INTERMEDIATE EXAMINATION

GROUP II

(SYLLABUS 2012)

SUGGESTED ANSWERS TO QUESTIONS

DECEMBER 2015

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.

This paper contains four 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) What are the disclosure requirements under AS-11?

   (b) State the methods of accounting for 'pooling of interest method' in case of mergers.

   (c) Green Ltd. finds at the end of financial year 2014-15 that there is a law suit outstanding. The possible outcome as estimated by Board of Directors are as under:

	Probability	Amount of Loss (`)
Win	0.60	—
Loss — with high damages	0.15	1,20,000
Loss — with low damages	0.25	80,000

   What will be the amount of contingent Liability to be shown by way of a note to financial statements as per AS-29?

   (d) What is segment expenses?

   (e) X Ltd. decides to redeem 650 nos. Redeemable Preference shares of ` 100 each. It is decided to issue 100 nos. 12% preference shares of ` 100 each at and 2000 nos. equity shares of ` 10 each for that purpose. Pass Journal entry for transfer to Capital Redemption Reserve Account.

   (f) What determines the price of Sweat Equity Shares?

   (g) What does an Auditor has to comply for ensuring true and fair view of the financial statement? (Mention *any four* aspects).

(h) What is meant by Internal Control and Internal Check?

(i) State the importance of Joint Audit.

(j) What does SA 230 say about utility and retention of working papers?

Answer:

1. (a) Disclosure requirements under AS - 11

The disclosure requirements under AS - 11 are the following, namely,

- The amount of exchange difference included in the net profit or loss for the period;
- The amount of exchange difference adjusted in the carrying amount of fixed assets during the accounting period;
- The amount of exchange difference in respect of forward contracts to be recognised in the profit / loss for one more subsequent accounting period;
- Foreign Currency risk management policy.

(b) Method of Accounting under Pooling of Interest method:

Pooling of Interest in the nature of merger includes:

(a) The assets, liabilities and reserves of the transferor company are to be recorded at their existing carrying amounts and in the same format as it was appearing in the books of the transferor company

(b) The identity of the reserves of the transferor company is to kept intact in the balance sheet of the transferee company

(c) Difference between the amounts of share capital issued plus any other additional consideration paid by the transferee company and the amount of the share capital of the transferor company should be adjusted in Reserves.

(c) According to AS-29 for the purpose of disclosure of contingent liability by way of note, the amount will be:

	`
0.15 × `1,20,000 =	18,000
0.25 × `80,000 =	<u>20,000</u>
	<u>38,000</u>

(d) Segment expense is the aggregate of

(i) the expense resulting from the operating activities of a segment that is directly attributable to the segment, and

(ii) the relevant portion of enterprise expense that can be allocated on a reasonable basis to the segment, including expense relating to transactions with other segments of the enterprise.

(e) Divisible Profits to be utilized & to be t/f to CRR

= Nominal Value of Pref. Shares to be redeemed - Proceeds of a Fresh Issue of Shares

= ` 65,000 - [(100 × ` 100) + (2000 × ` 10)] = ` 35,000

Journal

Date	Particulars	L.F.	Dr. (`)	Cr. (`)
	General Reserve A/c Dr.		35,000	
	To Capital Redemption Reserve A/c			35,000
	(Being the amount equal to nominal value of Pref. shares redeemed out of free reserves t/f to Capital Redemption Reserve A/c)			

(f) Determining the pricing of Sweat Equity Shares

This is covered under Regulation 7 concerning Sweat Equity Shares.

The price of sweat equity shares shall not be less than the higher of the following —

- The average of the weekly high and low of the closing prices of the related equity shares during last six months preceding the relevant date, or
- The average of the weekly high and low of the closing prices of the related equity shares during the two weeks preceding the relevant date.

(g) Compliance of an auditor for ensuring true and fair view of the financial statements

The concept of true and fair view is a fundamental concept in the auditing process. Thus what constitutes a true and fair view is a matter of an auditor's judgement in the particular circumstances of the case. In more specific terms, to ensure a true and fair view, an auditor has to see the following aspects, namely

- That the assets are neither overvalued or undervalued according to the accounting principles
- No material asset is omitted
- The charge if any on the assets are disclosed
- Material liability should not be omitted
- The profit and loss account discloses all the matters required to be disclosed by Part II of Schedule III and the balance sheet has been prepared in accordance with part I of Schedule III.
- All unusual exception or non - recurring items have been disclosed separately.

(h) 1. Internal Control is the process designed, implemented and maintained by those charged with governance, management and other personnel to provide reasonable assurance about the achievement of an entity's objectives with regard to reliability of financial reporting, effectiveness and efficiency of operations, safeguarding of assets, and compliance with applicable laws and regulations The term "controls" refers to any aspects of one or more of the components of Internal Control.

2. Internal check has been defined by the Institute of Chartered Accountants of England and Wales as the "checks on day to day transactions which operate continuously as part of the routine system whereby the work of one person is proved independently or is complementary to the work of another the object being the prevention or early detection of errors or fraud".

(i) The importance of Joint Audit

Joint Audit implies pooling together resources and expertise of more than one firm of auditors to render an expert job in a given time period which may be difficult to accomplish acting individually. It essentially involves sharing of the total work. This is by itself a great advantage, in specific terms, the importance which emerge out of such audit, are the following:

1. Sharing of expertise;
2. Advantages of mutual consultation;
3. Lower work load;
4. Better quality of performance;
5. Improved service to the client;
6. Displacement of the auditor of the company often obviated;
7. In respect of multinational companies, the work can be spread using the expertise of the local firms which are in a better position to deal with detailed work and the local laws and regulations;
8. Lower staff deployment cost;
9. Lower cost to carry out the work;
10. A sense of healthy competition towards a better performance.

(j)

1. Utility of working papers	According to SA 230 on 'Audit Documentation' working papers help in planning and performance of the audit, supervision and review of the audit work and provide evidence of the audit work performed to support the auditor's opinion.
2. Retention of working papers	Working papers should be retained, long enough, for a period of time sufficient to meet the needs of his practice and satisfy any legal or professional requirement of record retention. SQC 1 requires firms to establish policies and procedures for the retention of engagement documentation. The retention period for audit engagements ordinarily is no shorter than seven years from the date of the auditor's report, or, if later, the date of the group auditor's report.

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

(a) (i) Goods purchased on 24.02.2015 of US $ 1,000 for which payment made on 05.06.2015. Exchange Rate on 24.02.2015 ` 61.60 per US $, on 31.03.2015 ` 62.00 per US $ and on 05.06.2015 ` 62.50 per US $. State the Accounting Treatment at the date of transaction, reporting date and settlement date as per AS-11. 4

(ii) Explain the treatment of the following: 4

1. **` 100 lakhs received from the Central Govt, as subsidy for setting up a Plant in backward area. Cost of Plant ` 500 lakhs.**
2. **` 50 lakhs received from the State Govt, a Grant for setting up a Water Treatment Plant. Cost of Plant ` 150 lakhs.**

3. ` 25 lakhs received from the Local Authority for providing medical facilities to the employees.
4. Received Land worth ` 100 lakhs free of cost from the State Govt.

(b) (i) **As on 1st April, 2014 the Fair Value of Plan Assets was ` 2,00,000 in respect of a pension plan of Bharat & Tushar Ltd. The plan paid out benefits of ` 25,000 and received inward contributions of ` 55,000. On 31st March, 2015 the Fair Value of Plan Assets was ` 3,00,000. On 1st April, 2014 the company made the following estimates, based on its market studies, understanding and prevailing prices:**

Interest & Dividend Income, after tax payable by the fund 11.25%, Realized and Unrealized Gains on plan assets (after tax) 3%. Fund Administrative Costs 4%. Calculate expected return on plan assets for the year. (Equivalent compounding interest rate = 5%) 4

(ii) **Rajarshi Management Institute furnishes you the following information in respect of Development Fund in the year 2013-2014:**

Particulars	Amount ` in lakhs
Govt. grant received for construction of building	40
Private grant for acquisition of land	30
Transfer from unrestricted fund for purchase of furniture	5
Income from fixed deposit (Fixed Deposit for one year ` 40 lakhs)	2
Cost of land	10
Advance payment made for acquisition of further land	2
Payment made to construction of Building	10

Prepare a Statement of changes in balance of Development Fund for the year 2013-2014 and Balance Sheet for the Development Fund as on 31.03.2014. 4

(c) (i) **Manoj Ltd. has taken the assets on lease from PQR Ltd. The following information is given as under:**

Lease Term	= 4 years
Fair Value at the inception of lease	= ` 16,00,000
Lease Rent	= ` 5,00,000 p.a. at the end of the year
Guaranteed Residual Value	= ` 1,00,000
Expected Residual Value	= ` 2,00,000
Implicit Interest Rate	= 15%

Work out Unearned Finance Income. (Discount factors Yr. 1 – 0.8696, 2 – 0.7561, 3 – 0.6575 and Yr. 4 – 0.5718). 4

(ii) **State the advantages of Accounting Standards.** 4

Answer:

2. (a) (i) Accounting Treatment at the Date of Transaction

As per para 9 of AS 11 on 'The Effects of Changes in Foreign Exchange Rates', a foreign currency transaction should be recorded, on initial recognition in the reporting currency, by applying to the foreign currency amount the exchange rate at the date of the transaction. Accordingly, Goods purchased and corresponding Creditors would be recorded at ` 61,600 [i.e. 1,000 x ` 61.60]

Accounting Treatment at the Reporting Date

As per para 11 of AS 11, at balance sheet date all monetary items should be reported using the Closing Rate. Accordingly,

1. Closing Creditors will be reported at ` 62,000 [i.e. 1,000 x ` 62.00]
2. Exchange Loss of ` 400 [i.e. ` 62,000 - ` 61,600] should be debited in Profit and Loss Account for the year 2014-2015.

Accounting Treatment at the Settlement Date

Exchange Differences on settlement of monetary items should be transferred to Profit and Loss Account as gain or loss, Accordingly, Exchange Difference of ` 500 [i.e. ` 62,500 - ` 62,000] should be debited in Profit and Loss Account for the year 2015-2016.

2. (a) (ii)

1. As per AS 12, Government grants of the nature of promoters' contribution should be credited to capital reserve and treated as a part of shareholders' funds. In this case grant of ` 100 lakhs is in nature of promoters' contribution hence it should be credited to Capital Reserve which can neither be distributed as divided nor it can be considered as deferred income.
2. As per AS 12, the Grant relating to a specific fixed asset is shown as a deduction from the gross value of the asset concerned to arrive at book value. Grant of ` 50 lakhs will be deducted from the cost of the asset and the asset will be shown at ` 100 lakhs (i.e. ` 150 lakhs - ` 50).
3. As per AS 12, it is a revenue grant and should be shown in the Profit and Loss A/c. However, if the facilities are provided over a period of more than one year, it may be treated as deferred income and then taken to Profit and Loss A/c on a systematic basis.
4. As per AS 12, Asset received free of cost should be recorded at a nominal value. Land should be recorded at a nominal value.

2. (b) (i)

	Particulars	
(a)	**Actual Returns on Plan Assets**	
	A. Closing Balance of Fair Value of Plan Assets	` 3,00,000
	B. Add: Benefits Paid	` 25,000
	C. Less: Contributions Received	(` 55,000)
	D. Less: Opening Balance of Fair Value of Plan Assets	(` 2,00,000)
	E. Actual Return on Plan Assets	` 70,000
(b)	**Expected Rate of Return = 11.25% + 3% - 4% = 10.25%**	
(c)	**Expected Returns on Plan Assets**	
	A. Return on Opening Balance of Fair Value of Plan Assets [` 2,00,000 x 10.25% x 12/12]	` 20,500
	B. Return on Net Contributions Received [Contributions - Benefits Paid] [(` 55,000 - ` 25,000) x 5%]	` 1,500

	C. Expected Return on Plan Assets [A+B]	` 22,000
	Note: Equivalent Half Yearly Compounding Interest Rate $= \sqrt{(1+\text{Expected Rate of Return})} - 1$ $= \sqrt{(1+0.1025)} - 1 = 0.05$ or 5%	

2. (b) (ii)

(a) Statement of Changes in Balance of Development Fund

Particulars	Amt. ` in Lakhs
Government Grant	40
Private Grant	30
Transfer from Unrestricted fund	5
Income from Fixed deposit	2
Less: Payments Cost of Land	10
	67

(b) Balance Sheet for the Development Fund as at 31.03.2014

Liabilities	Amount (` in Lakhs)	Assets	Amount (` in Lakhs)
Development Fund Balance	67	Advance payment of land	2
		Fixed Deposit	40
		Construction of Building	10
		Cash at Bank	15
	67		67

(c) Balance of Cash and Bank Receipts

Particulars	` in Lakhs
Government Grant	40
Private Grant	30
Transfer from unrestricted fund	5
Income from Fixed Deposit	2
	77
Less: **Payments**	
Land 10	
Adv. for land 2	
Fixed Deposit 40	
Contractors 10	62
Balance of Cash and Bank Balance	15

2. (c) (i) Lessor should recognise asset given under lease of net investment in lease.

Net Investment in lease = Gross Investment - Unearned Finance Income

Gross Investment

= MLP + Guaranteed Residual Value + Unguaranteed Residual Value

= ` 20,00,000 + ` 1,00,000 + ` 1,00,000

= ` **22,00,000**

Unearned finance Income = Gross Investment - Present Value of Gross Investment

Year	Value of MLP `	Gross Investment discount factor	Present Value `
1	5,00,000	0.8696	4,34,800
2	5,00,000	0.7561	3,78,050
3	5,00,000	0.6575	3,28,750
4	7,00,000	0.5718	4,00,260
	22,00,000		**15,41,860**

Unearned Finance income = ` 22,00,000 – ` 15,41,850 = ` 6,58,140

2. (c) (ii) Following are the advantages of Accounting Standards:

1. It provides the accountancy profession with useful working rules.
2. It assists in improving quality of work performed by accountant.
3. It strengthens the accountant's resistances against the pressure from directors to use accounting policy which may be suspect in that situation in which they perform their work.
4. It ensures the various users of financial statements to get complete crystal information on more consistencies.

3. Answer *any two* questions from (a), (b) and (c): 16×2=32

(a) (i) The summarized Balance Sheet of Srishti Ltd. as on 31st March, 2015 was as follows:

Liabilities	Amount (`)	Assets	Amount (`)
Equity Shares (` 10)	**30,00,000**	**Goodwill**	**5,00,000**
Export Profit Reserves	**8,50,000**	**Tangible Fixed Assets**	**30,00,000**
General Reserves	**50,000**	**Inventories**	**10,40,000**
Profit and Loss Account	**5,50,000**	**Trade Receivables**	**1,80,000**
9% Debentures	**5,00,000**	**Gash & Bank**	**2,80,000**
Trade Payables	**1,00,000**	**Preliminary Expenses**	**50,000**
	50,50,000		**50,50,000**

On 01.04.2015 Anu Ltd. agreed to absorb the business of Srishti Ltd. on the following terms:

(a) To issue 4,50,000 Equity Shares of ` 10 each @ ` 15 per share.

(b) To make cash payment equivalent to ` 2.50 for every share in Srishti Ltd.

(c) To issue such an amount of fully paid 8% Debentures in Anu Ltd. at 96% as is sufficient to discharge 9% Debentures in Srishti Ltd. at a premium of 20%.

(d) To take over the Tangible Fixed Assets at 100% more than the book value, Inventories at ` 7,10,000 and Trade Receivables at their face value subject to a provision of 5% for doubtful debts.

(e) To reimburse Liquidation cost of Srishti Ltd. to the extent of `50,000. The actual cost of liquidation of Srishti Ltd. was ` 75,000.

(f) Statutory Reserves are to be maintained for 1 more year.

You are required to:

(i) prepare Realisation Account, Purchasing Company's Account, Shareholders Account and Debenture Account, and

(ii) pass Journal Entries in the books of Purchasing Company regarding acquisition of business. 8

(ii) From the following information, prepare a Cash Flow Statement:

Balance Sheet As at …

Particulars	Note	31.03.2015 `	31.03.2014 `
I. EQUITY AND LIABILITIES			
(1) Shareholders'Funds			
(a) Share Capital		12,50,000	10,00,000
(b) Reserves and Surplus	1	4,90,000	4,00,000
(2) Non-Current Liabilities (Long Term Loan)		4,00,000	5,00,000
(3) Current Liabilities			
Trade Payables		4,00,000	5,00,000
Short-term Provisions (Provision for tax)		60,000	50,000
Total		26,00,000	24,50,000
II. ASSETS			
(1) Non-Current Assets			
Tangible Fixed Assets	2	13,00,000	11,50,000
Non-Current Investments		50,000	1,00,000
(2) Current Assets			
Inventories		2,80,000	3,00,000
Trade Receivables		4,20,000	4,00,000
Cash & Cash Equivalents		5,50,000	5,00,000
Total		26,00,000	24,50,000

Note 1: Reserves and Surplus

Particulars	31.03.2015 `	31.03.2014 `
Profit and Loss A/c	4,80,000	4,00,000
Capital Reserve	10,000	—
	4,90,000	4,00,000

Note 2: tangible Fixed Assets

Particulars	31.03.2015 `	31.03.2014 `
Land & Building	3,80,000	4,00,000
Machinery	9,20,000	7,50,000
	13,00,000	11,50,000

Additional Information:

(1) Depreciation written off on land and building ` 20,000.

(2) The company sold some investment at a profit of ` 10,000, which was credited to Capital Reserve.

(3) Income-tax provided during the year ` 55,000.

(4) During the year the company purchased a machinery for ` 2,25,000. They paid ` 1,25,000 in cash and issued 10,000 equity shares of ` 10 each at par.

You are required to prepare a Cash Flow Statement for the year ended 31st March, 2015 by using indirect method. 8

(b) (i) The following was the Balance Sheet of Fortune Ltd. as on 31st March, 2015:

Liabilities:	(`)
Issued and paid-up-capital:	
6,00,000 equity shares of ` 10 each	60,00,000
General Reserve	2,00,000
Securities Premium	10,000
10% Debentures	28,00,000
Sundry Creditors	31,20,000
	1,21,30,000
Assets:	
Land & Building	12,60,000
Plant & Machinery	47,00,000
Furniture and fittings	7,00,000
Investments	7,40,000
Stock	24,00,000
Sundry Debtors	11,80,000
Cash & Bank	11,50,000
	1,21,30,000

On 1st April, 2015, the Shareholders of the Company have approved the scheme of buy-back of equity shares as under:

(i) 15% of the equity shares would be bought-back at ` 11 per share.

(ii) Balance in the General Reserve and Securities Premium Account may be fully utilized.

(iii) Issue 12% redeemable preference shares of ` 10 each as per the requirements.

Pass necessary journal entries to record the above transactions. 8

(ii) The following particulars of SQL Ltd. which went into voluntary liquidation,

You are required to prepare the Liquidator's Final Statement of Account.

(1) Cash with liquidators (after all assets are realized and secured Creditors and Debenture holders are paid) is ` 3,75,000.

(2) Preferential creditors to be paid ` 17,500.

(3) Other unsecured creditors ` 1,15,000 to be paid.

(4) 2,500,10% preference shares of ` 100 each fully paid up to be paid.

(5) 1,500 equity shares of ` 100 each, ` 75 per shares paid up to be paid as calculated.

(6) 3,500 equity shares of ` 100 each, ` 60 per shares paid up to be paid as calculated.

(7) Liquidator's remuneration is 2% on payments to preferential and other unsecured creditors. **8**

(c) (i) VEG LTD. decided to take over the whole business of SDA LTD. on the basis of following Balance Sheets as at March 31, 2015:

		VBG LTD. (`)	SDA LTD. (`)
I.	Equity and Liabilities:		
	(i) Shareholders' funds:		
	(a) Share capital		
	Equity shares of ` 10 each, fully paid	2,70,000	2,01,650
	(b) Reserves and surplus		
	General reserve	43,000	27,495
	Surplus	33,000	21,750
	(ii) Current liabilities		
	Trade payables	22,200	29,100
	TOTAL	3,68,200	2,79,995
II.	Assets:		
	(i) Non-current Assets		
	(a) Fixed Assets		
	(i) Plant	1,05,000	80,000
	(ii) Goodwill	25,000	17,500
	(iii) Current assets		
	(a) Inventories	45,750	41,250
	(b) Trade receivables	1,43,450	86,450
	(c) Cash and cash equivalents	49,000	54,795
	TOTAL	3,68,200	2,79,995

Additional Information:

(1) Plant of VBG LTD. and SDA LTD. is worth ` 97,500 and ` 87,500 respectively.

(2) Goodwill of VBG LTD. and SDA LTD. is to be valued at ` 37,500 and ` 25,000 respectively.

(3) Stock of SDA LTD. is over-valued by 10% above its cost.

(4) VBG LTD. is taking over SDA LTD. by issue of shares at the intrinsic value.

(5) All the Assets & Liabilities of SDA LTD. were incorporated in the books of VBG LTD. at fair value and Assets & Liabilities of VBG LTD. have been carried at carrying values only.

You are required to prepare post absorption Balance Sheet of VBG LTD. 8

(ii) On 31st March, 2015 the extract of Balance Sheet of Nanu Limited was as follows:

Balance Sheet of Nanu Limited as at 31st March, 2015 (Extract)

	Figures as at 31st March, 2015 (`)
I. EQUITY AND LIABILITIES	
(1) Shareholders' Funds	
(a) Share Capital	
Authorised	
Issued and Subscribed	
440000 Equity Shares of ` 10 each	44,00,000
12000, 7% Cumulative Preference Shares off ` 10 each	12,00,000
(b) Reserves and Surplus	
Securities Premium	5,20,000
Less: Profit and Loss Account (Debit)	(10,00,000)
Less: Preliminary Expenses	(1,00,000)
(2) Current Liabilities	
Creditors	6,20,000
Total	56,40,000
II. ASSETS	
(1) Non-Current Assets	
(a) Tangible Fixed Assets	
Land	10,00,000
Building	25,00,000
Machinery,	10,40,000
(b) Intangible Fixed Assets	
Goodwill at cost	3,40,000
(2) Current Assets	
Stock	4,80,000
Debtors	2,80,000
Total	56,40,000

** Dividend on preference shares is in arrear from 1st April, 2012.*

The following terms were settled under a duly approved Capital Reduction Scheme:

(a) Preference Shares to be reduced to ` 80 each fully paid and Equity Shares to ` 5 each fully paid.

(b) One fully paid-up ` 5 equity share to be issued for every ` 10 of preference share dividend arrears.

(c) Goodwill, Preliminary Expenses and debit balance of Profit and Loss Account to be written off. Securities premium account may be utilized for this purpose.

(d) Building and Machinery to be written down to ` 15,80,000 and ` 7,20,000 respectively.

Give journal entries recording the above transactions.

Ignore dividend distribution tax. **8**

Answer:

3. (a) (i)

Equity shares 3,00,000 @ ` 2.50 – Cash Payment	`7,50,000
Equity Shares (4,50,000 × ` 15)	`67,50,000
	`75,00,000

Dr. **Realisation Account** **Cr.**

Particulars	`	Particulars	`
To Goodwill	5,00,000	By 9% Debentures	5,00,000
To Tangible Fixed Assets	30,00,000	By Creditors	1,00,000
To Stock	10,40,000	By Anu Ltd. (Purchase consideration)	75,00,000
To Debtors	1,80,000		
To Cash & Bank A/c (2,80,000 - 25,000)	2,55,000		
To Cash & Bank A/c (Exp.)	25,000		
To Profit on realization	31,00,000		
	81,00,000		81,00,000

Dr. **Equity Shareholders' Account** **Cr.**

Particulars	`	Particulars	`
To Preliminary expenses	50,000	By Equity Share capital	30,00,000
To Equity Shares in Anu Ltd.	67,50,000	By Export Profit Reserves	8,50,000
To Cash & Bank A/c	7,50,000	By General Reserves	50,000
		By P & L A/c	5,50,000
		By Realization A/c	31,00,000
	75,50,000		75,50,000

Dr. **9% Debentures Account** **Cr.**

Particulars	`	Particulars	`
To Realization A/c	5,00,000	By Balance b/d	5,00,000

Dr. **Anu Ltd. Account** **Cr.**

Particulars	`	Particulars	`
To Realization A/c	75,00,000	By Share Capital	67,50,000
		By Bank A/c	7,50,000
	75,00,000		75,00,000

(II) Journal of Anu Ltd.

Date	Particulars		L.F.	Dr. (`)	Cr. (`)
1.	Business Purchase A/c	Dr.		75,00,000	
	To Liquidator of Srishti Ltd				75,00,000
	(Being business of Srishti Ltd. taken over)				
2.	Tangible Fixed Assets A/c	Dr.		60,00,000	
	Stock A/c	Dr.		7,10,000	
	Debtors A/c	Dr.		1,80,000	
	Cash & Bank A/c	Dr.		2,55,000	
	Goodwill A/c (Bal. fig.)	Dr.		10,64,000	
	To Provision for Doubtful Debts A/c				9,000
	To Liability for 9% Debentures A/c				6,00,000
	To Creditors A/c				1,00,000
	To Business Purchase A/c				75,00,000
	(Being assets and liabilities taken over)				
3.	Amalgamation Adjustment A/c	Dr.		8,50,000	
	To Export Profit Reserves A/c				8,50,000
	(Being Statutory Reserves taken over)				
4.	Goodwill A/c	Dr.		50,000	
	To Bank A/c				50,000
	(Liquidation Expenses reimbursed)				
5.	Liquidator of Shristi Ltd. A/c	Dr.		75,00,000	
	To Equity Share Capital A/c				5,00,000
	To Securities Premium A/c				22,50,000
	To Bank A/c				7,50,000
	(Being purchase consideration discharged)				
6.	Liability for 9% Debentures (5,00,000 x 120/100)A/c	Dr.		6,00,000	
	Discount on Issue of Debetnrues A/c	Dr.		25,000	
	To 8% Debetnrues (6,00,000 x 100/96) A/c				6,25,000
	(Being liability of debenture holder's discharged)				

3. (a) (ii) Cash Flow Statement for the year ended 31st March,2015

Particulars	`	`
I. Cash Flows from Operating Activities:		
Net Profit before tax for the year [` 80,000 + ` 55,000]	1,35,000	
Add: Depreciation on machinery	55,000	
Depreciation on land & building	20,000	
Operating profit before change in working capital	2,10,000	
Add: Decrease in Inventories	20,000	
Less: Increase in Trade Receivables	(20,000)	
Less: Decrease in Trade Payables	(1,00,000)	
Cash generated from Operations	1,10,000	
Less: income tax paid	(45,000)	
Net Cash generated from Operating Activities		65,000
II. Cash flow from Investing Activities:		
Purchase of machinery (2,25,000 - 1,00,000)	(1,25,000)	
Sale of investment	60,000	

Net Cash used in Investing Activities		(65,000)
III. Cash flow from Financing Activities:		
Issue of equity shares (2,50,000 - 1,00,000)	1,50,000	
Repayment of long term loan	(1,00,000)	
Net Cash generated from Financing Activities		50,000
Net Increase in Cash and Cash Equivalents		50,000
Cash and Cash Equivalents at the beginning (2,00,000 + 3,00,000)		5,00,000
Cash and Cash Equivalents at the end (1,40,000 + 4,10,000)		**5,50,000**

Working Notes:

1. Machinery Account

Dr. **Cr.**

Particulars	`	Particulars	`
To Balance b/d	7,50,000	By Depreciation (Bal.fig.)	55,000
To Bank A/c	1,25,000	By Balance c/d	9,20,000
To Equity Share Capital A/c	1,00,000		
	9,75,000		9,75,000

2. Provision for Taxation Account

Dr. **Cr.**

Particulars	`	Particulars	`
To Bank A/c (Bal.fig.)	45,000	By Balance b/d	50,000
To Balance c/d	60,000	By Profit and Loss A/c	55,000
	1,05,000		1,05,000

3. Investment Account

Dr. **Cr.**

Particulars	`	Particulars	`
To Balance b/d	1,00,000	By Bank A/c (Bal.fig.)	60,000
To Capital Reserve A/c (Profit on sale of investments)	10,000	By Balance c/d	50,000
	1,10,000		1,10,000

Answer:

3. (b) (i) Journal Entries in the Books of Fortune Ltd.

Particulars		Dr. (`)	Cr. (`)
Equity Share Capital A/c	Dr.	9,00,000	
Secuirties Premium A/c	Dr.	10,000	
General Reserve A/c	Dr.	80,000	
To Equity Shareholders A/c			9,90,000

(Being the cancellation of equity shares on buy back and transfer of securities premium and balance from general reserve for payment of premium)		
Bank A/c Dr. To 12% Preference Share Capital A/c (Being the issue of 78,000 12% preference shares of ` 10 each)	7,80,000	 7,80,000
Shareholders A/c Dr. To Bank A/c (Being the buyback of 90,000 equity shares @ ` 11 each)	9,90,000	 9,90,000
General Reserve A/c Dr. To Capital Redemption Reserve A/c (Being the amount transferred from general reserves to meet buy-back requirement)	1,20,000	 1,20,000

Note: As the nominal value of equity shares bought back is ` 9,00,000 and the balance available in General Reserve being ` 1,20,000 after transferring ` 80,000 to shareholders for payment of premium, 78,000, 12% redeemable preference shares of ` 10 each be issued in order to comply with the provisions of Section 69 of the Companies Act, 2013.

3. (b) (ii) Liquidator's Final Statement of Account

Particulars	`	Particulars	`
To Cash in hand	3,75,000	By Liquidator's Remuneration	2,650
To Cash at bank	22,855	(2% on ` 1,32,500)	
(Amount received on call for 3,500 equity shares @ ` 6.53 per share)		By Preferential creditors	17,500
		By Unsecured creditors	1,15,000
		By Preference shareholders	2,50,000
		By Equity shareholders	12,705
		(Amount paid to holders of 1,500 equity shares @ ` 8.47 per equity share)	
	3,97,855		**3,97,855**

Workings:

Calculation of amount receivable from equity shareholders or payable to equity shareholders.

Particulars	`	`
Cash in hand (Assets realized)		3,75,000
Less: Payments made:		
Liquidator's Remuneration	2,650	
Preference Creditors	17,500	
Unsecured Creditors	1,15,000	
Preference Shareholders	2,50,000	3,85,150
		10,150
Add: Amount payable to equity shareholders (paid up);		
1,500 equity shares of ` 100 each ` 75 paid up	1,12,500	

3,500 equity share of `100 each `60 paid up equity	2,10,000	 3,22,500
Total loss to be borne by equity shareholders		3,32,650

No. of equity shares: 5,000 shares

Loss per equity shares $\frac{3,32,650}{5,000}$ = `66.53

Amount receivable from 3,500 equity shareholder (`60 paid up)

= 3,500 × `6.53 = ` 22,855

Amount payable to 1,500 equity shareholders (`75 paid up)

= 1,500 × `8.47(75 - 66.53)= `12.705

Answer:

3. (c) (i) Balance Sheet of VBG LTD. as on 31.03.2015

Particulars		31.03.2015	31.03.2014
Equity and Liabilities		**` in Lakhs**	**` in Lakhs**
(1) Shareholders' Funds:			
(a) Share Capital	**1**	4,71,340	
(b) Reserves & Surplus	**2**	1,36,402	
(3) Current Liabilities:			
(a) Trade Payables - Sundry Creditors		51,300	
Total		**6,59,042**	
Assets			
(1) Non-Current Assets:			
(a) Fixed Assets: (i) Tangible Assets- Plant [1,05,000 +87,500] (ii) Intangible Assets – Goodwill [25,000 + 24972]		 1,92,500 49,972	
(2) Current Assets:			
(a) Inventories - Stock		82,875	
(b) Trade Receivables - Debtors		2,29,900	
(c) Cash & Cash Equivalents – Cash & Bank		1,03,795	
Total		**6,59,042**	

Notes to Balance Sheet:

1. Share Capital	31.03.2015 ` in Lakhs	31.03.2014 ` in Lakhs
Authorised, Subscribed and Paid up Capital :		
[27,000+20134] Equity Shares of `10 each	4,71,340	
Total		

2. Reserves and Surplus	31.03.2015 ` in Lakhs	31.03.2014 ` in Lakhs
(i) General Reserves	43,000	
(ii) Security premium Reserve	60,402	
(iii) Surplus - Profit & Loss Account	33,000	
Total	**1,36,402**	

Working Notes:

Particulars	VBG LTD. (`)	SDA LTD. (`)
Plant	97,500	87,500
Goodwill	37,500	25,000
Inventories	45,750	37,125
Trade receivables	1,43,450	86,450
Cash & cash equivalents	49,000	54,795
Total	**3,73,200**	**2,90,870**
Trade payables	22,200	29,100
Net Assets (A)	**3,51,000**	**2,61,770**
No. of equity shares (B)	**27,000**	**20,165**
Intrinsic Value (A ÷ B)	13	12.98

Purchase consideration: (12.98/13 × 20,165) × 13 = 2,61,742.

Calculation of Goodwill:

Particulars	(`)
Purchase Consideration paid	2,61,742
Less: Assets obtained except goodwill [87,500 + 37125 + 86450 + 54795 -29100]	2,36,770
Goodwill	24,972

3. (c) (ii)

Journal of Nanu Limited

Date	Particulars	L. F.	Amount (`) Dr.	Amount (`) Cr.
2015 April 1	` 100 7% Preference Share Capital A/c Dr. To ` 80 7% Preference Share Capital A/c To Capital Reduction A/c (Being Nominal Value of 12,000 preference shares reduced from ` 100 to ` 80 per share and the resultant profit credited to capital reduction account)		12,00,000	 9,60,000 2,40,000
April 1	` 10 Equity Share Capital A/c Dr. To ` 5 Equity Share Capital A/c To Capital Reduction A/c		44,00,000	 22,00,000 22,00,000

	(Being Nominal Value of 4,40,000 equity shares reduced from ` 10 to ` 5 per share and the resultant profit credited to capital reduction account)			
April 1	Capital reduction A/c Dr. To Preference Share Dividend A/c $(12,00,000 \times \frac{7}{100} \times 3 \times \frac{1}{2})$ (Being Provision for preference share dividend to be paid to agreed amount of arrears made out of capital reduction Account).		1,26,000	 1,26,000
April 1	Preference Share Dividend A/c Dr. To ` 5 Equity Share Capital A/c (Being 25200 Equity shares issued for payment of preference share dividend.)		1,26,000	 1,26,000
April 1	Securities Premium A/c Dr. To Capital reduction A/c (Being of Securities Premium A/c transferred to capital reduction account)		5,20,000	 5,20,000
April 1	Capital reduction A/c Dr. To Goodwill A/c To Preliminary Expenses A/c To Profit and Loss A/c To Buildings A/c To Machinery A/c To Capital Reserve A/c (Being losses written off and balance of capital reduction account transferred to capital reserve account)		28,34,000	 3,40,000 1,00,000 10,00,000 9,20,000 3,20,000 1,54,000

4. Answer *any two* questions from (a), (b) and (c): 16×2=32

(a) (i) In what way Cost Audit is an effective tool to Management and Auditor? 8

(ii) Discuss the methods of vouching following expenditures:

A. Preliminary Expenses

B. Research and Development Expenditures 4+4=8

(b) (i) As Auditor of a Company how will you treat the following situations:

A. The company has sent semi-finished goods to third parties of further processing, which are lying with them at the end of the year.

B. Reclassification of long term investment as short term investment has been made at cost by the company on the date of classification. 4+4=8

(ii) A. In case the appointment of an Auditor is not ratified by the Shareholders at Annual General Meeting as required under provisions of Companies Act what recourse does the Company have?

B. Only material frauds should be made reportable and the materiality should be left to the discretion of Auditor. — Comment. 4+4=8

(c) (i) State the points that Auditor should consider at the time of verification of Contingent Liability. 8

(ii) Comment on the following:

A. 'Information system Audit evaluates asset safeguarding, data integrity system effectiveness and system efficiency'.

B. 'Quality assurances are of prime importance in Internal Audit'. 4+4=8

Answer:

4. (a) (i) Cost Audit is an effective tool for the Management, Society, Shareholders and Government

In an audit process for verifying the cost of manufacture or production of any article, on the basis of accounts as regards utilisation of material or labour or other items of costs, maintained by the company, cost audit plays a vital role in discharging its relevant functions.

Cost Audit has important functions to different categories of stakeholders. The details are given as under:

To the Management, this includes —

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

It also includes the 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.
- Shareholders are assured of a fair return on nether investment.

The advantages of Cost audit to Auditor would be:

- The auditor can determine scope of his audit and make audit program after considering cost accounting system used in the organization.

- Audited cost data helps him to determine the value of stocks, remuneration of managerial personnel etc., with ease and accuracy.

- Data and statements of cost gives him sufficient data so that he can concentrate more on those aspects which are not under the purview of cost audit.

(ii) A. Preliminary Expenses

The expenditure incidental to the creation and floating of a company includes stamp duties, registration fees, legal costs, accountants' fees, cost of printing, etc.

The check which needs to put into includes, namely:

- Check the contracts relating to preliminary expenses;
- If preliminary expenses incurred by promoters have been reimbursed to them by the company, the resolution of the Board of Directors and the power in the articles to make such reimbursement should be seen;
- Examine the bills and statements supporting each items of preliminary expenses;
- It should be seen that no expenses other than those which constitutes preliminary expenses are booked under this specific head. Te auditor can cross heck the amount of preliminary expenses with that disclosed in the prospectus, statutory report and the balance sheet;
- Check that any amount which is paid in excess of the amount disclosed in the prospectus should have been approved by the shareholders;
- Expenditure in connection with the preliminary expenses so far it has not been written off should be separately disclosed under the head "Miscellaneous Expenditure";
- Further see that underwriting commission and brokerage paid for shares and debentures should not be included under the head "Preliminary Expenses";

B. Research and Development Expenditure

For undertaking vouching the payments of Research and Development, certain steps need to be undertaken. These are summarised as under:

- Ascertain the nature of research and development work to be carried out or that have already been carried out;
- If the expenses are routine development expenses, it should be seen that they are written off to the profit and loss account;
- Check whether the concerned research activity is authorised by the Board and has relevance to the objectives of the company;
- If any machinery and equipment have been bought specially for the purpose of research activity, the cost thereof, less the residual value should be appropriately debited to the Research and Development Account over the year of research;
- Ensure that the stipulations of AS - 26 on Intangible Assets have been adhered to;

- Tax benefit arising on the research and development expenses should be taken into consideration in creating tax provision;
- No expenses unrelated to the research and development programme should be allowed to be debited to Research and Development Account;

Answer:

4. (b) (i) (A) Semi-finished goods being composite part of the inventories, normally, constitute significant item in case of any entity. It is the duty of the auditor to ensure that entire inventories which are owned by the enterprise exist on that date and valuation thereof is also proper. Since the semi-finished goods belong to the company, it is necessary to ensure that the same have been included for in valuation of inventories. The auditor should also obtain direct confirmation about the quantity of inventories lying with the processors at the end of the year. Also the auditor should see that the valuation has been made properly with reference to the stage of completion in respect of work-in-progress inclusive of expenses incurred in sending the goods for processing.

(B) The statement is false. As per AS-13, 'Accounting for Investments' the transfer should be at lower of cost and carrying amount of the investment at the date of reclassification of long term as short term investment.

(ii) (A) Explanation to Rule 3(7) of the Companies (Audit and Auditors) Rules, 2014 provides that if the appointment is not ratified by the members of the company, the Board of Directors shall appoint another individual or firm as its auditor or auditors after following the procedure laid down in this behalf under the Act.

(B) Section 143(12) casts duty on the auditor to report fraud to the Central Government. Rule 13(1) of the Companies (Audit and Auditors) Rules, 2014 states that for the purpose of sub-section (12) of section 143, in case the auditor has sufficient reason to believe that an offence involving fraud, is being or has been committed against the company by officers or employees of the company, he shall report the matter to the Central Government immediately but not later than sixty days of his knowledge.

Answer:

4. (c) (i) The following points should keep in mind at the time of verification of Contingent Liabilities:

1. Obtain certificate about the contingent liabilities disclosed in the Balance Sheet, from a responsible officer.
2. Carefully examine whether such liabilities are in existence or not.
3. Check relevant documents to confirm the existence of contingent liability.
4. Verify the certified list given by responsible officer to ascertain whether there exists any contingent liability which may turn to be an actual liability.
5. Verify whether proper provision is made or not for the contingent liability turned out to be an actual liability.
6. Verify bill discounting register, investment register, minute book and other relevant records to establish the amount of contingent liability.

7. See whether contingent liability is properly disclosed in the Balance Sheet.

4. (c) (ii) (A) Information Systems Audit evaluates asset safeguarding, data integrity system effectiveness and system efficiency.

Information System audit has arisen due to seven major reasons. They are -

- The consequences of losing the data resource;
- The possibility of misallocating resources because of decision based on incorrect data or decision rules;
- The possibility of computer abuse if computer systems are not controlled;
- The high value of computer hardware and software and personnel;
- The high cost of computer error;
- The need to maintain the privacy of individual persons; and
- The need to control the evolutionary use of computers.

(B) "Quality assurances in Internal Audit are of prime importance".

A system for assuring quality in internal audit should provide reasonable assurance that the internal auditors comply with professional standards, regularity and legal framework requirements so that the reports issued by them are appropriate in the circumstances, in order to compliance with the professional standards, regularity and legal requirements and to achieve the desired objectives of internal audit, a person within the organisation should be entrusted with the responsibility for the quality in the internal audit whether done in house or by an external agency.

- In case of an in house internal audit of a firm carrying out internal audit, the person with the responsibility for the quality in internal audit should ensure that the system of quality assurance includes policies and procedures addressing leadership responsibilities for quality in internal audit.
- The internal quality review framework should be designed with a view to provide reasonable assurances that the internal audit is able to efficiently and effectively achieve the objectives of adding value and strengthening the overall governance mechanism of the entity, including the entity's strategic risk management and internal control system.
- The internal quality review should be undertaken on an ongoing basis. The person entrusted with the responsibility for quality in internal audit should ensure that the recommendations resulting from the quality reviews for improvements in the internal audit activity are promptly implemented.
- Internal quality reviews are also communicated to appropriate levels of management and those charged with governance on a timely basis along with the proposed plan of action to address issues and concerns raised in the review report.