more of the total revenue-external and internal of all segments. Hence M,N,O and R reportable segments as the revenue is 10% or more of the total revenue

Or,

Its segment result whether profit or loss is 10% or more of

- The combined result of all segments in profit; or
- The combined result of all segments in loss, In absolute terms.

Hence M,N and O have at least 10% of Total Segment Result i.e. ₹200 lakhs.

Or,

Its segment assets are 10% or more of the total assets of all segments. M,N and O have at least 10% of Total Segment Assets.

Reportable segments are – M,N,O and R.

4. (Answer any 2 questions)

(a) (i) For issuing an unqualified audit report, the auditor has to satisfy himself about some matters — discuss. [6]

Answer:

For issuing an Unqualified Audit Report, the Auditor has to satisfy himself that -

- **Evidence:** Reasonable evidence is obtained in support of transactions recorded in the books of account.
- **Standards:** Accounting entries passed in the books of accounts are in conformity with the generally applicable accounting principles and Accounting Standards followed consistently.

- **True and Fair:** The Financial Statements prepared represent a true and fair summary of the transactions that took place during the year.

- **Classification:** The process of classification and aggregation followed in the preparation of the Financial Statements is fair and it does not hide a material fact nor does it highlight something, which may distort the real state of affairs.

- **Format:** The form of Financial Statements is in accordance with the form prescribed by law, if any.

- **Free of Misstatements:** There are no material misstatements in the Financial Statements. No material transaction recorded in the books of account is illegal or beyond the legal competence of the Company.

- **Disclosure:** All the disclosures statutorily required or otherwise relevant have been made appropriately.

(ii) Write a note on — Audit Note Book. [6]

Answer:

An audit note book is usually a bound book in which a large variety of maters observed during the course of audit are recorded. The audit note book is a permanent record of the auditor. For each individual audit, the auditor usually maintains a separate audit note book. It should be maintained clearly, completely and systematically. It is a great evidential tool available as a defence with the auditors in the event of any charge is brought against them

Contents of Audit Note Book:

- Name of the business enterprise.
- Organisation structure.
- Important provisions of Memorandum and Articles of Association.
- Communication with the previous auditor, if any.
- Management representations and instructions.
- List of books of accounts maintained by the enterprise.
- Accounting methods, internal control systems followed by the enterprise, applicable laws etc.
- Key management personnel.
- Errors and fraud discovered.
- Matters requiring explanations or clarifications.
- Special points that need attention in the audit report and for subsequent audits.

(iii) List the areas to be considered while conducting audit of issue of bonus shares. [4]

Answer:

Areas to be considered while conducting audit of Issue of Bonus Shares [Section 63]:

- 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 issued 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 made 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.

(b) (i) Describe propriety audit in the context of government audit. [7]

Answer:

Propriety Audit in the context of Government Audit —

Under 'propriety audit', the auditors try to bring out cases of improper or avoidable expenditure even though the expenditure has been incurred in conformity with the existing rules and regulations. However, some general principles have been laid down in the Audit Code, which have for long been recognized as standards of financial propriety. Audit against propriety seeks to ensure that expenditure conforms to these principles which have been stated as follows:

i. The expenditure should not be prima facie more than the occasion demands. Every public officer is expected to exercise the same vigilance in respect of expenditure incurred from public moneys as a person of ordinary prudence would exercise in respect of expenditure of his own money.
ii. No authority should exercise its powers of sanctioning expenditure to pass an order which will be applicable directly or indirectly to its own advantage.
iii. Public moneys should not be utilised for the benefit of a particular person or section of the community unless:
    - the amount of expenditure involved is insignificant; or
    - a claim for the amount could be enforced in a Court of law; or
    - the expenditure is in pursuance of a recognised policy or custom; and
    - the amount of allowances, such as travelling allowances, granted to meet expenditure of a particular type should be so regulated that the allowances are not, on the whole, sources of profit to the recipients.

(ii) List any three areas to be checked in relation to retirement gratuity to employees while conducting audit. [3]

Answer:

Following are the areas to be checked in relation to Retirement Gratuity to Employees:

- the basis on which the gratuity payable to employees is worked out. The liability for gratuity may either be worked out on actuarial rules or agreement or on the presumption that all employees retire on the balance sheet date;
- the basis of computing gratuity is valid or not;
- computation of liability of gratuity on the aggregate basis.

(iii) State the objectives and functions of the Auditing and Assurance Standard Board (AASB). [6]

Answer:

Following are the objectives and functions of the Auditing and Assurance Standard Board (AASB):

- to review the existing and emerging auditing practices worldwide.
- to formulate Engagement Standards, Standards on Quality Control and Statement on Auditing.
- to review and revise the existing Standards and Statements on Auditing.
- to develop guidance notes on issues arising out of any Standard, auditing issues pertaining to any specific industry and revise.
- to review and revise the existing guidance notes.
- to formulate General Clarifications, where necessary, on issues arising from Standards.
- to formulate and issue Technical Guides, Practice Manuals, Studies and other papers.

(c) (i) List the steps involved in conducting the audit of an educational institution. [12]

Answer:

The special steps involved in the audit of an educational institution are the following:

- Examine the Trust Deed, or Regulations in the case of school or college and note all the provisions affecting accounts. In the case of a university, refer to the Act of Legislature and the Regulations framed thereunder.
- Read through the minutes of the meetings of the Managing Committee or Governing Body, noting resolutions affecting accounts to see that these have been duly complied with, specially the decisions as regards the operation of bank accounts and sanctioning of expenditure.
- Check names entered in the Students' Fee Register for each month or term, with the respective class registers, showing names of students on rolls and test amount of fees charged; and verify that there operates a system of internal check which ensures that demands against the students are properly raised.
- Check fees received by comparing counterfoils of receipts granted with entries in the cash book and tracing the collections in the Fee Register to confirm that the revenue from this source has been duly accounted for.
- Total up the various columns of the Fees Register for each month or term to ascertain that fees paid in advance have been carried forward and the arrears that are irrecoverable have been written off under the sanction of an appropriate authority.
- Check admission fees with admission slips signed by the head of the institution and confirm that the amount had been credited to a Capital Fund, unless the Managing Committee has taken a decision to the contrary.
- See that free studentship and concessions have been granted by a person authorised to do so, having regard to the prescribed Rules.
- Confirm that fines for late payment or absence, etc., have either been collected or remitted under proper authority.
- Confirm that hostel dues were recovered before students' accounts were closed and their deposits of caution money refunded.
- Verify rental income from landed property with the rent rolls, etc.

- Vouch income from endowments and legacies, as well as interest and dividends from investment; also inspect the securities in respect of investments held.
- Verify any Government or local authority grant with the relevant papers of grant. If any expense has been disallowed for purposes of grant, ascertain the reasons and compliance thereof.
- Report any old heavy arrears on account of fees, dormitory rents, etc, to the Managing Committee.
- Confirm that caution money and other deposits paid by students on admission have been shown as liability in the balance sheet and not transferred to revenue.
- See that the investments representing endowment funds for prizes are kept separate and any income in excess of the prizes has been accumulated and invested along with the corpus.
- Verify that the Provident Fund money of the staff has been invested in appropriate securities.
- Vouch donations, if any, with the list published with the annual report. If some donations were meant for any specific purpose, see that the money was utilised for the purpose.
- Vouch all capital expenditure in the usual way and verify the same with the sanction for the Committee as contained in the minute book.
- Vouch in the usual manner all establishment expenses and enquire into any unduly heavy expenditure under any head.
- See that increase in the salaries of the staff have been sanctioned and minuted by the Committee.
- Ascertain that the system ordering inspection on receipt and issue of provisions, foodstuffs, clothing and other equipment is efficient and all bills are duly authorised and passed before payment.
- Verify the inventories of furniture, stationery, clothing, provision and all equipment, etc. These should be checked by reference to Stock Register and values applied to various items should be test checked.
- Confirm that the refund of taxes deducted from the income from investment (interest on securities, etc.) has been claimed and recovered since the institutions are generally exempted from the payment of income-tax.
- Verify the annual statements of accounts and while doing so see that separate statements of account have been prepared as regards Poor Boys Fund, Games Fund, Hostel and Provident Fund of Staff, etc.

(ii) Write a note on — Adverse or Negative Audit Report. [4]

Answer:

Adverse or Negative Audit Report —

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.