# INTERMEDIATE EXAMINATION
## GROUP – II

### SYLLABUS – 2012
## SUGGESTED ANSWERS TO QUESTION

### DECEMBER 2013

# Paper – 12: COMPANY ACCOUNTS AND AUDIT

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

***The figures in the margin on the right side indicate full marks.***
***The paper is divided in three sections. From Section A, answer to Question No. 1 is compulsory. From Question No. 2(a), (b) and (c) any two questions to be answered.***
***From Section B, answer to Question No. 3 is compulsory. From Question No. 4(a), (b) and (c) any two questions to be answered.***
***From Section C, answer to Question No. 5 is compulsory. From Question No. 6(a) and (b) one question to be answered and from Question 7(a), (b) and (c) any two questions to be answered.***

### SECTION A

**1. (Compulsory) Answer the following:**

**(a) State the disclosure requirements under AS-12.**

**(b) During the year 2011-12, Pankaj Limited has spent and carried forward in Books an amount of ₹ 15,00,000 being costs incurred in developing a product for cure for cancer. During the year 2012-13, due to adverse test results after field trial, the company decided to abort the efforts tadevelop the product.**
**What will be the treatment for the amount spent so far on developing the product in the financial statements of the Company for the year ending 31st March, 2013?**

**Answer:**

**1. (a)** Disclosure under **AS-1**2

**(a)** The accounting policy, method of presentation in the financial statements.

**(b)** The nature and extent of Govt. grants recognized in the financial statements, including grants of non-monetary assets given at a concessional rate or fee of cost.

**(b)** As per AS 26, an intangible asset should be derecognized on disposal or when no future economic benefits are expected from its use and subsequent disposal. As per AS 26, gains or losses arising from the retirement or disposal of an intangible asset should be recognised as income or expense in the Statement of Profit and Loss.
In this case, however, the company decided ultimately to discontinue the product due to adverse test result. As such, the entire amount of 15 lakhs should be treated as an expense which should be adjusted against current year's P&L A/c.

**2. Answer *any two* questions from (a), (b) and (c):** **8x2=16**

**(a)**

**(i) What are the disclosure requirements for an enterprise as per AS-11?** **4**

**(ii) The following details are provided by an Import House:**

| Particulars | Exchange rate 1 US Dollar = |
|---|---|

| | |
|---|---|
| **Goods purchased on 24th August, 2012 Us Dollar 2,00,000** | **₹47.10** |
| **Exchange rate on 31st March, 2013** | **₹54.20** |
| **Exchange rate on date of actual payment on 25th May, 2013** | **₹56.30** |

**Calculate gain or loss for the financial years 2012-13 and 2013-14 and its accounting treatment. 4**

**(b) Kovid Limited has taken a Machinery on Lease from Krishna Limited.**
**The following information are provided by Kovid Limited:**

| | |
|---|---|
| **Lease Term** | **5 years** |
| **Fair value at inception of Lease** | **₹ 20 Lakhs** |
| **Lease Rent** | **₹ 5 Lakhs per annum payable at the end of the year** |
| **Expected Residual value** | **₹ 3 Lakhs** |
| **Guaranteed Residual value** | **₹ 2 Lakhs** |
| **Implicit Interest rate** | **15.5% per annum** |

**You are required to prepare Lease Rent Account and Lease Liability Account in the Books of Kovid Limited.**
**(The present value of Re. 1 at Discount rate of 15.5% are 0.8658, 0.7496, 0.6490, 0.5619 and 0.4865 for year 1 to year 5 respectively.) 8**

**(c)**
**(i) What are the characteristics of a liability?**
**(ii) How is software acquired for internal use accounted for under AS-26? 4**

**Answer:**
**2. (a)**
**(i) Disclosure under AS -11: An enterprise should disclose:**

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

**(ii)** As per AS-11, all foreign currency transactions should be recorded by applying the exchange rate at the date of transaction. Therefore, goods purchased on 24th Aug, 2012 and corresponding creditor would be recorded at ₹ 47.10 = 2,00,000 x 47.10 = ₹ 94,20,000.

At the balance sheet date (As per AS-11) all monetary items should be reported using the closing rate. Therefore, the creditor of US $ 2,00,000 outstanding on 31st March, 2013, will be reported as : 2,00,000 x 54.20 = ₹ 1,08,40,000.

Exchange loss 1,08,40,000 – 94,20,000= ₹ 14,20,000 should be debited to profit and loss account for the year 2012-13.

Exchange difference on settlement of monetary items (as per AS -11) should be transferred to profit and loss amount thereof: 2,00,000 x 56.3 = 1,12,60,000 – 1,08,40,000 = ₹ 4,20,000 should be debited to profit and loss account for the year 2013 -14.

**(b)**

**Calculation of Present value of MLP**

| Year | **MLP (₹)** | **Discount Rate 15.5%** | **Present Value (₹)** |
|---|---|---|---|
| 1 | 500000 | 0.8658 | 432900 |
| 2 | 500000 | 0.7496 | 374800 |
| 3 | 500000 | 0.6490 | 324500 |
| 4 | 500000 | 0.5619 | 280950 |
| 5 | 700000 (5 Lakhs+2 .Lakhs) | 0.4865 | 340550 |
| | **2700000** | | **1753700** |

Present Value of MLP ₹ 17,53,700 is less than fair value at the inception of lease ₹ 20,00,000 , so the leased asset and liability should be recognized at ₹ 17,53,700 Apportionment of finance lease:

| **Year** | **Liability (₹)** | **MLP (₹)** | **Finance Charge (liability at beginning X interest rate ) (₹)** | **Principal Amount of reduction (₹)** |
|---|---|---|---|---|
| 0 | 1753700 | - | - | |
| 1 | 1525524 | 500000 | 271824 | 228176 |
| 2 | 1261980 | 500000 | 236456 | 263544 |
| 3 | 957587 | 500000 | 195607 | 304393 |
| 4 | 606013 | 500000 | 148426 | 351574 |
| **5** | - | 700000 | 93932 | 606068 |

**Books of Kovid Ltd.**
**Lease Rent Account**

**Dr.** **Cr.**

| **Particulars** | **(₹)** | **Particulars** | **(₹)** |
|---|---|---|---|
| 1st year<br><br>To Bank A/c | 5,00,000 | By Finance Charge A/c<br>By Lease Liability A/c | 271824<br>228176 |
| | 500000 | | 500000 |
| 2nd year<br><br>To Bank A/c | 500000 | By Finance Charge A/c By Lease Liability A/c | 236456<br>263544 |
| | 500000 | | 500000 |
| 3rdyear<br>To Bank A/c | 500000 | By Finance Charge A/c By Lease Liability A/c | 195607<br>304393 |
| | 500000 | | 500000 |
| 4tn year<br><br>To Bank A/c | 500000 | By Finance Charge A/c<br>By Lease Liability A/c | 148426<br>351574 |
| | 500000 | | 500000 |
| 5 th year<br>To Bank A/c | 700000 | By Finance Charge A/c<br>By Lease Liability A/c | 93932<br>606068 |
| | 700000 | | 700000 |

**Lease Liability Account**

**Dr.** **Cr.**

| Particulars | (₹) | Particulars | (₹) |
|---|---|---|---|
| 1st year<br>To Lease Rent A/c<br>To Balance c/d | <br>228176<br>1525524 | By Balance b/d | 1753700 |
| | 1753700 | | 1753700 |
| 2nd year<br>To Lease Rent A/c<br>To Balance c/d | <br>263544<br>1261980 | By Balance b/d | 1525524 |
| | 1525524 | | 1525524 |
| 3rd year<br>To Lease Rent A/c<br>To Balance c/d | <br>304393<br>957587 | By Balance b/d | 1261980 |
| | 1261980 | | 1261980 |
| 4th year<br>To Lease Rent A/c<br>To Balance c/d | <br>351574<br>606013 | By Balance b/d | 957587 |
| | 957587 | | 957587 |
| 5 th year<br>To Lease Rent A/c | <br>606013 | By Balance b/d | 606013 |
| | 606013 | | 606013 |

(c) (i) Characteristics of a Liability:

i. Normally liability arises from present obligation. But future obligation may also create liability if they are irrevocable. A forward contract to buy goods is irrevocable; therefore, gain or loss on such contract is evaluated and recognized as an asset or a liability.

ii. Liabilities result from past transactions or other past events. Even an irrevocable future obligation arises from past transactions or commitment (events) only.

iii. Normally liabilities are measurable in money terms. Sometimes liabilities are estimated which are termed as provisions. Framework defines the term liability broadly that includes provisions.

iv. Settlement of liability means giving up resources embodying economic benefits.

Liabilities are settled in any of the following ways-

- payment cash or transfer of other assets ;
- provision of services (services are rendered or to be rendered)
- replacement by a new obligation;
- conversion of an obligation into equity;
- extinguished by way of waiver from the creditors

(c) (ii) As per AS 26, the cost of a software acquired for internal use should be recognized as an asset if it meets the recognition criteria prescribed in paragraphs 20 and 21 of the Statement.

The cost of a software purchased for internal use comprises its purchase price, including any import duties and other taxes (other than those subsequently recoverable by the enterprise from the taxing authorities) and any directly attributable expenditure on making the software ready for its use. Any trade discounts and rebates are deducted in arriving at the cost. In the determination of cost, matters stated in paragraphs 24 to 34 of the Statement need to be considered, as appropriate.

Recognition criteria as per paras 20 and 21:
"An intangible assets should be recognized if, and only if:
(a) It is probable that the future economic benefits that are attributable to the asset will flow to the enterprise, and
(b) The cost of the assets can be measured reliably."

An enterprise should assess the probability of future economic benefits using reasonable and supportable assumptions that represent best estimate of the set of economic conditions that will exist over its useful life of the asset.

**SECTION B**

**3. (Compulsory) Answer the following: 2x4=8**
**(a) What is the meaning of the expression 'cash equivalent'?**
**(b) What are the maximum limit of Managerial remuneration payable for a Company earning sufficient Profit as per Section 198 of Companies Act?**
**(c) What are the sources available for buy-back of shares for a Company as per Section 77A of Companies Act?**
**(d) Chandu Limited was incorporated on August 1, 2012. It had acquired a running business from April 1, 2012. During the year 2012-13 the total sales of the business were ₹ 63,00,000. The Sales per month in the first half year were ½ of what they were in the second half. Calculate the ratio of Sales for the period prior to and post incorporation.**

Answer:

**3. (a)** Cash equivalent means bank balance and other risk free short-term investments and advances which are readily encashable. Cash equivalents means short-term highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value.

**(b)** Maximum Limit of Managerial Remuneration on the basis of Net Profit-

| | |
|---|---|
| **Situation – I** | |
| If company having only one Whole Time Director, Managing Director or Managers | 5% of Net Profit |
| **Situation – II** | |
| If company having more than one Whole Time Director or Managing Director or Managers | 10% of Net Profit |
| **Situation – III** | |
| Other than Director (not being Whole Time Director/Managing Director)- where there is a Whole Time Director/Managing Director/Manager | 1% of Net Profit |
| **Situation – IV** | |
| Other than Director (not being Whole Time Director/Managing Director)- any other case | 3% of Net Profit |
| **Situation – V** | |
| Overall Maximum Remuneration to Director and Manager | 11% of Net Profit |

**(c)** Sources for buy – back of shares
(i) Free reserves
(ii) Securities premium account
(iii) The proceeds of any shares or other specified securities

**(d)** Let, the monthly sales for second half year was ₹ 1
Then the monthly sales for first half year was ₹ ½
Sales for the period of prior to incorporation April, May, June & July = ½ x 4 = ₹ 2
Sales for the period of post Incorporation i.e. Aug, Sep, Oct, Nov., Dec.(2012).
Jan, Feb & March (2013)
Aug & Sept 2012 = ½ x 2 = ₹1
Oct 2012 to March 2013 = 1 x 6 = ₹6
₹7
Hence, Sales Ratio = 2 : 7

**4. Answer *any two* questions from (a), (b) and (c):** **16x2=32**

**(a)**

**(i) The following is the Balance Sheet of Superstar Ltd. as at 31.03.2013:**

| Liabilities | Amount (₹ in Lakhs) |
|---|---|
| 10% Redeemable Pref. Shares of ₹ 10 each, fully paid | 2,500 |
| Equity Shares of ₹ 10 each, fully paid | 8,000 |
| Capital Redemption Reserve | 1,000 |
| Securities Premium | 800 |
| General Reserve | 6,000 |
| Profit and Loss A/c | 300 |
| 9% Debentures | 5,000 |
| Sundry Creditors | 2,300 |
| Sundry Provisions | 1,000 |
| | 26,900 |

| Assets | Amount (₹ in Lakhs) |
|---|---|
| Fixed Assets | 14,000 |
| Investments | 3,000 |
| Cash at Bank | 1,650 |
| Other Current Assets | 8,250 |
| | 26,900 |

**On 1st April, 2013 the company redeemed all of its preference shares at a premium of 10% and bought back 25% of its equity shares @ ₹ 20 per share. In order to make cash available, the company sold all the investments for ₹ 3,150 lakh and raised a bank loan amounting to ₹ 2,000 lakhs on the security of the company's plant.**
**Pass Journal Entries for all the above mentioned transactions including Cash transactions. The amount of securities premium has been utilised to the maximum extent allowed by law.** **8**

**(ii) The following relevant items from the Balance Sheet of LM Limited are provided:**

| | Balance Sheet figures | |
|---|---|---|
| | As at 31.3.2012 | As at 31.3.2013 |
| | ₹ | ₹ |
| Goodwill | 90,000 | 75,000 |
| Profit and Loss A/c | 4,15,000 | 6,25,000 |
| General Reserve | 3,25,000 | 3,75,000 |

| | | |
|---|---|---|
| Inventories | 4,15,000 | 5,10,000 |
| Debtors | 3,45,000 | 3,22,000 |
| Prepaid Expenses | 18,000 | 15,000 |
| Creditors | 2,35,000 | 2,70,000 |
| Provision for Taxation | 1,05,000 | 1,55,000 |
| Provision for Doubtful Debts | 17,250 | 15,000 |

Depreciation amounting to ₹ 1,42,000 and Profit on sale of Machinery amounting to ₹ 21,000 appeared in the Profit and Loss A/c for the year ending 31.3.2013. During the year 2012-13 ₹ 1,00,000 was paid as Income Tax.

You are required to calculate Net Cash Flow from operating activity for the year ending 31st March,2013.

4

(iii) ABC Ltd. issued 40,000 Equity shares. Three Underwriters were appointed to underwrite the shares and the shares were underwritten as under:

| Underwriter | No. of Shares Underwritten |
|---|---|
| X | 24,000 |
| Y | 10,000 |
| Z | 6,000 |

The above Underwriters made application for 'firm' underwriting as under:

Underwriter X for 3,200 nos. shares, Underwriter Y for 4,000 nos. shares and underwriter Z for 1,200 nos. shares.

The Company received application for 20,000 nos. shares, excluding 'firm' underwriting but including marked applications which were as under:

| Underwriter | Marked application for No. of Shares |
|---|---|
| X | 4,000 |
| Y | 5,000 |
| Z | 2,000 |

You are required to calculate the allocation of liability of the respective Underwriters. (As per contract, the Underwriters are to be given credit for 'firm' applications and that credit for unmarked applications be given in proportion to the shares underwritten.) 4

(b)

(i) Tree Ltd. agreed to acquire all the assets of Plant Ltd. except its investments, as on 31st March, 2013:

Balance Sheet of Plant Ltd. as on 31st March, 2013

| Liabilities | ₹ | Assets | ₹ |
|---|---|---|---|
| Share Capital (₹ 10 each) | 5,00,000 | Goodwill | 70,000 |
| Reserves | 75,000 | Land & Building | 1,50,000 |
| 8% Debentures | 2,25,000 | Plant | 2,50,000 |
| Creditors | 3,00,000 | Investments | 50,000 |
| | | Stock | 1,00,000 |
| | | Debtors | 3,50,000 |
| | | Bank | 1,30,000 |
| | 11,00,000 | | 11,00,000 |

Tree Ltd. will:

(1) Discharge the debentures at 8% premium by issue of 7% debentures in Tree Ltd. at 10% discount;

(2) Issue of 3 shares of Tree Ltd. (face value ₹ 10 each) for every 2 shares in Plant Ltd.;

(3) Pay ₹ 2 in cash for each share of Plant Ltd.; and

(4) Pay absorption expenses of ₹ 5,000.

Plant Ltd. sold its investments for ₹ 55,000. Shares received from Tree Ltd. are sold at ₹ 11 each. Before the absorption, Plant Ltd. declared and paid 10% dividend to its shareholders.
You are required to give the required Journal entries and Ledger accounts in the books of the vendor company i.e. Plant Ltd. . 10

(ii) A company went into voluntary liquidation on 31.3.2013 when the following Balance Sheet was prepared:

| Liabilities | ₹ | Assets | ₹ |
|---|---|---|---|
| Authorised Capital: | | Goodwill | 1,70,000 |
| 40,000 shares of ₹ 10 each | 4,00,000 | Freehold Property | 20,000 |
| Issued Capital: | | Machinery | 75,000 |
| 25,000 shares of ₹ 10 each | 2,50,000 | Stock | 25,000 |
| Unsecured Creditors | 50,000 | Debtors | 35,000 |
| Partly Secured Creditors | 1,20,000 | Cash | 500 |
| Preferential Creditors | 3,000 | Profit & Loss A/c | 98,000 |
| Bank Overdraft | 500 | | |
| (Unsecured) | 4,23,500 | | 4,23,500 |

The liquidator realized the assets as follows:
Freehold property which was sold to pay the partly secured creditors and it fetched ₹ 15,000;
Other assets realized as Machinery ₹ 50,000; Stock ₹ 20,000; Debtors ₹ 25,000.
The expenses of liquidation amounted to ₹ 1,000 and the liquidator's remuneration was agreed at 2.5% on the amount realized and 2% on the amount paid to unsecured creditors.
Prepare liquidator's final statement of account. 6

(c)
(i) Following are the summarised Balance Sheets of Y Ltd. and Z Ltd. as on 31st March, 2013:

(₹ in ,000)

| Liabilites | Y. Ltd. | Z. Ltd. | Assets | Y. Ltd. | Z. Ltd. |
|---|---|---|---|---|---|
| Equity Share Capital | 10,000 | 6,000 | Fixed Assets | 11,000 | 5,000 |
| (Shares of ₹ 10 each) | | | Shares in Y Ltd. | — | 2,000 |
| Reserves | 2,000 | 1,100 | (2,00,000 nos.) | | |
| Creditors | 3,000 | 1,900 | Stock | 1,800 | 1,100 |
| | | | Debtors | 1,890 | 750 |
| | | | Cash at Bank | 310 | 150 |
| | 15,000 | 9,000 | | 15,000 | 9,000 |

Y Ltd. acquired the business of Z Ltd. on the basis of intrinsic value of shares. The purchase consideration is to be discharged in the form of fully paid equity shares. On the Balance Sheet date a sum of ₹ 5,00,000 is owed by Y Ltd. to Z Ltd. Amount of stock of Y Ltd. include goods worth ₹ 5,50,000 supplied by Z Ltd. at cost plus 25%.
You are required to:
(1) Calculate the purchase consideration and compute the number of Equity shares to be issued by Y Ltd. to eligible outsiders.
(2) Show the necessary Journal entries in books of Y Ltd., if the entries are made at intrinsic value.
(3) Prepare Balance Sheet of Y Ltd. after absorption. 10

(ii) Explain what is Segment Revenue and what are the disclosure requirements of reportable segment. 6

**Answer:**

**4. (a)**
**(i)**

**In the books of Superstar Ltd.**
**Journal Entries**

| **Particulars** | | | **₹ in Lakhs** |
|---|---|---|---|
| | | **Amount** | **Amount** |
| Bank A/c<br>To, Investments<br>To, Profit and Loss A/c<br>(Being sale of investments and profit thereon) | Dr. | 3,150 | <br>3,000<br>150 |
| Bank A/c<br>To, Bank Loan A/c<br>(Being loan taken from bank) | Dr. | 2,000 | <br>2,000 |
| 10% Redeemable Pref. Share Cap A/c<br>Premium on Redemption of Pref. Shareholder A/c<br>To, Preference Shareholder A/c<br>(Being redemption of Preference shares) | Dr.<br>Dr. | 2,500<br>250 | <br><br>2,750 |
| Preference Shareholders A/c<br>To, Bank A/c<br>(Being payment of amount due to Pref. Shareholders) | Dr. | 2,750 | <br>2,750 |
| Securities Premium A/c<br>To, Premium on Red. of Pref. Shares A/c<br>(Being use of Securities premium to provide premium on red. of preference shares) | Dr. | 250 | <br>250 |
| Equity Share Capital A/c<br>Securities Premium (800 - 250) A/c<br>General Reserve A/c<br>To, Equity Shareholders<br>(Being buy back of Equity Shares)<br>**Note:** General Reserve Balance (6,000- 1450) = ₹ 4,550 | Dr.<br>Dr.<br>Dr. | 2,000<br>550<br>1,420 | <br><br><br>4,000 |
| General Reserve A/c<br>To, Capital Redemption Reserve A/c<br>(Being creation of capital redemption reserve to the extent of the face value of preference share redeemed and equity shares bought back) | Dr. | 4,500 | <br>4,500 |
| Equity Shareholders A/c<br>To, Bank A/c<br>(Being payment of amount due to Equity Shareholders) | Dr. | 4,000 | <br>4,000 |

Note: Cash at Bank = (1,650 + 3,150 + 2,000 – 2,750 – 4,000) = ₹ 50

**(ii)**

Cash flow from **operating** Activities
**for the year ending 31st March,**2013

| | ₹ |
|---|---|
| Net Profit before taxation and extra ordinary items:<br>625000-415000=210000+150000 | 3,60,000 |
| Adjustment for: | |

| | |
|---|---|
| Depreciation | 1,42,000 |
| Goodwill written off | 15,000 |
| Transfer to General Reserve | 50,000 |
| Profit on sale of machinery | (21,000) |
| Operating profit before working capital Adj. | 5,46,000 |
| Increase in Inventories | (95,000) |
| Decrease in Debtors | 23,000 |
| Decrease in prepaid Expenses | 3,000 |
| Increase in Creditors | 35,000 |
| Decrease in provision for Doubtful debts | (2,250) |
| Cash generated from operations | **5,09,750** |
| Income tax paid | (1,00,000) |
| Net cash from operating Activities | 4,09,750 |

Provision for Taxation A/c

| | ₹ | | ₹ |
|---|---|---|---|
| To Bank A/c(Tax paid)<br>To Balance c/d | 1,00,000<br><br>1,55,000 | By Balance b/d<br>By P.&.L. A/c | 1,05,000<br>1,50,000 |
| | 2,55,000 | | 2,55,000 |

**(iii)**

Statement showing liability of Underwriters

| Particulars | Underwriter X | Underwriter Y | Underwriter Z | Total |
|---|---|---|---|---|
| Gross Liability<br>Unmarked application (24:10:6) | 24,000<br>5,400 | 10,000<br>2,250 | 6,000<br>1,350 | 40,000<br>9,000 |
| <br>Marked Application | 18,600<br>4,000 | 7,750<br>5,000 | 4,650<br>2,000 | 31,000<br>11,000 |
| <br>Firm underwriting | 14,600<br>3,200 | 2,750<br>4,000 | 2,650<br>1,200 | 20,000<br>8,400 |
| Balance<br>Credit for excess (24 :6) | 11,400<br>1,000 | (1,250)<br>1,250 | 1,450<br>250 | 11,600 |
| Net Liability<br>Add: Firm underwriting | 10,400<br>3,200 | Nil<br>4,000 | 1,200<br>1,200 | 11,600<br>8,400 |
| Total Liability | 13,600 | 4,000 | 2,400 | 20,000 |

**(b)**

**(i)**

Books of Plant Ltd (Vendor Company)
Journal entries

| | Debit | Credit |
|---|---|---|
| Dividend A/c Dr.<br>To Bank A/c<br>(Being dividend at 10% paid to the shareholders) | 50,000 | <br>50,000 |
| Reserves A/c Dr.<br>To Dividend A/c<br>(Being dividend paid adjusted out of revenue profits) | 50,000 | <br>50,000 |

| | | | |
|---|---|---|---|
| Realisation A/c | Dr. | 10,50,000 | |
| To Goodwill A/c | | | 70,000 |
| To Land & Buildings A/c | | | 1,50,000 |
| To Plant A/c | | | 2,50,000 |
| To Investments A/c | | | 50,000 |
| To Stock A/c | | | 1,00,000 |
| To Debtors A/c | | | 3,50,000 |
| To Bank A/c (1,30,000 - 50,000) | | | 80,000 |
| [Being transfer of assets to realization] | | | |
| 8% Debentures A/c | Dr. | 2,25,000 | |
| To Realisation A/c | | | 2,25,000 |
| [Being transfer] | | | |
| Tree Ltd A/c | Dr. | 8,50,000 | |
| To Realisation A/c | | | 8,50,000 |
| [being purchase consideration receivable as per agreement] | | | |
| Shares in Tree Ltd A/c | Dr. | 7,50,000 | |
| Cash/ Bank A/C | Dr. | 1,00,000 | |
| To Tree Ltd | | | 8,50,000 |
| (being purchase consideration received in par agreement) | | | |
| Bank A/c | Dr. | 55,000 | |
| To Realisation A/c | | | 55,000 |
| (Being realization of investments which were not taken over) | | | |
| Tree Ltd A/c | Dr. | 5,000 | |
| To Bank A/c | | | 5,000 |
| [Being payment of expenses of absorption on behalf of Tree Ltd] | | | |
| Bank A/c | Dr. | 5,000 | |
| To Tree Ltd | | | 5,000 |
| (Being reimbursement of expenses by Tree Ltd) | | | |
| Bank A/c | Dr. | 8,25,000 | |
| To Shares in Tree Ltd | | | 7,50,000 |
| To Realisation A/c | | | 75,000 |
| (being sale of 75,000 equity shares @ ₹ 11 per share) | | | |
| Share capital A/c | Dr. | 5,00,000 | |
| Realisation A/c | Dr. | 1,55,000 | |
| General Reserve A/c | Dr. | 25,000 | |
| To Shareholders A/c | | | 6,80,000 |
| (being equity share capital, general reserve and realization profit transferred to shareholders A/c) | | | |
| Creditors A/c | Dr. | 3,00,000 | |
| To Bank | | | 3,00,000 |
| (being settlement of creditors) | | | |
| Shareholders A/c | Dr. | 5,80,000 | |
| To Bank | | | 5,80,000 |
| (being settlement of amount to equity shareholders) | | | |

**Realization Account**

**Dr.** **Cr.**

| **Particulars** | **Amount(₹)** | **Particulars** | **Amount(₹)** |
|---|---|---|---|
| To, Goodwill A/c | 70,000 | By, 8% Debentures A/c | 2,25,000 |
| To, Land & Building A/c | 1,50,000 | By, Tree Ltd. A/c | 8,50,000 |
| To, Plant A/c | 2,50,000 | By, Bank A/c (Sale of | |

| | | | |
|---|---|---|---|
| | | Investment) | 55,000 |
| To, Stock A/c | 1,00,000 | By, Bank (Profit on sale of Shares) | 75,000 |
| To, Debtors A/c | 3,50,000 | | |
| To, Bank A/c (1,30,0000 – 50,000) | 80,000 | | |
| To, Shareholders A/c | 1,55,000 | | |
| | 12,05,000 | | 12,05,000 |

**Tree Ltd. Account**

**Dr.** **Cr.**

| **Particulars** | **Amount(₹)** | **Particulars** | **Amount(₹)** |
|---|---|---|---|
| | | By, Equity shares in Tree Ltd. A/c | 7,50,000 |
| To, Realization A/c | 8,50,000 | By, Cash A/c | 1,00,000 |
| | 8,50,000 | | 8,50,000 |

**Bank Account**

**Dr.** **Cr.**

| **Particulars** | **Amount(₹)** | **Particulars** | **Amount(₹)** |
|---|---|---|---|
| To, Balance b/d | 1,30,000 | By, Creditors A/c | 3,00,000 |
| To, Tree Ltd. A/c | 1,00,000 | By, Dividend A/c | 50,000 |
| To, Sale of Investment A/c | 55,000 | By, Realization A/c | 80,000 |
| To, Sale of shares in Tree Ltd A/c | 8,25,000 | By, Shareholders A/c | 6,80,000 |
| | 11,10,000 | | 11,10,000 |

**Shareholders Account**

**Dr.** **Cr.**

| **Particulars** | **Amount(₹)** | **Particulars** | **Amount(₹)** |
|---|---|---|---|
| To, Bank A/c | 6,80,000 | By, Realization A/c | 1,55,000 |
| | | By, Shareholder A/c | 5,00,000 |
| | | By, Reserves A/c | 25,000 |
| | 6,80,000 | | 6,80,000 |

**(b)**

**(ii)**

**Liquidator's Final Statement Account**

**Dr.** **Cr.**

| Receipts | ₹ | Payments | ₹ |
|---|---|---|---|
| To Assets realized | | By Liquidator's Remuneration: (workings) | 4,490 |
| Cash | 500 | | |
| Debtors | 25,000 | | |
| Stock | 20,000 | By Liquidation expenses | 1,000 |
| Machinery | 50,000 | By Preferential creditors | 3,000 |
| | | By Unsecured creditors (Balance in figure) | 87,010 |
| | | By Equity shareholders | Nil |
| | 95,500 | | 95,500 |

**Workings:**

**Calculation of Liquidator's Remuneration:**

- 2.5% of amount realized

  2.5% of (25,000+20,000+50,000+15,000) = 2.5% of 1,10,000 = 2,750
- 2% on the amount paid to Unsecured Creditors

  95,500-(2,750+1,000+3,000) x 2/102 = 1,740

  4,490

**Note: Balance Partly Secured creditors are treated as Unsecured Creditors.**

**(c)**

**(i)**

**(1)** Calculation of Purchase Consideration

Intrinsic value of Y Ltd's share = $\frac{1,50,00,000 - 30,00,000}{10,00,000}$

= $\frac{1,20,00,000}{10,00,000}$ = ₹ 12 per share

| | |
|---|---|
| Net Assets of Z Ltd or Gross Purchase Consideration | |
| Fixed Assets | ₹ 50,00,000 |
| Current Assets | ₹ 20,00,000 |
| Value of shares in Y ltd. (2,00,000 x12) | 24,00,000 |
| | 94,00,000 |
| Less : creditors | 19,00,000 |
| Net Assets or Gross Purchase Consideration | 75,00,000 |

No. of shares to be issued for Net Assets

= Net Assets / Intrinsic value for Y Ltd. = $\frac{75,00,000}{12}$ = 6,25,000 shares

| | |
|---|---|
| Less: shares already held by Y Ltd. | 2,00,000 |
| Shares to be issued at value of ₹ 12 | 4,25,000 |

Hence, Purchase Consideration for accounting purpose
= 4,25,000 shares x ₹ 12 = ₹ 51,00,000 in-which ₹ 42,50,000 is share capital and ₹ 8,50,000 is securities premium .

(2)

Journal of Y Ltd.

| | | Debit | Credit |
|---|---|---|---|
| Business Purchase A/c | Dr. | 51,00,000 | |
| To Liquidator of Z Ltd A/c | | | 51,00,000 |
| Fixed Assets A/c | Dr. | 50,00,000 | |
| Stock A/c | Dr. | 11,00,000 | |
| Debtors A/c | Dr. | 7,50,000 | |
| Cash & Bank A/c | Dr. | 1,50,000 | |
| To Creditors A/c | | | 19,00,000 |
| To Business Purchase A/c | | | 51,00,000 |
| Liquidator of Z Ltd. A/c | Dr. | 51,00,000 | |
| To E. S. Capital A/c | | | 42,50,000 |
| To Securities Premium A/c | | | 8,50,000 |

| | | |
|---|---|---|
| Creditors A/c Dr.<br>To Debtors (of Z Ltd.)A/c | 5,00,000 | <br>5,00,000 |
| Goodwill A/c Dr.<br>To Stock A/c<br>[Eliminate of unrealized profit on stock = 5,50,000 x 25/125 = 1,10,000] | 1,10,000 | <br>1,10,000 |

(3)

**Name of the Company: Y Ltd.**

**Balance Sheet as at 31.03.2013**

| Ref No. | | Particulars | Note No. | As at 31st March, 2013 |
|---|---|---|---|---|
| | | | | ₹ |
| | **I.** | **Equity and Liabilities** | | |
| | 1 | Shareholders' funds | | |
| | | (a) Share capital | 1 | 1,42,50,000 |
| | | (b) Reserves and surplus | 2 | 28,50,000 |
| | 2 | Share application money pending allotment | | - |
| | 3 | Non-current liabilities | | - |
| | 4 | Current Liabilities | | |
| | | (b) Trade payables | 3 | 44,00,000 |
| | | Total | | 2,15,00,000 |
| | **II.** | **Assets** | | |
| | 1 | Non-current assets | | |
| | | (a) Fixed assets | | |
| | | (i) Tangible assets | 4 | 1,60,00,000 |
| | | (ii) Intangible assets | 5 | 1,10,000 |
| | 2 | Current assets | | |
| | | (b) Inventories | 6 | 27,90,000 |
| | | (c) Trade receivables | 7 | 21,40,000 |
| | | (d) Cash and cash equivalents | 8 | 4,60,000 |

| | | | | |
|---|---|---|---|---|
| | | Total | | 2,15,00,000 |

**ANNEXURE**

| **Note 1.Share Capital** | **As at 31st March, 2013** |
|---|---|
| Equity Share Capital | 1,42,50,000 |
| Total | 1,42,50,000 |

**Reconciliation of Equity Shares**

| **FOR EQUITY SHARE (₹10 per share) :-** | **31.3.2013** | |
|---|---|---|
| | **Nos** | **Amount (₹)** |
| Opening Balance of ₹10 each | 10,00,000 | 100,00,000 |
| Add: Fresh Issue (Incld Bonus shares , Right shares, split shares, shares issued other than cash) | 4,25,000 | 42,50,000 |
| | 14,25,000 | 145,20,000 |
| Less: Buy Back of shares | NIL | NIL |
| | 14,25,000 | 145,20,000 |

| **Note 2. Reserves and Surplus** | **As at 31st March, 2013** |
|---|---|
| Reserve and Surplus | 20,00,000 |
| Securities Premium | 8,50,000 |
| Total | 28,50,000 |
| **Note 3. Trade Payables** | **As at 31st March, 2013** |
| Sundry creditors (30,00,000 + 19,00,000 – 5,00,000) | 44,00,000 |
| Total | 44,00,000 |

| **Note 4. Tangible Assets** | **As at 31st March, 2013** |
|---|---|
| Fixed Assets (1,10,00,000+50,00,000) | 1,60,00,000 |
| Total | 1,60,00,000 |

| Note 5. Intangible Assets | As at 31st March, 2013 |
|---|---|
| Goodwill | 1,10,000 |
| Total | 1,10,000 |

| Note 6. Inventories | As at 31st March, 2013 |
|---|---|
| Stock-in trade (18,00,000 +11,00,000 – 1,10,000) | 27,90,000 |
| Total | 27,90,000 |
| **Note 7. Trade receivables** | **As at 31st March, 2013** |
| Debtors ( 18,90,000 + 7,50,000 – 5,00,000) | 21,40,000 |
| Total | 21,40,000 |
| **8. Cash and Cash Equivalents** | **As at 31st March, 2013** |
| Cash at Bank (3,10,000 + 1,50,000) | 4,60,000 |
| Total | 4,60,000 |

**(ii)**

**Segment revenue** is the aggregate of

(i) the portion of enterprise revenue that is directly attributable to a segment,

(ii) the relevant portion of enterprise revenue that can be allocated on a reasonable basis to a segment, and

(iii) revenue from transactions with other segments of the enterprise,

Segment revenue does not include:

(a) extraordinary items as defined in AS 5, Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies;

(b) interest or dividend income, including interest earned on advances or loans to other segments unless the operations of the segment are primarily of a financial nature; and

(c) gains on sales of investments or on extinguishment of debt unless the operations of the segment are primarily of a financial nature.

Disclosure Requirements

An enterprise should disclose the following for each reportable segment:

(a) segment revenue, classified into segment revenue from sales to external customers and segment revenue from transactions with other segments;

(b) segment result;

(c) total carrying amount of segment assets;
(d) total amount of segment liabilities;
(e) total cost incurred during the period to acquire segment assets that are expected to be used during more than one period (tangible and intangible fixed assets);
(f) total amount of expense included in the segment result for depreciation and amortization in respect of segment assets for the period; and
(g) total amount of significant non-cash expenses, other than depreciation and amortisation in respect of segment assets, that were included in segment expense and, therefore, deducted in measuring segment result.

## SECTION C

**5. (Compulsory) Answer the following:**
**(a) What do you understand by audit evidence?**
**(b) What is Tax audit?**
**(c) Describe 'Voucher' and 'Vouching'.**
**(d) What are the disqualifications for appointment of Statutory Auditor of a Company?**
**2x4=8**

**Answer:**

**5. (a)** 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 auditor should evaluate whether he has obtained sufficient appropriate audit evidence so that reasonable conclusions can be drawn there from. It is to be noted that sufficiency an appropriateness are interrelated and apply to evidence obtained from both substantive and compliance procedures.

**(b)** The main Purpose of the tax audit is to compute the taxable income according to the law and for maintaining transparency in the financial statements filed by the assesses with the Income tax department.

"A systematic and independent examination of data, statements, records, operations and performances (financial or otherwise) of an enterprise for a stated purpose. In any auditing situation, the auditor perceives and recognizes the propositions before him for examination, collects evidence, evaluates the same and on this basis formulates his judgment which is communicated through his audit report'.

Under the existing provisions of section 44AB, every person carrying on business is required to get his accounts audited if the total sales, turnover or gross receipts in the previous year exceeds one crore rupees.

**(c)** A voucher is a piece of substantiating evidence, in the form of a written record of expenditure disbursement, or completed transaction

Examples of types of vouchers: Cash Memo, Sale Invoice. Purchase Requisition Slip, Purchase Invoice Gate Keeper's Note, Bank Paying Slip, Bank Statements. Minutes Book, etc
The act of examining all documentary evidences (vouchers) is referred to as vouching Its basic objective is to establish the authenticity of the transactions

recorded in the primary books of account.
Vouching is said to be 'the essence of auditing" or may be termed as the 'backbone of auditing"

Importance of Vouching
(i) Serves as evidence, (ii) Assurance, (iii) Preliminary for Verification, (iv) Establishes Authenticity.

**(d)** Section 226 (3) provides that none of the following persons shall be qualified for appointment as auditor of a company
i) A body corporate
ii) An office; or employee of the company
iii) A person who is a partner or who is in the employment of an officer or employee of the company
iv) A person who is indebted to the company or has given any guarantee or provided any security connection with the indebtedness of any third person to the company for amount exceeding ₹ 1,000.
v) A person holding any security of that company after a period of one year w.e.f. 13.12.2000.

It may be notes that if an auditor already holds appointment as auditor in the specified number or more of companies as per section 224(1B), he will be disqualified for being appointed as an auditor of any other company.

**6. Answer either (a) or (b):**
**(a)**
**(i) State the basic features and necessity of continuous Audit.**
**(ii) State the scope and advantages of Operational Audit.**
**4+4**

**Or**

**(b)**
**(i) State the advantages of Cost Audit to Management and Shareholders.**
**(ii) What are the limitations of Internal Control?** **4+4**

**Answer:**

**6. (a)**
**(i)** Basic features and scope of continuous audit.
Basic features are:
(1) It is a process conducted throughout the year.
(2) It is conducted at regular or irregular intervals.
(3) It focuses on testing 100% of transactions.
(4) Technology is important to enabling it.
(5) It provides advance notice about errors and irregularities detected.
(6) Surprise visits by the auditor are involved.

Necessity of continuous audit:
Continuous audit is necessary where:
1) Internal controls are inadequate.
2) The transactions run in large numbers.
3) The management is interested in getting statements of accounts audited periodically for enabling better management of resources.

**(ii)** Scope of Operational audit:
Operational audit, in its initial stages, was developed as a branch of internal auditing,

Internal audit focuses on accounting operations of the entity But operational audit has a wider scope of working and covers all other operations, such as production and marketing too.

Advantage of operational audit:
Operational audit is one of the management tools to get first hand information. It is more useful in an entity where the management is at a distance from actual operation due to layers of delegation of responsibility. The management information system has various tools like routine performance report from department heads, internal audit reports, surprise checks, periodic inspections add investigation to control managers responsible for their departments. The operational audit is also one of the tools used in large or geographically vast entities to control the operation at first stage and to fill up the gaps of information provided by department heads through periodic reports.

**(b)**

**(i)** Advantages of cost audit to the Management:

1) Management gets reliable data for its day-to-day operations like" price fixing, control, decision making.
2) A close and continuous check on all wastages will be kept through a proper system of reporting to management.
3) Inefficiencies in the working of the company will be brought to light to facilitate corrective action.
4) Management by exception becomes possible through allocation of responsibilities to individual managers.
5) System of budgetary control and standard costing will be greatly facilitated.
6) Reliable check on valuation of ± closing stock and work-in-progress can be established.
7) Helps in detection of frauds and errors.

Advantages to the shareholders:
Cost audit ensures that proper records are kept as to purchases and utilisation of material and expenses incurred on wages, etc. It also makes sure that the valuation of closing stock and work-in-progress is on a fair basis. Thus, the shareholders are assured of a fair return on their investments.

**(ii)** Limitations of Internal control:

(i) Organizational structures: Deficiencies in organizational structure make internal control ineffective.
(ii) Size of the organization: Small organizations have very low levels of internal control, which are almost negligible due to more interference by owners and management.
(iii) Unusual transactions: The internal control procedures normally fail to keep a check on unusual transactions.
(iv) Costly: The implementation of internal control procedures and processes involves incurring costs in terms of time, effort and resources.
(v) Abuse of power: Members at the top level management may override/ interfere with control.
(v) Conclusion of two or more people.
(vii) Obsolence
(viii) Potential for human error.
(ix) Frequent follow-up measures.

**7. Answer any two questions from (a), (b) and (c): 12x2=24**

**(a)**

**(i) Mr. Jaggu, Auditor of Baiju Limited is of the opinion that 'Standards on Auditing' are meant only for reference purpose and it is not necessary to follow such standards while auditing. Give your comments. 4**

**(ii) Discuss the role of C & AG in the Audit of Government Company. 4**

**(iii) Distinguish between 'Qualified Report' and 'Adverse Report' of an Auditor. 4**

**(b)**

**(i) State the parameters to be satisfied for issuing an unqualified audit report? 4**

**(ii) Explain the significance of audit working papers. 4**

**(iii) A Company disclosed ₹ 15 Lakhs as outstanding from Bihar Ltd. as on 31.3.2013. Bihar Ltd. declared itself sick and filed for bankruptcy in May, 2013. As the Auditor of the Company how will you approach the issue? 4**

**(c)**

**(i) State the areas of operations of Internal Audit and its features. 8**

**(ii) What is cut off procedure? Explain its significance in the context of Auditing. 4**

**Answer:**

**7. (a)**

**(i)** Contention of Mr. Jaggu is totally wrong and is against the fundamental assumptions and guidelines governing auditing and assurance standards.

As per ICAI, while discharging their attest function, it will be the duty of the members of the Institute to ensure that the Auditing Standards are followed. The Auditing Standards will apply whenever an independent financial audit is carried out to express an opinion thereon.

The member of the Institute must follow the Auditing Standards. The auditors must draw attention to the material departures from Auditing Standards in their audit report along with the reasons for such departure.

Auditors in their report have to mention that audit was conducted in accordance with "Generally accepted auditing standards" in Indian context. Hence Mr. Jaggu is duty bound to follow the Auditing Standards.

**(ii) Role of** C&AG in the **Audit of** a **Government company:** The auditor of a government company is appointed by the C&AG. The C&AG have powers under section 619(3) of the Companies Act, 1956 as follows:

A. to direct the manner in which the company's accounts shall be audited by the auditor and to give such auditor instructions in regard to any matter relating to the performance of his functions as such;

B. to conduct a supplementary or test audit of the company's accounts by such person or persons as he may authorize in this behalf; and for the purposes of such audit, to require information or additional information to be furnished to person or persons so authorized, on such matters, by such person or persons, and in such form, as the Comptroller and Auditor-General may by general or special order; direct.

In addition, the C&AG has a right to comment upon or supplement the audit report in such manner as he thinks fit.

**(iii)**

**Distinguish Between Qualified Report and Adverse Report**

| Qualified Report | Adverse Report |
|---|---|

| | |
|---|---|
| i. A Qualified Audit Report is one an Auditor gives an opinion subject to certain reservations. | An Adverse 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, |
| ii. The Auditor's reservation is generally Stated as: "Subject to the above, we report that the Balance Sheet shows a true and fair view." | The Auditor states that the Financial Statements do not present a true and fair view of the state of affairs and working results of the organisation. |
| iii. The accounts present a true and fair view subject to certain reservations. | The accounts do not present a true and fair view on the whole. |
| iv. A Qualification is made In the Audit Report when the Auditor has reservation on specific item(s) of material nature | An Adverse Report is given when the Auditor has his reservations on the true and fair view presented by the Financial Statements |

**(b)**

**(i)** An unqualified audit report could be issued when the following parameters are met:

(i) Evidence: Reasonable evidence is obtained in support of transactions recorded in the books of account.

(ii) Standards: Accounting entries passed in the books of account are in conformity with the generally applicable accounting principles and Accounting standards followed consistently.

(iii) True and Fair: The financial statements prepared represent a true and fair summary of the transactions that took place during the year.

(iv) 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.

(v) Format: The form of financial statement is in accordance with the form prescribed by law, if any.

(vi) 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.

**(ii)**

Working Papers are necessary to -

(a) Aid in planning and performance of the audit,

(b) Aid in the supervision and review of the audit work,

(c) Provide evidence of the audit work performed to support the Auditor's opinion,

(d) Record and demonstrate the audit work from one year to another,

(e) Plan the timing and extent of audit procedures to be performed,

(f) Draw conclusions from the evidence obtained,

(g) Standardize the Working Papers and audit procedures to improve the efficiency of the audit,

(h) Facilitate the delegation of work as a means to control quality of work performed,

(i) Provide guidance to the audit staff with regard to the manner of checking the schedules,

(j) Fix responsibility on the staff member who signs each schedule checked by him, and

(k) Act as evidence in a Court of law when a charge of negligence is brought against the auditor.

**(iii)** AS-4 requires all significant events occurring after the balance sheet date and before the date of approval of accounts by the Board of directors should be adjusted, if additional evidence is available in respect of conditions that existed on the balance sheet date.
In the given case, debtors should be suitable adjusted in the financial statements, to show their realizable amount, since the conditions existed on the balance sheet date in respect of which additional evidence has been provided by the insolvency of Bihar Ltd.
So the auditor should examine the company's compliance with AS-4 and report accordingly.

**(c)**

**(i)** Internal audit involves five areas of operations -

(i) Reliability and integrity of financial and operative information: Internal auditors should review the reliability and integrity of financial and operation information and the means used to identify measures classify and report of such information.

(ii) Compliance with laws, policies, plans, procedures and regulations: Internal auditor should review the systems established to ensure compliance with those policies, plans and procedures. Law and regulations which could have a significant impact on operations and it should determine whether the organization is in compliance thereof.

(iii) Safeguarding of assets: Internal auditors should verify the existence of assets and should review the means of safeguarding assets.

(iv) Economic and efficient use of resources: Internal auditor should ensure the economic and efficient use of resources available.

(v) Accomplishing of established objectives and goals for operations: Internal auditor should review operations or programmes to ascertain whether results are consistent with established objectives and goals and whether the operations or programmes are being carried out as planned.

**Features of internal audit:**

(i) It is an independent appraisal activity within the organization or through an external source.

(ii) It can also be conducted by the staff of the entity or by an independent professional appointed for that purpose.

(iii) It is conducted for review of accounting, financial and other operations and controls established within an organization.

(iv) It is conducted as a service to the organization and is not a part of the organization.

(v) It intends to furnish the analysis, appraisals, suggestions and information concerning the activities to be reviewed by the management.

(vi) Internal auditing functions as a continuous effort for promoting effective control at reasonable cost.

**(ii)** Cut off procedure would mean a procedure adopted to give a delink between two time periods prompted by accounting procedure or a legal requirement.
Example: Date of accounting closing to ascertain the profit or loss - for accounting procedure.
Ascertain the profits between pre and post incorporation periods - legal requirement.
Possible areas were cut off procedure has significant impact is given below:

(a) Accounts receivable and accounts payable these are the most susceptible to recording of transactions in the inappropriate accounting period.

(b) Purchase bills or rising of sales invoice which requires to be linked to the accounting period for determining the profit or loss of the period.

It is the auditor's duty to examine cut off points and ensure that the transactions are recorded in the relevant period in which the commercial transactions relate to or take place.