INTERMEDIATE EXAMINATION
GROUP - II
(SYLLABUS 2016)

SUGGESTED ANSWERS TO QUESTIONS
JUNE - 2017

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.
Where considered necessary, suitable assumptions may be made and clearly indicated in the answer.
The Question paper has two Sections, A and B. Both sections are to be answered as per instruction given against each.

Section – A (Company Accounts)

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

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

(i) Underwriting Agreements are of
(A) One type
(B) Two types
(C) Three types
(D) Four types

(ii) Segment Reporting is covered under
(A) AS 16
(B) AS 17
(C) AS 18
(D) AS 19

(iii) On redemption of Debentures, the amount lying in Debenture Redemption Reserve, which is no longer necessary to be retained, should be transferred to
(A) Revaluation Reserve
(B) Securities Premium Reserve
(C) Capital Reserve
(D) General Reserve

(iv) Rate of provisioning by a Bank for Advances doubtful for more than 1 year but less than 3 years is
(A) 25%
(B) 40%
(C) 60%
(D) 100%

(v) Balance of Interest Accrued on Security Deposit A/c of an Electricity company should be shown
(A) under Current Liability.
(B) under Non-current Liability.
(C) under Current Asset.
(D) under Non-current Asset.

(vi) Which of the following items is not a part of cash flow from operating activities?
(A) Collection from customers
(B) Payment of outstanding wages

(C) Payment to suppliers of machinery
(D) Advances to foreign suppliers for raw materials

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

	Column 'A'		Column 'B'
1.	Grants Received from Government	A.	Capital Redemption Reserve
2.	Redemption of Debentures	B.	AS 15
3.	Issue of Bonus shares	C.	AS 12
4.	Defined benefit plans	D.	Sinking Fund

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

(i) Exchange difference arising in respect of monetary items is to be recognized as income or expenditure during the year.
(ii) Capital Reserve is a Reserve which is available for distribution as Dividend.
(iii) Interest received by a finance company is a part of cash flow from investing activities.
(iv) Interest accrued and due should be shown under the head Other Current Liabilities in a Balance Sheet of a Company.

Answer:

1. (a)

(i) — B
(ii) — B
(iii) — D
(iv) — B
(v) — B
(vi) — C

(b)

1	C
2	D
3	A
4	B

(c)

(i)	T
(ii)	F
(iii)	F
(iv)	T

2. (a) A joint stock company resolved to issue 5 lakh equity shares of ₹10 each at a premium of ₹1 per share. 50000 of these shares were taken up by the directors and their relatives, the entire amount being received forthwith. The remaining shares were offered to the public, the entire amount being asked for with applications.
The issue was underwritten by P, Q and R for a commission of 2% of the issue price. 65% of the issue was underwritten by P, while Q and R's share were 25% and 10% respectively.
Their firm underwriting was as follows:
P 15000 shares, Q 10000 shares and R 5000 shares. The underwriters were to submit unmarked applications for shares underwritten firm with full application money along with the members of the general public.
Marked applications were as follows:
P 59750 shares, Q 28750 shares and R 5250 shares. Unmarked applications totaled 350000 shares.
Accounts with the underwriters were promptly settled.
You are required to prepare a statement calculating liability of the Underwriters for

shares other than shares underwritten Firm and also calculate the amount due from/to the Underwriters. **8**

(b) M Ltd. sold machinery having WDV of ₹ 200 Lakhs to N Ltd. for ₹ 250 Lakhs and the same machinery was leased back by N Ltd. to M Ltd. The lease back is an operating lease. Comment on the accounting treatment as per AS 19 in the following circumstances:

(i) Fair value is ₹ 230 Lakhs and sale price is ₹ 250 Lakhs

(ii) Fair value is ₹ 175 Lakhs and sale price is ₹ 195 Lakhs **4**

Answer:

2. (a) Total number of shares issued = 5,00,000
Less: Shares taken by the directors etc. 50,000
Shares offered to public 4,50,000

Calculation of underwriters' liability

Particulars	P	Q	R
Gross liability (65:25:10)	2,92,500	1,12,500	45,000
(-) Marked application	59,750	28,750	5,250
	2,32,750	83,750	39,750
(-) Unmarked application in the ratio of gross liability	2,27,500	87,500	35,000
Resultant liability (or surplus)	5,250	(3,750)	4,750
(-)Surplus of Q allocated to P and R in the ratio of 65:10	3,250	3,750	500
Net liability	2,000	Nil	4,250

Workings: Calculation of amount due from/to underwriters

Particulars	P	Q	R
No. of shares to be subscribed as per agreement (exc. Firm)	2,000	Nil	4,250
Amount payable @ ₹ 11	22,000	Nil	46,750
Underwriting commission @2 %			
P: (292500×11×2%)	64,350		
Q: (112500×11×2%)		24,750	
R: (45000×11×2%)			9,900
Amount (paid) / received	(42,350)	(24,750)	36,850

(b) Here the leaseback is an operating lease.
So, the treatment of the given circumstances will be as follows:

(i) Here, sale price > Fair value, so, profit of ₹(230-200) = ₹30 Lakhs is to be immediately recognized by M Ltd in its books and balance profit of ₹(250-230) i.e. ₹20 Lakhs is to be amortized over the lease period.

(ii) Here, sale price > Fair value, so, loss of ₹(200-175) = ₹25 Lakhs is to be immediately recognized by M Ltd in its books and balance profit of ₹ (195-175) i.e. ₹20 Lakhs is to be amortized over the lease period.

3. (a) From the following information provided, prepare a Cash Flow Statement as per AS-3.

Balance Sheet of PQR Ltd.

		Particulars	**Note No.**	**As on 31.03.16 ₹**	**As on 31.03.15 ₹**
I		**Equity and Liabilities**			
	1.	**Shareholders' fund**			
		(a) Share Capital	**1**	**20,00,000**	**20,00,000**
		(b) Reserves and Surplus	**2**	**10,00,000**	**8,70,000**
	2.	**Share application money pending allotment**		**Nil**	**Nil**

	3.	Non-Current Liability		Nil	Nil
	4.	Current Liabilities		6,50,000	8,00,000
		Total		36,50,000	36,70,000
II		Assets			
	1.	Non-current Assets			
		(a) Fixed Assets (Tangible)		16,50,000	15,00,000
		(b) Non-current Investment		7,00,000	8,00,000
	2	Current Assets			
		(a) Inventories		7,60,000	7,00,000
		(b) Trade Receivables		4,50,000	5,00,000
		(c) Cash and Cash Equivalent		6,000	74,000
		(d) Short term loan and advances (Prepaid Expenses)		84,000	96,000
				36,50,000	36,70,000

Notes to Accounts:

	1.	Share Capital		
		Equity Share Capital	20,00,000	15,00,000
		Redeemable Preference Share Capital of ₹100, ₹50 paid	Nil	5,00,000
			20,00,000	20,00,000
	2.	Reserve and Surplus		
		Balance of Profit	3,00,000	4,50,000
		General Reserve	2,00,000	4,00,000
		Capital redemption reserve	5,00,000	Nil
		Securities Premium	Nil	20,000
			10,00,000	8,70,000

Additional information:

(i) During the year the company got income from investment ₹ 80,000.

(ii) Company paid ₹1,50,000 as equity dividend and ₹ 76,000 as preference dividend.

(iii) The company redeemed the preference shares at a premium of 5% after making a successful call of ₹ 50 per share to make the shares fully paid.

(iv) During the year one machine was sold for ₹ 50,000 and the profit on sale of ₹ 6,000 was taken to Profit and Loss A/c. Depreciation for the year on fixed assets was ₹ 1,80,000. **9**

(b) From the following information calculate Return on Equity as per Regulation 21 of the Central Electricity Regulatory Commission (Terms and Conditions of Tariff) Regulations, 2004:

(i) Date of Commercial Operation COD = 1st April 2016

(ii) Approved Opening Capital Cost as on 1st April 2016 = ₹ 20,00,000

(iv) Return of equity to be computed @ 14% p.a.

(v) Additional Capital Expenditure (Allowed) is as follows:

Year	1	2	3	4
Amount (₹)	1,20,000	40,000	30,000	15,000

3

Answer:

3. (a)

Particulars	₹	₹
1. Cash Flow from Operating Activities:		
Fund from Operation	5,00,000	
(-) increase in Inventory	60,000	
(+) Decrease in Trade Receivables	50,000	
(+) Decrease in Prepaid Expenses	12,000	
(-) Decrease in Current Liability	1,50,000	

Cash Flow from operating activities		3,52,000
II. Cash Flow from Investing Activities:		
Income received from investment	80,000	
Machinery sold	50,000	
Sale of investment	1,00,000	
Purchase of machinery	(3,74,000)	(1,44,000)
III. Cash Flow from Financing Activities		
Dividend Paid (1,50,000+76,000)	(2,26,000)	
Call received on Preference shares	5,00,000	
Preference shares redeemed at premium	(10,50,000)	
Equity share issued	5,00,000	(2,76,000)
		(68,000)
(+)Opening cash and cash equivalent		74,000
Closing cash and cash equivalent		6,000

Workings:

Profit & Loss Account

Dr. Cr.

To Dividend	2,26,000	By Balance b/f	4,50,000
To Prem. on redemption	30,000	By Profit on Sale of Machine	6,000
To Cap. Red. Reserve	3,00,000	By Income from Investment	80,000
To Depreciation	1,80,000	By Fund from Operation (bal.fig)	5,00,000
To Balance c/f	3,00,000		
	10,36,000		10,36,000

Fixed Assets Account

Dr. Cr.

To Balance b/f	15,00,000	By Bank	50,000
To Profit and Loss	6,000	By Depreciation	1,80,000
To Bank (bal.fig.)	3,74,000	By Balance c/f	16,50,000
	18,80,000		18,80,000

Equity Share Capital Account

Dr. Cr.

		By Balance c/f	15,00,000
		By Bank	5,00,000
To Balance c/f	20,00,000		
	20,00,000		20,00,000

Preference Share Capital Account

Dr. Cr.

To PSH	10,00,000	By Balance c/f	5,00,000
		By Bank	5,00,000
	10,00,000		10,00,000

Preference Share Holders (PSH) Account

Dr. Cr.

To Bank	10,50,000	By Pref. Sh. Capital	10,00,000
		By Premium on Redemption	50,000
	10,50,000		10,50,000

General Reserve Account

Dr. Cr.

To CRR	2,00,000	By Balance b/f	4,00,000
To Balance c/f	2,00,000		
	4,00,000		4,00,000

Capital Redemption Reserve Account

Dr. Cr.

To Balance c/f	5,00,000	By Balance b/f	Nil
		By General Reserve	2,00,000
		By Profit & Loss	3,00,000
	5,00,000		5,00,000

Securities Premium Account

Dr. Cr.

To Premium on Redemption	20,000	By Balance b/f	20,000
To Balance c/f	Nil		
	20,000		20,000

Premium on Redemption Account

Dr. Cr.

To Securities Premium	20,000	By PSH	50,000
To Profit and Loss	30,000		
	50,000		50,000

Investment Account

Dr. Cr.

To Balance b/f	8,00,000	By Bank	1,00,000
		By Balance c/f	7,00,000
	8,00,000		8,00,000

(b)

Calculation for Return on Equity

Particulars	1st Year	2nd Year	3rd Year	4th Year
A. Opening Equity (30%)	6,00,000	6,36,000	6,48,000	6,57,000
B. Additional equity (30%)	36,000	12,000	9,000	4,500
C. Closing Equity (A+B)	6,36,000	6,48,000	6,57,000	6,61,500
D. Average Equity [(A+C)/2]	6,18,000	6,42,000	6,52,500	6,59,250
E. Return on Equity (14% of D)	86,520	89,880	91,350	92,295

4. Elixir Ltd. provides the following Trial Balance as on 31st March 2016:

Particulars	**Dr. Balance (₹)**	**Cr. Balance (₹)**
Equity Share Capital 300000 shares of ₹ 10 each fully paid		**30,00,000**
12% Bank Loan		**2,00,000**
Furniture	**2,25,000**	
Machinery	**7,50,000**	
Building	**12,50,000**	
Non-current Investment	**2,00,000**	
Sales		**48,00,000**
Sales Return	**4,00,000**	
Interest Received on Investment		**20,000**
Interest on Bank Loan	**20,000**	
Purchase	**33,20,000**	

Purchase Returns		**420,000**
Opening Stock	**2,00,000**	
Discount	**6,250**	
Carriage on Goods Sold	**1,39,000**	
Rent and Taxes	**60,000**	
Trade Receivables	**12,00,000**	
Trade Payables		**80,000**
Advertisement	**1,20,000**	
Bad Debt	**10,000**	
Salaries	**4,00,750**	
Audit Fees	**27,000**	
Contribution of P.F.	**60,000**	
Cash at Bank and in hand	**1,32,000**	
Total	**85,20,000**	**85,20,000**

Additional Information:

(i) Closing Stock as on 31st March 2016 was ₹ 2,12,500

(ii) Depreciation Rates: Furniture 10%; Machinery 20% and Building 10%

(iii) Outstanding salaries as on 31st March 2016 was ₹ 62,250

(iv) Trade receivables include a sum of ₹ 25,000 due from Mr. B. Reddy and trade payables include ₹ 15,000 due to him.

(v) Create a provision for doubtful debt @ 5% on trade receivables.

(vi) Provide for income tax ₹ 80,000.

Prepare a Statement of Profit and Loss for the year ended on 31st March 2016 and a Balance Sheet as on that date. 12

Answer:

4. Notes to Accounts (Schedules):

Schedule - 1. Employee Benefit Expenditure	₹
Salaries	4,00,750
Outstanding Salaries	62,250
Contribution to P.F.	60,000
	5,23,000

Schedule - 2. Finance Cost	₹
Interest on loan	20,000
Outstanding Interest	4,000
	24,000

Schedule - 3. Other Expenditure	₹
Discount	6,250
Carriage	1,39,000
Rent	60,000
Advertisement	1,20,000
Bad Debt	10,000
Audit fees	27,000
Provision for Bad debt	59,250
	4,21,500

Schedule - 4. Trade Receivable	₹
Total Receivable	12,00,000
(-) Set off	15,000
	11,85,000
(-) Provision @ 5%	59,250
	11,25,750

Schedule - 5. Fixed Assets	Furniture (₹)	Machine (₹)	Building (₹)
Balance	2,25,000	7,50,000	12,50,000
(-) Depreciation	22,500	1,50,000	1,25,000
	2,02,500	6,00,000	11,25,000
Total Fixed Assets			19,27,500
Depreciation			2,97,500

Statement of Profit and Loss for the year ended on 31.03.2016

Particulars	Note	₹
1. Revenue from operation (sales less returns)		44,00,000
II. Other Income (Income from investment)		20,000
III. Total revenue		44,20,000
IV. Expenses:		
Purchase		29,00,000
Changes in inventory i.e. opening less. Closing		(12,500)
Employee Benefit expenses	1	5,23,000
Finance cost	2	24,000
Depreciation	5	2,97,500
Other expenses	3	4,21,500
		41,53,500
V. Profit before exceptional and extraordinary items and tax		2,66,500
VI. Exceptional items		Nil
VI Profit before extraordinary items and tax		2,66,500
VII. Extraordinary items		Nil
VIII. Profit before tax		2,66,500
IX. Tax (provision for tax)		80,000
X. Profit after tax		1,86,500

Balance Sheet as on 31.03.2016

I. Equity and Liabilities	Note	₹
1. Shareholders' Funds		
(a) Share Capital		30,00,000
(b) Reserve and Surplus (Balance of Profit)		1,86,500
2. Share Application money pending allotment		Nil
3. Non-current liabilities (12% Bank loan)		2,00,000
4. Current Liabilities		
Trade Payable (after set off of ₹ 15,000)		65,000
Outstanding interest		4,000
Outstanding salary		62,250
Provision for Tax		80,000
Total		35,97,750
II. Assets		
1. Non-current Assets		
(a) Fixed Assets (Tangible)	5	19,27,500
(b)Non-current Investment		2,00,000
2. Current Assets		
Inventories		2,12,500
Trade Receivable	4	11,25,750
Cash and cash equivalent		1,32,000
Total		35,97,750

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

(a) Recognition of Govt. grants related to specific fixed assets

(b) Sweat Equity Shares

(c) Treatment of Service Line Cum Development Charges

(d) Objective of preparing Cash Flow Statement

Answer:

5. (a) Recognition of Govt. grants related to specific fixed assets:

Grants received specifically for fixed asset is disclosed in the financial statement either

(i) by way of deduction from the gross block of the asset concerned, thus grant is recognized in Profit and Loss Account through reduced depreciation (in case of funding of specific asset Cost entirely, the asset should be stated at a nominal value in Balance Sheet); or

(ii) the grant treated as deferred revenue income and charged off on a systematic and rational basis over the useful life of the asset, until appropriated disclosed as —Deferred Govt. grant under Reserves and Surplus in the Balance Sheet (grants relating to depreciable assets should be credited to Capital Reserve and suitably credited to Profit and Loss Account to offset the cost charged to income).

(b) Sweat Equity Share:

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

(a) the issue is authorised by a special resolution passed by the company;

(b) the resolution specifies the number of shares, the current market price, consideration, if any, and the class or classes of directors or employees to whom such equity shares are to be issued;

(c) not less than one year has, at the date of such issue, elapsed since the date on which the company had commenced business; and

(d) where the equity shares of the company are listed on a recognised stock exchange, the sweat equity shares are issued in accordance with the regulations made by the Securities and Exchange Board in this behalf and if they are not so listed, the sweat equity shares are issued in accordance with such rules as may be prescribed.

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

Where the sweat equity shares are issued for a non-cash consideration, such non-cash consideration shall be treated in the following manner in the books of account of the company:-

(a) where the non-cash consideration takes the form of a depreciable or amortizable asset, it shall be carried to the balance sheet of the company in accordance with the relevant accounting standards; or

(b) where clause (a) is not applicable, it shall be expensed as provided in the relevant accounting standards.

(c) Treatment of Service Line Cum Development Charges:

Following different accounting and reporting practices are noticed in published Financial Statements of some Electricity Companies:

Accounting Practice 1: SLD is accounted for as a liability and subsequently proportionate amount is transferred to Income Statement during the expected life of the Asset.

Accounting Practice 2: SLD is accounted for as Reserve as the amount is not refundable and disclosed under the head Reserves and Surplus without transferring any proportionate amount to Income Statement during the expected life of the Asset.

Accounting Practice 3: SLD is accounted for as Capital Reserve as the amount is not refundable and subsequently proportionate amount is transferred to Income Statement during the expected life of the Asset to match against depreciation on total cost of such asset.

Accounting Practice 4: SLD is accounted for as reduction in the cost of Non-Current Asset and depreciation is provided on such reduced cost.

(d) Objective of preparing Cash Flow Statement:

The objectives are as follows:

(i) To provide information about firm's liquidity, flexibility and ability to generate future cash flow.
(ii) To provide information about firm's ability to meet future obligations.
(iii) To enhance comparability among firms.
(iv) To assess reliability of net profit and quality of earnings.
(v) To enable the users to assess how assets and liabilities have increased or decreased.
(vi) To project future cash flow streams.
(vii) To provide information on different types of cash flow.

Section - B (Audit)

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

6. (a) Identify the correct alternative: **1×6=6**

(i) Which of the following is not an audit risk?
(A) Inherent Risk
(B) Detection Risk
(C) Control Risk
(D) Omission Risk

(ii) Dividend cannot be paid out of
(A) current year's profit after providing depreciation.
(B) undistributed profits for any previous financial year or years after providing for depreciation.
(C) profit on revaluation of any fixed assets.
(D) money provided by the Central Government or a State Government.

(iii) Permanent Audit File does not contain
(A) a record of study and evaluation of internal control system.
(B) significant audit observations of earlier years.
(C) copies of management letters.
(D) analysis of significant ratios and trends.

(iv) Audit Procedures to obtain audit evidences include
(A) Compliance Procedure
(B) Substantive Procedure
(C) Both (A) and (B)
(D) Neither (A) nor (B)

(v) A Cost Auditor submits his report to
(A) Board of Directors
(B) Government

(C) Shareholders
(D) Statutory Auditor

(vi) The first Auditor of a Company shall be appointed by the Board of Directors within
(A) 30 days from the date of registration.
(B) 90 days from the date of registration.
(C) 30 days from the date of first AGM.
(D) 1 year from the date of registration.

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

	Column 'A'		Column 'B'
1.	Responsibility of Joint Auditor	A.	Qualified Audit Report
2.	Unable to form an overall conclusion on Financial Statement	B.	SA 230
3.	Audit Report with reservations	C.	SA 299
4.	Audit Documentation	D.	Disclaimer of Opinion

(c) State whether the following statements are True or False: 1×4=4
(i) Audit Programme is a part of Current Audit File.
(ii) Internal audit is conducted by the staff of the entity or by an independent professional appointed for that purpose.
(iii) The first auditor of a company is appointed by the shareholders of the company at the general meeting.
(iv) A company auditor can render actuarial services to his client.

Answer:

6. (a)
(i) — D
(ii) — C
(iii) — C
(iv) — C
(v) — A
(vi) — A

(b)

(1)	C
(2)	D
(3)	A
(4)	B

(c)

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

7. (a) Define 'Audit Engagement Letter'. What are the general contents of an audit engagement letter? 2+6=8

(b) 'Checklist and Internal Control Questionnaire are not the same.'—Discuss. 4

Answer:

7. (a) Unlike a statutory audit, in a non-statutory audit the objective and scope of an audit is not clearly described in any law. Accordingly, a misunderstanding may arise about the exact scope of the work. Thus to avoid any kind of misunderstanding or dispute it is in the interests of both the auditor as well as the client to exactly define the scope of the engagement. An auditor's engagement letter signifies the confirmation by the auditor of his acceptance of appointment as auditor, the documentation of the objective and scope of audit or other work, and the extent of his responsibilities to the client and the form of any reports.

Although the form and content of the engagement letter differs from client to client but in general the following references should be made in audit engagement letter:

(vii) The objective and the scope of the engagement.
(viii) Management's responsibility for the financial statements.
(ix) The existence of inherent limitations of audit and resulting material misstatements that may remain undiscovered,
(x) The need for use of services of internal auditors and/or other experts that may arise during the course of the engagement.
(xi) The requirement of management confirmation letter as regards representations made by them concerning audit.
(xii) Restriction of the auditor's liability, if any.
(xiii) Basis for computation of audit fees and billing arrangements.
(xiv) The form of reports or other communication of results of the engagement.

(b) Difference between Checklist and Internal Control Questionnaire.

Sl. No.	Basis	Check List	Internal Control Questionnaire
1	Point of Time	It is issued at the commencement of audit and reported back after completion of audit.	It can be issued at any point of time and reported back immediately.
2	Issued to	It is issued to the audit staff to be followed by them during audit and reported back at completion.	It is issued to various people at different levels in the organization.
3	Contents	It contains instructions to be followed by audit assistants.	It contains questions to be answered by the employees of the organization.
4	Objective	It works as a guideline for audit staff so that none remains unchecked.	This is used to collect the information to know about the internal control system and to evaluate the weaknesses therein.

8. (a) Who are the persons not qualified for appointment as an Auditor of a company under section 141 of the Companies Act 2013? 7

(b) Mention the services that an Auditor cannot render u/s 144 of the Companies Act 2013. 5

Answer:

8. (a) As per Section 141(3) read with Rule 10 of Company (Audit and Auditor) Rule 2014, the following persons shall not be eligible for appointment as an auditor of a company.

(a) a body corporate other than a limited liability partnership registered under the Limited Liability Partnership Act, 2008;
(b) an officer or employee of the company;
(c) a person who is a partner, or who is in the employment, of an officer or employee of the company;

(d) a person who, or his relative or partner—
   (i) is holding any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company, of face value not exceeding rupees one lakh;
   (ii) is indebted to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, in excess of rupees five lakh;
   (iii) has given a guarantee or provided any security in connection with the indebtedness of any third person to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, in excess of rupees one lakh;
(e) a person or a firm who, whether directly or indirectly, has business relationship with the company, or its subsidiary, or its holding or associate company or subsidiary of such holding company or associate company of such nature as may be prescribed;
(f) a person whose relative is a director or is in the employment of the company as a director or key managerial personnel;
(g) a person who is in full time employment elsewhere or a person or a partner of a firm holding appointment as its auditor, if such persons or partner is at the date of such appointment or reappointment holding appointment as auditor of more than twenty companies;
(h) a person who has been convicted by a court of an offence involving fraud and a period of ten years has not elapsed from the date of such conviction;
(i) any person whose subsidiary or associate company or any other form of entity, is engaged as on the date of appointment in consulting and specialised services as provided in section 144.

(b) According to Section 144 of the Companies Act 2013, an auditor appointed under this Act shall provide to the company only such other services as are approved by the Board of Directors or the audit committee, as the case may be. However, such services shall not include the following services, whether rendered directly or indirectly to the company or its holding company or subsidiary company.
(a) accounting and book keeping services;
(b) internal audit;
(c) design and implementation of any financial information system;
(d) actuarial services;
(e) investment advisory services;
(f) investment banking services;
(g) rendering of outsourced financial services;
(h) management services; and
(i) any other kind of services as may be prescribed.

9. (a) Distinguish between Qualified Audit Report and Adverse Report. 4

(b) Discuss the provisions of Cost Audit under Companies Act 2013. 8

Answer:

9. (a)

Qualified Report	Adverse Report
A Qualified Audit Report is one where 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.

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.
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.
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) Cost Audit Provision of Section 148 of the Companies Act.

As per Section 148 —

(1) Notwithstanding anything contained in this Chapter, the Central Government may, by order, in respect of such class of companies engaged in the production of such goods or providing such services as may be prescribed, direct that particulars relating to the utilisation of material or labour or to other items of cost as may be prescribed shall also be included in the books of account kept by that class of companies:
Provided that the Central Government shall, before issuing such order in respect of any class of companies regulated under a special Act, consult the regulatory body constituted or established under such special Act.

(2) If the Central Government is of the opinion, that it is necessary to do so, it may, by order, direct that the audit of cost records of class of companies, which are covered under subsection (1) and which have a net worth of such amount as may be prescribed or a turnover of such amount as may be prescribed, shall be conducted in the manner specified in the order.

(3) The audit under sub-section (2) shall be conducted by a Cost Accountant in practice who shall be appointed by the Board on such remuneration as may be determined by the members in such manner as may be prescribed:
Provided that no person appointed under section 139 as an auditor of the company shall be appointed for conducting the audit of cost records:
Provided further that the auditor conducting the cost audit shall comply with the cost auditing standards.
Explanation. - For the purposes of this sub-section, the expression "cost auditing standards" mean such standards are as issued by the Institute of Cost and Works Accountants of India, constituted under the Cost and Works Accountants Act, 1959, with the approval of the Central Government.

(4) An audit conducted under this section shall be in addition to the audit conducted under section 143.

(5) The qualifications, disqualifications, rights, duties and obligations applicable to auditors under this Chapter shall, so far as may be applicable, apply to a cost auditor appointed under this section and it shall be the duty of the company to give all assistance and facilities to the cost auditor appointed under this section for auditing the cost records of the company:
Provided that the report on the audit of cost records shall be submitted by the cost accountant in practice to the Board of Directors of the company.

(6) A company shall within thirty days from the date of receipt of a copy of the cost audit report prepared in pursuance of a direction under sub-section (2) furnish the Central Government with such report along with full information and explanation on every reservation or qualification contained therein.

(7) If, after considering the cost audit report referred to under this section and the information and explanation furnished by the company under sub-section (6), the Central
Government is of the opinion that any further information or explanation is

necessary, it may call for such further information and explanation and the company shall furnish the same within such time as may be specified by that Government.

(8) If any default is made in complying with the provisions of this section,—
   (a) The company and every officer of the company who is in default shall be punishable in the manner as provided in sub-section (1) of section 147;
   (b) The cost auditor of the company who is in default shall be punishable in the manner as provided in sub-sections (2) to (4) of section 147.

Eligibility for Cost Audit:

The students may also be given marks, if they state the limits for Cost Audit as per Companies (Cost Records and Audit) Amended Rules, 2014 w.e.f. 31-12-2014. The Rule states:

(i) Every company covered under regulated sector of Rule 3 shall get its cost records audited if the overall annual turnover of the company from all its products and services during the immediately preceding financial year is rupees fifty crore or more and the aggregate turnover of the individual product or products or service or services for which cost records are required to be maintained is rupees twenty five crore or more.

(ii) Every company covered under non-regulated sector of Rule 3 shall get its cost records audited if the overall annual turnover of the company from all its products and services during the immediately preceding financial year is rupees one hundred crore or more and the aggregate turnover of the individual product or products or service or services for which cost records are required to be maintained is rupees thirty five crore or more.

(iii) The requirement for cost audit shall not apply to a company-
   (a) Whose revenue from exports, in foreign exchange, exceeds seventy five per cent of its total revenue; or
   (b) Which is operating in Special Economic Zone.

10. Write short notes (any three): **4×3=12**
(a) Audit of a Hospital
(b) Difference between Statutory Audit and Internal Audit
(c) Audit of Inventories
(d) Benefits offered by Joint Audit

Answer:

10. (a) The following points are to be considered necessary for conducting an audit of Hospital.

(i) Check the letter of appointment to ascertain the scope of responsibilities.
(ii) Study the Charter or Trust Deed under which the hospital has been set up and take a special note of the provisions affecting the accounts.
(iii) Examine, evaluate and verify the system of internal check, internal control and determine the nature, timing and the extent of the audit procedures.
(iv) Vouch the entries in the Patient's Bill Register with a copies of bill issued. Test check the selected bills to see that these have been correctly prepared taking into consideration the period of stay of each patient as recorded in the Attendance Schedule.
(v) Vouch the collection from patients with copies of bills and entries in Bills

Register. Arrears of dues should be properly carried forward and where these are deemed to be irrecoverable, they should be written off under due authorizations.

(vi) Interest and/or dividend income should be vouched with reference to the Investment Register and Interest and Dividend warrants.

(vii) In case of legacies and donations which are received for specific purposes, it should be ensured that any income there from is not utilized for any other purposes.

(viii) Where receipts of subscription show a significant deviations from budgeted figures, it should be thoroughly inquired into and the matter be brought to the notice of the trustees or the Managing Committee.

(ix) Government grants or grants from local bodies should be verifies with the reference to the correspondence with the concerned authorities.

(x) Clear distinction should be made between the items of capital and revenue nature.

(xi) The capital expenditure should be incurred under proper authorization by a valid resolution of the trustees or the Managing Committee.

(xii) Verify the system of internal check as regards purchases and issue of stores, medicines etc.

(xiii) Examine that the appointment of the staff, payment of salaries etc. are duly authorized.

(xiv) Physically verify the investments, fixed assets and inventories.

(xv) Check that adequate depreciation has been provided on all the depreciable assets.

(b)

Sl.No.	Basis	Statutory Audit	Internal Audit
1	Appointing Authority	Statutory Auditor is appointed by the shareholder in the general meeting.	Internal Auditor is appointed by the Board.
2	Scope of the work	The scope of work is defined in the Companies Act.	The scope of work includes the adherence of management policies and procedures and indentifies the weakness in the internal control.
3	Removal of auditor	Statutory Auditor can be removed by the shareholders.	Internal Auditor can be removed by the Board.
4	Remuneration	It is fixed by the shareholders.	It is fixed by the board.
5	Audit report	It is submitted to the appointing Authority.	It is submitted to the Board as a suggestion to improve weakness in the internal control.

(c) Inventories are tangible property held for sale in the ordinary course of business, or in the process of production for such sale, or for consumption in the production of goods or services for sale, including maintenance supplies and consumable stores and spare parts meant for replacement in the normal course. Inventories normally comprise raw materials including components, work-in-process, finished goods including by-products, maintenance supplies, stores and spare parts, and loose tools.

Inventories normally constitute a significant portion of the total assets, particularly in the case of manufacturing and trading entities as well as some service rendering entities. Audit of inventories, therefore, assumes special importance.

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

(i) By their very nature, inventories normally turn over rapidly.

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

(d) Benefits of Joint Audit are –

(i) Lower workload: In large organizations where auditing is a mammoth task, the work-load gets divided among all the auditors and hence reduce.
(ii) Timely completion of work: Huge auditing work can be completed on timely basis which is divided among joint auditors.
(iii) Sharing of expertise: Expertise of different auditors gets shared if there are several auditors.
(iv) Improved quality of services: Since specific auditors concentrate on their specialised areas of operation, hence improving quality of services.
(v) Healthy competition: Healthy competition increases efficiency and productivity.
(vi) Quality of performance: Quality of performance increases with healthy competition and sharing of knowledge.