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.

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

(a) The carrying amount of an asset given on sale and leaseback that results in an operating lease is ₹10,000. The fair value and the selling price of the asset at inception of the lease is ₹9,000. Give the accounting treatment in the books.

Answer:

Loss of ₹1,000 (₹10,000 - ₹9,000) to be immediately recognized in the Profit And Loss Account.

(b) The share capital of M Ltd. consists of 3,50,000 equity shares of ₹10 each, and 87,500 preference shares of ₹100 each, fully called up. Besides, its securities premium account shows a balance of ₹1,40,000 and general reserve of ₹24,50,000. The company decides to buy-back 1,05,000 equity shares of ₹12 each. For this purpose, it utilises the securities premium in full and general reserve to the extent necessary.
Pass the necessary journal entries only showing the effects on the securities premium account and the general reserve account.

Answer:

Journal Entries

Particulars		Dr. (₹)	Cr.(₹)
Equity Share Capital A/c	Dr.	10,50,000	
Securities Premium A/c	Dr.	1,40,000	
General Reserve A/c	Dr.	70,000	
To, Equity Shareholders A/c			12,60,000
(Being the amount due to equity shareholders for buying-back of 1,05,000 equity shares)			
General Reserve A/c	Dr.	10,50,000	
To, Capital Redemption Reserve A/c			10,50,000
(Being the nominal amount or equity shares bought back transferred)			

(c) 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.

(d) Journalize the following transaction:

Machinery worth ₹38 Lakhs was purchased. The amount due to the Vendor was settled by way of issue of 6% Debentures of ₹400 each, issued at a discount of 5%.

Answer:

Journal Entries

Particulars	Dr. (₹)	Cr.(₹)
Machinery A/c Dr. To, Asset Vendor A/c (Being the purchase of Machinery, and amount due to the Vendor)	38,00,000	 38,00,000
Asset Vendor A/c Dr. Discount on Issue of Debentures A/c Dr. To, 6% Debenture A/c (Being allotment of 10,000 6% Debentures of ₹400 each, at a discount of ₹20 each) [Issue Price = Face Value ₹400 less 5% discount = ₹380. So, number of debentures = 10,000]	38,00,000 2,00,000	 40,00,000

(e) Calculate from the following information- Theoretical ex-right fair value

- **Number of equity shares outstanding 2 lakhs**
- **Right issue 2 shares for each 5 shares**
- **Fair value per share before right ₹ 34.00**
- **Right issue price ₹ 20.00**

Answer:

Determination of Theoretical Ex-Rights Fair Value / Price:

$$= \frac{\text{(Base Shares Quantity x Fair Value per Share Before Rights)+(Rights Issue ×Rights Issue Price)}}{\text{Base Shares Quantity + Rights Shares Quantity}}$$

$$\text{Theoretical ex-right fair} = \frac{(2{,}00{,}000 \times 34)+(80{,}000 \times 20)}{2{,}00{,}000+80{,}000} = ₹30$$

(f) Goodwill arising on acquisition as per AS-14 is to be treated as per AS-26. Comment.

Answer:

An Intangible Asset acquired in the course of an amalgamation in the nature of purchase, is accounted for in accordance with AS-14. The Transferee Company should recognize an Intangible Asset meeting the recognition criteria under AS – 26, even if such asset had not been recognized in the Financial Statement of the Transferor Company.

(g) What is meant by the term "Judgmental Sampling"?

Answer:

There are two main methods for determining the size of sample viz. Judgmental Sampling and Statistical Sampling.

In Judgmental Sampling method, the sample size is determined on the basis of the personal experience and the knowledge of the auditor. It is one of the simple methods of sampling. This method is simple in its applicability, but it is not scientific and not objective. The risk of personal bias in selection of sample is always present. Thus, an element of subjectivity does prevail in this method.

(h) State the reason of conducting an efficiency audit.

Answer:

Efficiency Audit is conducted to ensure the economical execution of various schemes and policies.
It refers to the relationship between inputs and output i.e. the goods and services produced and resources used to produce them, yielding the expected results.

(i) As per section 139 of Companies Act, 2013 an auditor shall furnish a certificate and consent — discuss.

Answer:

As per section 139(8) before any appointment of auditor, the auditor shall furnish to the company —

(a) His written concent for such appointment; and
(b) A certificate that —
- The appointment, if made, shall be in accordance with the conditions as may be prescribed; and
- The auditor satisfies the criteria provided in section 141.

(j) What we understand by the term 'partial audit'?

Answer:

A partial audit is a non statutory audit, which restricts the scope of the auditor to checking of certain specific aspects only. The auditor's powers to enquiry are restricted by his terms of engagement. He may not be allowed to obtain information which falls outside the purview of the scope defined for him. e.g. an auditor may be appointed to check the accuracy of recording of transactions relating to cash sales, or he may be appointed to conduct an audit for the month of Diwali only.

2. (Answer any 2 questions)

(a) (i) S. S. Corporate Securities Ltd. is showing an intangible asset at ₹ 144 lakhs as on 01.04.2014 and that an item was acquired for ₹ 192 lakhs on 01.04.2011 and that the item was available for use from that date. It has been following the policy of amortisation of the

intangible asset over a period of 12 years on straight line basis. As per AS 26 how will it affect the accounts? [4]

Answer:

As per para 63 of AS 26 "Intangible Assets", the depreciable amount of an intangible asset should be allocated on a systematic basis over the best estimate of its useful life. There is a rebuttable presumption that the useful life of an intangible asset will not exceed ten years from the date when the asset is available for use. Amortisation should commence when the asset is available for use.

The company has been following the policy of amortisation of the intangible asset over a period of 12 years on straight line basis. The period of 12 years is more than the maximum period of 10 years specified under AS 26. Accordingly, The company would be required to restate the carrying amount of intangible asset as on 1.4.2014 at ₹ 192 lakhs less ₹ 57.6 lakhs (₹ 19.2 lakhs × 3 years) = ₹ 134.4 lakhs. If amortisation had been as per AS 26, the carrying amount would have been ₹ 134.4 lakhs. The difference of ₹ 9.6 lakhs i.e. (₹ 144 lakhs – ₹ 134.4 lakhs) would be required to be adjusted against the opening balance of revenue reserves. The carrying amount of ₹ 134.4 lakhs would be amortised over 7 (10 - 3) years in future.

(ii) List the intended users of the Financial Statement. [4]

Answer:

The intended users of the financial statement are:

- Existing and prospective shareholder of the company,
- Preference shareholder of the company,
- Debenture holder of the company,
- Employees of the company,
- Banker's of the company,
- Debtor's of the company,
- Creditor's of the company,
- Government authorities- I.Tax, IDT, ROC, Ministry of corporate affairs
- Lender's of the company,
- Other authorities.

(b) (i) Write a note on Financial Lease as per AS – 19. [6]

Answer:

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

- The lessee will get the ownership of leased asset at the end of the lease term.
- The lessee has an option to buy the leased asset at the end of term at price, which is lower than its expected fair value at the date on which option will be exercised.
- The lease term covers the major part of the life of the asset.
- At the beginning of lease term, present value of minimum lease rental covers substantially the initial fair value of the leased asset.

- The asset given on lease to lessee is of specialised nature and can only be used by the lessee without major modification.

(ii) Due to the contribution of Great Men Ltd to the Society, the State Government has given a product licence at a nominal consideration of ₹40 lakhs. The market price of the license is however ₹3 Cores. The Company incurred ₹4 lakhs as expenditure in registration and initial operation of the licence. At what price should the license be recorded? [2]

Answer:

By applying Para 33 of AS – 26, the licence should be recorded in the books at ₹40 Lakhs (being the nominal consideration paid) + ₹4 lakhs (being the direct expenditure incurred).

Cost of Licence = ₹44 lakhs. The Market Value of ₹3 Crores is not relevant in this regard.

(c) Explain the treatment of the following:

(i) A firm acquired a fixed asset for ₹ 500 lakhs on which the Government grant received was 40%.
(ii) Capital subsidy received from the Central Government for setting up a plant in the notified backward region. Cost of the plant ₹ 450 lakhs, subsidy received ₹ 150 lakhs.
(iii) ₹ 50 lakhs received from the State Government for the setting up of water-treatment plant.
(iv) ₹75 lakhs received from the local authority for providing medical facilities to the employees. [2×4=8]

Answer:

(i) The total cost of the fixed asset is ₹ 500 lakhs and the grant is 40% i.e., ₹ 200 lakhs. In the balance sheet, the asset will be shown at the net amount (₹ 500 lakhs - ₹ 200 lakhs) i.e., ₹ 300 lakhs only. This will be depreciated over the life of the asset.
(ii) In this case, the subsidy received for setting up a plant in the notified region, should be treated as a capital subsidy. The amount of subsidy i.e., ₹ 150 lakhs be added to the Capital Reserves and the plant should be shown at ₹ 450 lakhs.
(iii) ₹ 200 lakhs received from State Government for setting up of water treatment plant should be deducted from the cost of the plant in the balance sheet.
(iv) It is a case of revenue grant and should be shown in the profit and loss account.

3. (Answer any 2 questions)

(a) (i) Uday Ltd. issued 8% Debentures of ₹3,00,000 in earlier year, on which interest is payable half yearly on 31st March and 30th September. The company has power to purchase its Own Debenture in the Open Market for cancellation thereof. The following purchases were made during the Financial Year 2014-2015 and cancellation made on 31st March 2015 —

- **On 1st April, ₹50,000 Nominal Value purchased for ₹49,450 ex-interest.**
- **On 1st September, ₹30,000 Nominal Value purchased for ₹30,250 cum-interest.**

Show the Journal Entries for the transactions held in year 2014-15. [10]

Answer:

Journal Entries

Date	Particulars	Dr. (₹)	Cr.(₹)
01.04.2014	Investment in Own Debenture A/c Dr. To, Bank A/c (Being Purchase of ₹1,00,000 Nominal Value Own Debentures at ₹98,900 ex-interest)	98,900	 98,900
01.09.2014	Investment in Own Debentures A/c **(balance figure)** Dr. Interest on Own Debentures A/c (₹60,000×8%×5/12) Dr. To, Bank A/c (Given) (Being Purchase of ₹60,000 Nominal Value Own Debentures at ₹60,500 cum-interest)	58,500 2,000	 60,500
30.09.2014	Interest on Debentures A/c (₹6,00,000×8%×6/12) Dr. To, Interest on Own Debentures (Income) A/c (₹1,60,000×8%×6/12) To, Bank A/c (Being Interest due on 60,000 Debentures for 6 months, Interest on Own Debentures recognised and balance paid to outsiders)	24,000	 6,400 17,600
31.03.2015	Interest on debentures A/c (₹6,00,000×8%×6/12) Dr. To, Interest on Own Debentures (Income) A/c (₹80,000×8%×6/12) To, Bank A/c (Being Interest due on 60,000 Debentures for 6 months, Interest on Own Debentures recognised and balance paid to outsiders)	24,000	 6,400 17,600
31.03.2015	8% Debentures A/c (1,00,000+60,000) Dr. To, Investment in Own Debentures A/c (98,900+58,500) To, P&L A/c (Profit on Cancellation) **(balancing figure)** (Being cancellation of Own Debentures against Debenture Liability)	1,60,000	 1,57,400 2,600

(ii) Following information relates to Utkal Ltd. State under which heads these items will appear in the Balance Sheet as per Schedule III ?

- **2,00,000 8% Preference Share of ₹100 each.**
- **Investment of ₹45,00,000 in 40,000 12% Debenture of ₹100 each of Amrit Ltd.**
- **License of ₹18,00,000 for Mining Right.**
- **Loan repayable on demand of ₹20,00,000 from X Bank.**
- **Provision for taxation of ₹88,000.**
- **Stock in transit of ₹80,000.** **[6]**

Answer:

As per Schedule III —

- 2,00,000 8% Prefence Shares of ₹100 each will come under : Equity and Liabilities – Shareholders' funds - Share Capital.
- Investment of ₹45,00,000 in 40,000 12% Debenture of ₹100 each of Amrit Ltd. will come under: Assets - Non-current Assets – Non-current Investments.

- License of ₹18,00,000 for Mining Right : Assets - Non-current Assets – Intangible assets.
- Loan repayable on demand of ₹20,00,000 from X Bank : Equity and Liabilities – Current Liabilities – Short - term Borrowings.
- Provision for taxation of ₹88,000 will come under: Equity and Liabilities – Current Liabilities – Short-term Provision.
- Stock in transit of ₹80,000 will come under: Assets – Current Assets – Inventories.

(b) (i) Bharat Ltd. which had experienced trading difficulties decided to reorganise its finances. On 31st March, a Final Trial Balance extracted from the books of the Company showed the following position: (in ₹)

Particulars	Dr.	Cr.
Share Capital, Authorised and Issued:		
1,500 6% Cumulative Preference Shares of ₹ 100 each		**1,50,000**
2,000 Equity Shares of ₹ 100 each		**2,00,000**
Capital Reserve		**36,000**
Profit and Loss Account	**1,10,375**	
Preliminary Expenses	**7,250**	
Goodwill at Cost	**50,000**	
Trade Creditors		**42,500**
Debtors	**30,200**	
Bank Overdraft		**51,000**
Leasehold Property at Cost	**80,000**	
Lease hold Property Provision for Depreciation		**30,000**
Plant and Machinery at Cost	**2,10,000**	
Plant and Machinery Provision for Depreciation		**57,500**
Stock-in-Trade	**79,175**	
Total	**5,67,000**	**5,67,000**

Approval from appropriate authorities was obtained for the following scheme for Reduction of Capital -

- **Preference Shares to be reduced to ₹ 75 per Share and Equity Shares to be reduced to ₹ 12.50 per Share.**
- **One ₹ 12.50 Equity Share to be issued for each ₹ 100 of Gross Preference Dividend Arrears, the Preference Dividend had not been paid for three years.**
- **The balance in Capital Reserve Account to be utilized.**
- **Plant and Machinery to be written down to ₹ 75,000.**
- **Profit and Loss Account balance and all Intangible Assets to be written off.**

At the same time as the resolution to reduce Capital was passed, another resolution was approved restoring the Total Authorised Capital to ₹ 3,50,000 consisting of 1,500 6% Cumulative Preference Shares of ₹ 75 each and the balance in Equity Shares of ₹ 12.50 each. As soon as the above resolution had been passed, 6,000 Equity Shares were issued at par for cash payable in full upon application. The same were fully subscribed and paid.

You are required to show the Journal Entries necessary to record the above transaction in the Company's books. [10]

Answer:

Journal Entries in the books of Bharat Ltd.

Sl. No.	Particulars	Dr. (₹)	Cr. (₹)
1.	6% Cum. Preference Share Capital (₹ 100 each) A/c Dr. To 6% Cumulative Pref. Share Capital (₹ 75 each) A/c To Reconstruction A/c (Being 1,500 6% Cum. Preference Shares converted into equal number of 6% Cum. Preference Shares of ₹ 75 each, balance of the amount transferred to Reconstruction Account vide approved Scheme of Reconstruction dated....)	1,50,000	 1,12,500 37,500
2.	Equity Share Capital (₹ 100 each) A/c Dr. To Equity Share Capital (₹ 12.50 each) A/c To Reconstruction A/c (Being 2,000 Equity Shares of ₹ 100 each reduced to Equity Shares of ₹ 12.50 each, balance trfd. to Reconstruction A/c vide approved Reconstruction Scheme dated……….)	2,00,000	 25,000 1,75,000
3.	Reconstruction A/c Dr. To Equity Share Capital A/c (Being allotment of 270 Equity Shares of ₹ 12.50 each to Pref. Shareholders as under Preference Dividend due for 3 years = ₹ 1,50,000 x 6 x 3 years = ₹ 27,000 No. of Equity Shares to be issued for every ₹ 100 Dividend due $= \frac{27,000}{100} = 270$ Equity Shares. Nominal Value of ESC issued = 270 Shares x ₹ 12.50 = ₹ 3,375)	3,375	 3,375
4.	Capital Reserve A/c Dr. To Reconstruction A/c (Being balance of Capital Reserve transferred to Reconstruction A/c vide Scheme of Reconstruction dated....)	36,000	 36,000
5.	Reconstruction A/c Dr. To Plant & Machinery A/c (Being Net Amount of Plant & Machinery reduced to ₹ 75,000 vide approved Scheme of Reconstruction dated...) (2,10,000 - 57,500 - 75,000 = 77,500)	77,500	 77,500
6.	Reconstruction A/c Dr. To Profit & Loss A/c To Preliminary Expenses A/c ToGoodwillA/c (Being Dr. balance of P&L Account, Preliminary Expenses and Goodwill written off against Reconstruction Account vide	1,67,625	 1,10,375 7,250 50,000

	approved Scheme of Reconstruction dated ....)		
7.	Bank A/c Dr. To Share Application & Allotment A/c (Being money received on 6,000 Equity Shares at ₹ 12.50 per share)	75,000	 75,000
8.	Share Application and Allotment A/c Dr. To Equity Share Capital A/c (Being allotment of 6,000 Equity Shares of ₹ 12.50 each vide Board Resin dated ....)	75,000	 75,000

(ii) A liquidator is entitled to receive remuneration at 2% on the Assets realized, 3% on the amount distributed to Preferential Creditors and 3% on the payment made to Unsecured Creditors. The assets were realized for ₹50,00,000 against which payment was made as follows:

Liquidation Expenses	**₹50,000**
Secured Creditors	**₹20,00,000**
Preferential Creditors	**₹1,50,000**

The amount due to Unsecured Creditors was ₹30,00,000. Calculate the Total remuneration payable to Liquidator. [6]

Answer:

Particulars	Computation	₹
2% on Assets realized	₹50,00,000×2%	1,00,000
3% on Amount distributed to Preferential Creditors	₹1,50,000×3%	4,500
3% on Amount distributed to Unsecured Creditors	₹26,95,500×3/103	78,510
Total Remuneration to Liquidator		1,83,010

Note:

- Since the surplus available is insufficient, Liquidator's Remuneration should be paid before distributing the surplus to Unsecured Creditors.
- Amount available for Unsecured Creditors+ Liquidator's Remuneration at 3% thereon= assets realized ₹50,00,000 – Liquidation Expenses ₹50,000 – Payment to Secured Creditors ₹20,00,000 – Payment to Preferential Creditors ₹1,50,000 – Liquidator's Other Remuneration ₹1,00,000 and ₹4,500 =₹26,95,500.

(c) (i) 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.

(ii) 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	**77,940**
Proceeds from short-term borrowings	**61,725**
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	77,940	
Proceeds from short-term borrowings	61,725	
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.

4. (Answer any 2 questions)

(a) (i) List the factors that influence an auditor's judgment at the time of obtaining audit evidence and how he obtains such evidence? [5+3=8]

Answer:

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

The following factors influence auditor's judgment while obtaining audit evidence:

- the nature of the item;
- the adequacy of internal controls;
- the nature and size of the business carried on by the entity;
- Situations which may exert an unusual influence on the management;
- The financial position of the entity;
- The materiality of the item;
- The experience gained during the previous audits;

- The results of auditing procedures, including fraud or error which may have been found;
- The type of information available;
- The trend indicated by accounting ratios and analysis.

The auditor obtains evidence by any one or more of the following methods –

- Inspection — It consists of examining records, documents, or tangible assets. Inspection of records and documents provides evidence of varying degrees of reliability depending on their nature, source and the effectiveness of internal controls over their processing.
- Observation — It consists of witnessing a process or procedure being performed by others.
- Inquiry and Confirmation — Inquiry consists of seeking appropriate information from a knowledgeable person inside or outside the entity, Confirmation consists of the response to an inquiry to corroborate information contained in the accounting records.
- Computation — It consists of checking the arithmetical accuracy of source documents and accounting records or performing independent calculations.
- Analytical Review — It consists of studying significant ratios and trends and investigating unusual fluctuations and items.

(ii) State the meaning of Continuous Audit and the advantages of Continuous Audit. [3+5=8]

Answer:

Continuous audit involves the detailed examination of all the transactions by the auditor continuously throughout the year or at regular intervals, say fortnightly or monthly. A continuous audit is one which is commenced and carried on before the close of the financial year to which it relates. It involves the constant engagement of auditor's staff at the client office throughout the period under review.
Continuous audit is suitable in cases where the final accounts are desired to be presented soon after the close of the financial year or there is great volume of transactions or the system of internal check is weak.

Advantages of Continuous Audit are:

- A close and extensive examination of accounts is possible as the auditor gets full year for the purpose.
- The errors and frauds can be detected and rectified soon.
- A regular supervision by the auditor brings increased efficiency and accuracy in the accounts of the enterprise.
- Better MIS system because of availability of updated and accurate accounts.
- Continuous audit create more check on the client's staff.
- The auditor can have much better understanding of the client's business and thus he can suggest the client the ways to improve operational efficiency.
- The final accounts can be prepared and reported upon soon after the end of the financial year.
- It also facilitates auditor to schedule his work in convenient manner and avoid the pressure that may mount at the close of financial year.

(b) (i) Describe the techniques used to evaluate an Internal Control System. [4]

Answer:

Techniques for evaluation of Internal Control System:

- **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.

- **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.

- **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.

➢ **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''.

(ii) Describe the procedure of submission of Cost Audit Report by the Auditor of a Company. [4]

Answer:

The cost auditor shall submit his report to the Board of Directors.
Within 30 days of receipt of cost audit report, the company shall furnish to the Central Government —

- A copy of cost audit report; and
- Along with full information and explanation on every reservation or qualification contained in the cost audit report.

➢ The Central Government may call for such further information and explanation as it may deem fit.
➢ The company shall furnish such further information and explanation within such time as may be specified by the Central Government.

(iii) Narrate the steps to be followed by the Branch Auditor regarding Branch Audit Report. [2]

Answer:

The steps to be followed by the Branch Auditor regarding Branch Audit Report —

- The Branch Auditor shall prepare a report on the accounts of the branch examined by him.
- The branch auditor shall send his report to the auditor of the company.
- The auditor of the company shall deal with the report of the branch auditor, in his report in such manner as he considers necessary.

(iv) Mr. A. Bhagat is a whole time director of Bhagirathi Ltd. Recently he visited Australia for an official purpose. You, as the auditor of the company, list the steps to be followed while conducting the audit of foreign travelling expenses of Mr. A. Bhagat. [6]

Answer:

Travelling expenses are normally payable according to rules approved. Where no rules exist, the auditor should recommend that these be framed for controlling the expenditure.
In the absence of T.A. Rules, the expenditure should be vouched on the basis of actual expenditure incurred. A voucher should be demanded for all items of expenses incurred, except those which are capable of independent verification.
As regards travelling expenses claimed by directors the auditor should satisfy himself that these were incurred by them in the interest of the business and that the directors were entitled to receive the amount from the business.

The voucher for travelling expenses should normally contain the under mentioned information:

- Name and designation of the person claiming the amount.
- Particulars of the journey.
- Amount of railway or air fare.
- If the journey was undertaken by air, the boarding pass of travel should be attached to the voucher, this should be inspected. For travel by rail or road , in the foreign land the amount of the fare claimed should be checked from some independent source.
- Visa for travel — which shows the purpose of travel.
- Amount of Foreign exchange — Sanctioned for the travel including the authenticity/jurisdiction of the sanctioning authority. Sanction given by the board , if any
- Proof of foreign exchange — Additional purchased, if any, in that foreign land or anytime during the course of the journey.
- Mode of payment of expenses — Cash or card. Card used in that foreign land to either procure goods or to receive services in that land.
- Whether any unutilized forex or not — If yes, whether the same exchanged in INR ? Receipt of Exchange to be verified.
- D.A. for foreign travel – Whether paid as per norm or not and whether the same was paid in forex or in INR?
- Particulars of boarding and lodging expenses and in the case of halting allowance the rates thereof should be verified.

(c) (i) State the role of an auditor in verification of Imported Plant & Machinery. [4]

Answer:

Role of an auditor in verification of Imported Plant & Machinery:

- The Auditor should examine the directors Minute Book for the resolution passed authorizing the purchases.
- The Auditor should check the RBI's permission and the import License.
- The Auditor should examine the agreement with the foreign supplier, particularly check the terms of payment, interest rates and the basis of deferred payment.
- The Auditor should vouch the bills & receipts relating to purchases, customs duty payment, clearing & shipping charge, insurance premium etc.
- The Auditor should check the entries made in the books of account.

(ii) List the objectives and functions of Auditing and Assurance Standard Board (AASB). [3]

Answer:

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

- To review the existing and emerging auditing practices worldwide and 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.

(iii) List the areas to be covered while conducting the audit of an NGO incorporated as a company under Section 8 of the Companies Act, 2013. [9]

Answer:

While planning the audit of a Non- Governmental Organisation (NGO), the auditor may concentrate on the following:

- Knowledge of the NGO's work, its mission and vision, areas of operations and environment in which it operates; and
- Reviewing the legal form of the organisation and its Memorandum of Association, Articles of Association, rules and Regulations.
- Reviewing the NGO's Organisation chart, Financial and Administrative Manuals, Project and Programme Guidelines, Funding Agencies Requirements and Formats, budgetary policies, if any.
- Examination of minutes of the Board/Managing Committee/Governing Body/Management and Committees thereof to ascertain the impact of any decisions on the financial records.
- Study the accounting system, procedures, internal controls and internal checks existing for the NGO and verify their applicability.

The audit programme should include in a sequential order all assets, liabilities, income and expenditure ensuring that no material is omitted:

- Corpus Fund: The contributions/grants received towards corpus be vouched with reference to the letters from the donor(s). The interest income be checked with investment Register and physical investments in hand.
- Reserves: Vouch transfers from projects/programmes with donors letters and board resolutions of NGO. Also check transfers and adjustments made during the year.
- Ear-marked Funds: Check requirements of donors' institutions, board resolution of NGO, rules and regulations of the schemes of the ear-marked funds.
- Project/Agency Balances: Vouch disbursements and expenditures as per agreements.
- Loans: Vouch loans with loan agreements receipt counter –foil issued.

- Fixed Assets: Vouch all acquisitions/sale or disposal of assets including depreciation and the authorisations for the same. Also check donor's letters/agreements for the grants. For immovable property, check title, etc.
- Investments: Check Investment Register and the investments physically ensuring that investments are in the name of the NGO. Verify further investments and disinvestments for approval by the appropriate authority and reference in the bank accounts for the principal amount and interest.
- Cash in Hand and Bank Balance: Physically verify the cash in hand and imprest balance, at the close of the year. Check the bank reconciliation statements and ascertain details for old outstanding and unadjusted amounts.
- Stock in Hand: Verify stock in hand and obtain certificate from the management for the quantities and valuation of the same.
- Programme and Project Expenses : Verify agreement with donor/contributor (s) supporting the particular programme or project to ascertain the conditions with respect to undertaking the programme/project and accordingly, in the case of programmes/projects involving contracts, ensure that income tax is deducted, deposited and returns filed and verify the terms of the contract.
- Establishment Expenses: Verify that provident fund, life insurance and their administrative charges are deducted, contributed and deposited within the prescribed time. Also check other office and administrative expenses such as postage, stationery, travelling, etc.
- Check in details the contribution and grants for projects and programs, receipts from Fund arising programmes, Membership Fee and any Subscription related matters and any other matters that are related to Interest and Dividends.