

INTERMEDIATE EXAMINATION

**GROUP - II
(SYLLABUS 2016)**

**SUGGESTED ANSWERS TO QUESTIONS
JUNE - 2019**

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 instructions given against each.

**Section – A
(Company Accounts)**

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

1. (a) Choose the correct alternative: 1×6=6
- (i) Profit on forfeiture and re-issue of equity shares is credited to
(A) Dividend Equalization Reserve
(B) General Reserve
(C) Capital Reserve
(D) Securities Premium
- (ii) In a Balance Sheet prepared under Schedule III of Companies Act, 2013, 'Share application money pending allotment' shall be shown
(A) under Shareholder's Fund
(B) under Non-current Liabilities
(C) under Current Liabilities
(D) as a separate line item.
- (iii) In case of Cash Flow Statement prepared under Direct Method, decrease in current liabilities is
(A) added to cash flow from operating activities
(B) deducted to cash flow from operating activities
(C) added to cash flow from investing activities
(D) None of the above
- (iv) For calculation of depreciation, Central Electricity Regulatory Commission has recommended
(A) Straight Line Method
(B) Optimized Depreciated Replacement Cost Method
(C) Written Down Value Method
(D) Both (A) and (B)

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(v) In case of Electricity Company while calculating depreciation for the purpose of tariff as per Regulation 21, the salvage value of the Asset shall be considered as

- (A) 3%
- (B) 5%
- (C) 10%
- (D) None of the above

(vi) As per Section 52 of Companies Act 2013, Securities Premium A/c cannot be used

- (A) to issue fully paid up bonus shares
- (B) to pay interim dividend
- (C) to write off the discount on issue of debentures
- (D) to write off the premium on redemption of preference shares

(b) Match the following items in Column 'A' with items shown in Column 'B': 1x4=4

Column 'A'		Column 'B'	
1.	Underwriting	A.	Issue and Redemption of Preference shares
2.	Borrowing Cost	B.	Firm
3.	Dividend and interest	C.	Qualifying Assets
4.	Section 55 of Companies Act 2013	D.	Investing Activity

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

- (i) Buy-back of shares can also be made out of the proceeds of the earlier issues of the same kind of shares.
- (ii) Transfer to Capital redemption reserve account is not allowed from Dividend Equalization Fund.
- (iii) Operating Lease is a lease which transfers substantially all the risks and rewards incidental to ownership.
- (iv) Machinery purchased by issuing shares is shown under Cash Flow from Investments Activities in Cash Flow Statement.

Answer:

1. (a)

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

(b)

1.	B
2.	C
3.	D
4.	A

(c)

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

2. (a) A company issued 1,50,000 shares of ₹10 each at a premium of ₹10. The entire issue was underwritten as follows:

A - 90000 shares (Firm underwriting 12000 shares)

B - 37500 shares (Firm underwriting 4500 shares)

C - 22500 shares (Firm underwriting 15000 shares)

Total applications received by the company (excluding firm underwriting and marked applications) were 22500 shares.

The marked applications (excluding firm underwriting) were as follows:

A - 15000 shares; B - 30000 shares; C - 7500 shares

Commission payable to underwriters is at 5% of the issue price. The underwriting contract provides that credit for unmarked applications be given to the underwriters in proportion to the shares underwritten and benefit of firm underwriting is to be given to individual underwriters.

- (i) Determine the liability of each underwriter (number of shares)
(ii) Compute the amount payable or due to underwriters.

- (b) A Ltd. has taken the assets on lease from X Ltd. The following information is given below:

Lease Term = 3 years

Fair value at inception of lease = ₹14,00,000

Lease Rent = ₹6,00,000 p.a. at the end of each year

Guaranteed Residual Value = ₹44,000

Implicit Interest Rate = 15% p.a.

Calculate the value of the asset to be considered by A Ltd. and the interest (finance charges) in each year.

Present value of ₹1.00 at 15% is given below:

Year	1	2	3
PVIF (15%)	0.869	0.756	0.657

(5+2)+5=12

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Answer:

2. (a) (i) Computation of Underwriters' Liability (Number of Shares)

Particulars	A	B	C
Gross Liability	90,000	37,500	22,500
Less: Marked applications	(15,000)	(30,000)	(7,500)
Less: Unmarked applications in the ratio of (90:37.5:22.5)	(13,500)	(5,625)	(3,375)
Less: Firm Underwriting	(12,000)	(4,500)	(15,000)
Balance	49,500	(2,625)	(3,375)
Less: Surplus of B & C distributed to A	(6,000)	2,625	3,375
Net Liability (excluding firm underwriting)	43,500	Nil	Nil
Add: Firm Underwriting	12,000	4,500	15,000
Total Liability (number of shares)	55,500	4,500	15,000

(ii) Computation of Amounts payable to Underwriters

Particulars	₹	₹	₹
Liability towards shares to be subscribed @ ₹ 20 per share	11,10,000	90,000	3,00,000
Less: Commission @ 5% on 1,50,000 shares @ ₹ 20	(90,000)	(37,500)	(22,500)
Net Amount to be paid by Underwriters	10,20,000	52,500	2,77,500

(b) Calculation of Present value of Minimum Lease Payments

Year (end)	MLP (₹)	PVIF at 15%	Present Value (₹)
1	6,00,000	0.869	5,21,400
2	6,00,000	0.756	4,53,600
3	6,44,000 (6,00,000+44,000)	0.657	4,23,108
			13,98,108

Value of the asset will be the lower of fair value at the inception of lease and present value of MLP plus residual value. Therefore, the value of the asset will be ₹ 13,98,108.

Calculation for Interest (Finance Charge)

Year	Balance Due	Interest @ 15% of Balance Due	Repayment of Capital (₹ 6,00,000 - Interest)	Closing Balance
(1)	(2) ₹	(3) ₹	(4) ₹	(5) = (2)-(4) ₹
1	13,98,108	2,09,716	3,90,284	10,07,824
2	10,07,824	1,51,174	4,48,826	5,58,998
3	5,58,998	83,850	5,16,150	42,848* (Residual Value)

(Alternative Calculation)

Year	Liability (₹)	MLP (₹)	Finance Charge (₹)	Principle Amt. of reduction (₹)
1	13,98,108	—	—	—
2	10,07,824	6,00,000	2,09,716	3,90,284
3	5,58,998	6,00,000	1,51,174	4,48,826

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4	—	6,44,000	83,850	5,60,150
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Note: The difference between this figure and the guaranteed residual value (as per the problem) is due to approximation.

3. (a) Prepare the fire Insurance Revenue Account of Agni Fire Insurance Ltd. as per IRDA regulations for the year ended 31st March, 2019 from the following details:

Particulars	Amount (₹)
Claims paid	6,00,000
Legal Expenses regarding claims	10,000
Premiums received	12,50,000
Re-insurance premium paid	50,000
Commission	3,00,000
Expenses of Management	2,00,000
Provision against unexpired risk as on 1st April 2018	5,75,000
Claims unpaid on 1st April, 2018	50,000
Claims unpaid on 31st March, 2019	80,000

Provide for unexpired risk @ 50% less reinsurance.

- (b) From the following information find out the amount of provisions required to be made in the Profit & Loss Account of a Commercial Bank for the year ended 31st March, 2019:

- (i) Credit outstanding for ₹ 80 lakhs against which the Bank holds securities worth ₹ 20 lakhs. 50% of the above advance is covered by ECGC. The above advance has remained doubtful for more than 3 years.

- (ii) Other advances:

Assets classification	₹ in lakhs
Standard	2,500
Sub-standard	1,800
Doubtful:	
For one year	750
For two years	600
For three years	500
For more than 3 years	350
Loss assets	600

6+6=12

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Answer:

3. (a)

Form B - RA

**Name of the Insurer: Agni Fire Insurance Ltd.
Revenue Account for the year ended 31st March, 2019**

Sr. No	Particulars	Schedule	Amount (₹)
1	Premium earned	1	11,75,000
2	Other income		----
3	Interest, dividend and rent		----
	Total (A)		11,75,000
4	Claims incurred	2	6,40,000
5	Commission	3	3,00,000
6	Operating expenses related to insurance business	4	2,00,000
	Total (B)		11,40,000
	Operating Profit (A - B)		35,000

Schedule 1 : Premium Earned (Net)	(₹)
Premium received	12,50,000
Less: Re-insurance premium	(50,000)
Net Premium	12,00,000
Adjustment for change in reserve for unexpired risks	(25,000)
	11,75,000

Schedule 2 : Claims incurred	(₹)
Claims paid including legal expenses (6,00,000 + 10,000)	6,10,000
Add: Claims outstanding at the end of the year	80,000
Less: Claims outstanding at the beginning of the year	(50,000)
Total Claims Incurred	6,40,000

Schedule 3 : Commission	(₹)
Commission paid	3,00,000

Schedule 4 : Operating Expenses	(₹)
Expenses of Management	2,00,000

Working Note:

Change in the Provision for Unexpired Risk	(₹)
Unexpired risk reserve on 31 st March, 2018 = 50% of net premium (i.e., 50% of ₹ 12,00,000)	6,00,000
Less : Unexpired risk reserve as on 1 st April, 2018	(5,75,000)
	25,000

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(b) (i) Calculation of provision on credit partly secured by ECGC

Particulars	₹ in lakh
Credit outstanding	80.00
Less: Realisable value of securities	20.00
	60.00
Less. ECGC cover (50%)	30.00
Net Unsecured balance	30.00
Provision on unsecured portion (100%)	30.00
Provision on secured portion (100% of 20.00)	20.00
Total provision	50.00

(ii) Calculation of provision on other advances

Assets	Amount (₹ in Lakh)	% of Provision	Provision (₹ in Lakh)
Standard	2500	0.40	10
Sub-standard	1800	15	270
Doubtful:			
For 1 year	750	25	187.50
For 2 years	600	40	240
For 3 years	500	40	200
For More than 3 years	350	100	350
Loss Assets	600	100	600
			1857.50

Total provision to be made = 50.00 + 1857.50 = ₹ 1907.50 lakhs.

4. The following is the Trial Balance of Pioneer Limited as on 31.03.2019:

Particulars		Debit (₹)	Credit (₹)
Equity Capital (Face value of ₹100)		—	10,00,000
Calls in Arrears		1,000	—
Land		2,00,000	—
Building		3,50,000	—
Plant & Machinery		5,25,000	—
Furniture & Fittings		50,000	—
General Reserve		—	2,10,000
Loan from State Financial Corporation		—	1,50,000
Inventory:			
Finished Goods	2,00,000		
Raw Materials	50,000	2,50,000	—
Provision for taxation		—	68,000
Trade Receivables		2,00,000	—
Advances		42,700	—
Dividends Payable		—	60,000

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Profit & Loss A/c		—	86,700
Cash Balance		30,000	—
Cash at Bank		2,47,000	—
Loans (unsecured)		—	1,21,000
Trade Payables (For Goods and Expenses)		—	2,00,000
Total		18,95,700	18,95,700

Additional information:

(i) 2000 equity shares were issued for consideration other than cash.

(ii) Trade Receivables of ₹ 52,000 are due for more than six months.

(iii) (a) The cost of assets: 31.03.2019

(b) Depreciation till 31.03.2019

Building	—	₹ 4,00,000	Building	—	₹ 50,000
Plant & Machinery	—	₹ 7,00,000	Plant & Machinery	—	₹ 1,75,000
Furniture	—	₹ 62,500	Furniture & Fittings	—	₹ 50,000

(iv) The balance of ₹1,50,000 in the loan account with State Financial Corporation is inclusive of ₹7,500 for interest accrued but not due. The loan is secured by hypothecation of the Plant & Machinery.

(v) Balance at bank includes ₹2,000 with Perfect Bank Ltd., which is not a Scheduled Bank.

(vi) The company had contract for the erection of machinery at ₹ 1,50,000 which is still incomplete.

You are required to prepare Pioneer Limited's Balance Sheet as at 31.03.2019 as per Schedule III in accordance with the Companies Act, 2013 in the Vertical Form along with the Notes to Accounts. Ignore previous years' figures. 12

Answer:

4. If Depreciation on Furniture is considered as ₹50,000, the solution will be as follows:

Balance Sheet of Pioneer Limited as on 31st March, 2019

Particulars	Note No.	Amount (₹ 000)
I. Equity & Liabilities		
(1) Shareholders' Funds:		
(a) Share Capital	1	9,99,000
(b) Reserves & Surplus	2	2,59,200
(2) Non-Current Liabilities		
(a) Long Term Borrowing	3	2,63,500
(3) Current Liabilities:		
(a) Trade Payable		2,00,000
(b) Other Current Liabilities	4	67,500
(c) Short-term provisions	5	68,000
Total		18,57,200

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II. Assets		
(1) Non-Current Assets		
Fixed Assets		
Tangible Assets	6	10,87,500
(2) Current Assets:		
(a) Inventories	7	2,50,000
(b) Trade Receivables	8	2,00,000
(c) Cash & bank balances	9	2,77,000
(d) Short-term loans and advances		42,700
Total		18,57,200

Notes to Accounts:

	₹	₹
1. Share Capital		
Equity Share Capital		
Issued, Subscribed & called up		
10,000 equity shares of ₹ 100 each (Of the above 2,000 shares have been issued for consideration other than cash)	10,00,000	
Less : Calls in arrears	(1,000)	9,99,000
Total		9,99,000
2. Reserves & Surplus		
General Reserve		2,10,000
Surplus (Profit & Loss A/c)		49,200
Total		2,59,200
3. Long Term Borrowings:		
Secured		
Term loans		
Loan from State Financial Corporation (1,50,000 - 7,500) (Secured by hypothecation of Plant & Machinery)		1,42,500
Unsecured Loan		1,21,000
Total		2,63,500
4. Other Current Liabilities:		
Interest accrued but not due on loans (SFC)		7,500
Dividend Payable		60,000
Total		67,500
5. Short-term provisions:		
Provision for taxation		68,000
Total		68,000
6. Tangible assets:		
Land		2,00,000
Buildings	4,00,000	
Less: Depreciation	(50,000)	3,50,000
Plant and Machinery	7,00,000	
Less: Depreciation	(1,75,000)	5,25,000
Furniture & Fittings	62,500	

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Less: Depreciation	(50,000)	12,500
Total		10,87,500
7. Inventories:		
Raw Materials		50,000
Finished Goods		2,00,000
Total		2,50,000
8. Trade Receivables:		
Debt outstanding for a period exceeding six months		52,000
Other Debts		1,48,000
Total		2,00,000
9. Cash and Bank balances:		
Cash and cash equivalents		
Cash at bank		
With scheduled banks	2,45,000	
With others (Perfect Bank Ltd.)	2,000	2,47,000
Cash in hand		30,000
Other bank balances		Nil
Total		2,77,000

If Depreciation on Furniture is considered as ₹12,500, the solution will be as follows:

Balance Sheet of Pioneer Limited as on 31st March, 2019

Particulars	Note No.	Amount (₹ 000)
I. Equity & Liabilities		
(1) Shareholders' Funds:		
(a) Share Capital	1	9,99,000
(b) Reserves & Surplus	2	2,96,700
(2) Non-Current Liabilities		
(a) Long Term Borrowing	3	2,63,500
(3) Current Liabilities:		
(a) Trade Payable		2,00,000
(b) Other Current Liabilities	4	67,500
(c) Short-term provisions	5	68,000
Total		18,94,700
II. Assets		
(1) Non-Current Assets		
Fixed Assets		
Tangible Assets	6	11,25,000
(2) Current Assets:		
(a) Inventories	7	2,50,000
(b) Trade Receivables	8	2,00,000
(c) Cash & bank balances	9	2,77,000
(d) Short-term loans and advances		42,700
Total		18,94,700

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Notes to Accounts:

1. Share Capital	₹	₹
Equity Share Capital		
Issued, Subscribed & called up		
10,000 equity shares of ₹ 100 each (Of the above 2,000 shares have been issued for consideration other than cash)	10,00,000	
Less : Calls in arrears	(1,000)	9,99,000
Total		9,99,000
2. Reserves & Surplus		
General Reserve		2,10,000
Surplus (Profit & Loss A/c)		86,700
Total		2,96,700
3. Long Term Borrowings:		
Secured		
Term loans		
Loan from State Financial Corporation (1,50,000 - 7,500) (Secured by hypothecation of Plant & Machinery)		1,42,500
Unsecured Loan		1,21,000
Total		2,63,500
4. Other Current Liabilities:		
Interest accrued but not due on loans (SFC)		7,500
Dividend Payable		60,000
Total		67,500
5. Short-term provisions:		
Provision for taxation		68,000
Total		68,000
6. Tangible assets:		
Land		2,00,000
Buildings	4,00,000	
Less: Depreciation	(50,000)	3,50,000
Plant and Machinery	7,00,000	
Less: Depreciation	(1,75,000)	5,25,000
Furniture & Fittings	62,500	
Less: Depreciation	(12,500)	50,000
Total		11,25,000
7. Inventories:		
Raw Materials		50,000
Finished Goods		2,00,000
Total		2,50,000
8. Trade Receivables:		
Debt outstanding for a period exceeding six months		52,000
Other Debts		1,48,000
Total		2,00,000
9. Cash and Bank balances:		

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Cash and cash equivalents		
Cash at bank		
With scheduled banks	2,45,000	
With others (Perfect Bank Ltd.)	2,000	2,47,000
Cash in hand		30,000
Other bank balances		Nil
Total		2,77,000

Note: Estimated amount of contract remaining to be executed on capital account and not provided for ₹ 1,50,000. It has been assumed that the company had given contract for purchase of machinery.

5. Write short note on (any three):

4×3=12

- (a) Reasons for preparation of Cash Flows
- (b) Differences between Shares & Debentures
- (c) Surrender Value of a Life Insurance Policy
- (d) Finance Lease

Answer:

5. (a) Reasons for preparation of Cash Flows:

Cash Flow statement is considered to be a summarized statement showing sources of Cash Inflows and application of cash outflows of an enterprise during a particular period of time. It is prepared on the basis of the published data as disclosed by the Financial Statement of two different financial periods. It is an essential tool for managerial decision-making. Cash Flow Statement reports the management net Cash Flow (i.e. cash inflow less cash outflow or vice versa) from each activity of the enterprise as well as of the overall business of the enterprise. The management of the enterprise gets a picture of movement of cash resources from the Cash Flow Statement and can assess the stronger and weaker area of movement of cash for different activities of the business for drawing up the future planning.

(b) Difference between Shares & Debentures:

	SHARES	DEBENTURES
Definition	An instrument to acknowledge the ownership of the company.	An instrument to acknowledge the creditors of the company.
Status	A shareholder is the owner and a member of the company.	A debenture holder is not a member but a creditor.
Return	A shareholder may receive dividend only when a company makes a profit.	A debenture holder has a right to interest even if the company does not make profit.
Rate of return	Dividend rate can vary depending on the profit position.	Debenture carries a fixed rate of interest.
Accounting Treatment	Dividend is given out of appropriate profit and not chargeable to Profit & Loss Account.	Debenture interest is chargeable to Profit and Loss Account.
Redemption	In case of shares, the concept of	Debentures are normally

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	redemption does not apply. However, as per the recent changes in the Companies Act, a company can buy back shares in accordance with the provisions in the Act.	redeemable although a company can issue perpetual debentures.
Voting rights	A shareholder has voting rights.	A debenture holder can't have voting rights.
Status at the time of winding up	At the time of winding up, shareholders have the least priority regarding the return of amount due to them.	At the time of winding up, debenture holders have a priority over the shareholders regarding the return of amount due to them.

(c) Surrender Value of a Life Insurance Policy

In the case of life policy, the policy normally has value only when it matures. But to facilitate the promotion of business, insurance companies assign value to the policy on the basis of the premiums paid. Insurance companies will be prepared to pay such value on the surrender of the policy by a needy policy holder desiring to realize the policy. Therefore, the value is referred to as 'surrender value'. Surrender value is usually nil until at least two annual premiums are paid. Amount paid as surrender value is an expenditure and is similar to claims paid.

(d) Finance Lease

It is a lease, which transfers substantially all the risks and rewards incidental to ownership of an asset to the Lessee by the Lessor but not the legal ownership. In following situations, the lease transactions are called Finance Lease.

- (i) The lessee will get the ownership of leased asset at the end of the lease term.
- (ii) The lessee has an option to buy the leased asset at the end of term at price, which is lower than its expected fair value at the date on which option will be exercised.
- (iii) The lease term covers the major part of the life of asset.
- (iv) At the beginning of lease term, present value of minimum lease rental covers substantially the initial fair value of the leased asset.
- (v) The asset given on lease to lessee is of specialized nature and can only be used by the lessee without major modification.

Section - B

(Audit)

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

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

1×6=6

(i) A nomination and remuneration committee should have _____ directors.

(A) 5

(B) 10

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- (C) 2
(D) 3

(ii) An individual auditor who has completed his term shall not be eligible for reappointment as auditor in the same company for

- (A) Next 3 Years
(B) Next 5 Years
(C) Next 7 Years
(D) Next 8 Years

(iii) Proving the truth means vouching of _____ .

- (A) payment
(B) expenses
(C) assets
(D) liabilities

(iv) Secretarial Audit is applicable to the Public Company having the paid-up share capital of ₹ _____.

- (A) 50 crore
(B) 75 crore
(C) 100 crore
(D) 200 crore

(v) Internal Control Questionnaire contains the questions which need to be followed by the _____ .

- (A) Employer of the organisation
(B) Employee of the organisation
(C) Auditor of the entity
(D) Banker to the organisation

(vi) Declaration of dividend is covered under section _____ of the Companies Act, 2013.

- (A) 122
(B) 123
(C) 124
(D) 125

(b) Match the following items in Column 'A' with items shown in Column 'B' 1x4=4

	Column 'A'		Column 'B'
1.	CRA-1	A.	Audit Sampling
2.	Verification	B.	Maintenance of Cost Records by the Company
3.	SA 530	C.	Comptroller and Auditor General of India
4.	The authority for Government Audit	D.	Proving the truth

(c) State whether the following statements are true or false: 1x4=4

- (i) An Audit notebook is a bound book in which a large variety of matters observed during the course of audit are recorded.
(ii) The concept of true and fair is a fundamental concept in auditing.
(iii) First auditor of the company is appointed by the Board of Directors within 45 days from the date of first AGM.
(iv) A Statutory Audit is an official investigation into alleged wrong doing.

Answer:

6. (a) (i) D 3

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- (ii) B Next 5 years
 - (iii) B expenses
 - (iv) A ₹50 crore
 - (v) B Employee of the organisation
 - (vi) B 123
- (b) 1. B
2. D
3. A
4. C
- (c) (i) True
(ii) True
(iii) False
(iv) False

7. (a) What do you mean by Audit Programme? Discuss the various advantages of an Audit Programme.

(b) Discuss different types of internal control systems with example. (1+5)+6=12

Answer:

7. (a) An audit programme is a detailed plan of the auditing work to be performed, specifying the procedures to be followed in verification of each item and the financial statements and the estimated time required. To be more comprehensive, an audit programme is written plan containing exact details with regard to the conduct of a particular audit. It is a description or memorandum of the work to be done during an audit. Audit programme serves as a guide in arranging and distributing the audit work as well as checking against the possibility of the omissions.

Advantages of audit programme

The main advantages of an audit programme are enumerated below;

- (i) It serves as a ready check list of audit procedures to be performed.
- (ii) The audit work can be properly allocated to the audit assistants or the article clerks.
- (iii) The auditor may easily know the extent of work done at any point of time. Thus, the progress of work done can be under the supervision and control of the auditor.
- (iv) Audit programme would not only be useful for the audit assistants in carrying the audit work but for the principal too as he would be in a position to account for the individual responsibilities.
- (v) A uniformity of the work can be attained as the same programme would be followed from time to time.
- (vi) It is a useful basis for planning the programme for the following year it is useful in selection of team members & delegation of responsibilities to them.
- (vii) It may be used as evidence by the auditor in the event when any charge is brought against him.
- (viii) It is useful in selection of Team members and delegation of responsibilities to them.
- (ix) He can prove that there has no negligence on his part and he exercised

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reasonable care and skill while performing the task.

(x) It helps in timely completion of the audit work.

(b) Generally, there are two types of Internal Control in an Organisation: preventive and detective controls. Both types of controls are essential to an effective internal control system. From a quality standpoint, preventive controls are essential because they are proactive and emphasize quality. However, detective controls play a critical role by providing evidence that the preventive controls are functioning as intended.

i) **Preventive Controls** are designed to discourage errors or irregularities from occurring. They are proactive controls that help to ensure departmental objectives are being met. Examples of preventive controls are:

- **Segregation of Duties:** Duties are segregated among different people to reduce the risk of error or inappropriate action. Normally, responsibilities for authorizing transactions (approval), recording transactions (accounting) and handling the related asset (custody) are divided.
- **Approvals, Authorizations, and Verifications:** Management authorizes employees to perform certain activities and to execute certain transactions within limited parameters. In addition, management specifies those activities or transactions that need supervisory approval before they are performed or executed by employees. A supervisor's approval (manual or electronic) implies that he or she has verified and validated that the activity or transaction conforms to established policies and procedures.
- **Security of Assets (Preventive and Detective):** Access to equipment, inventories, securities, cash and other assets is restricted; assets are periodically counted and compared to amounts shown on control records.

ii) **Detective Controls** are designed to find errors or irregularities after they have occurred. Examples of detective controls are:

- **Reviews of Performance:** Management compares information about current performance to budgets, forecasts, prior periods, or other benchmarks to measure the extent to which goals and objectives are being achieved and to identify unexpected results or unusual conditions that require follow-up.
- **Reconciliations:** An employee relates different sets of data to one another, identifies and investigates differences, and takes corrective action, when necessary.
- Physical Inventories
- Audits

8. (a) Discuss the rights of an auditor according to the Companies Act, 2013.

(b) How can an auditor, who is appointed under section 139 of the Companies Act, 2013, be removed from his office before the expiry of his term? 8+4=12

Answer:

8. (a) Rights of an Auditor according to Companies Act 2013:

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- a) Right to Inspect Books of Accounts and Vouchers: Every auditor of a company shall have a right of access at all times to the books of account and vouchers of the company, whether kept at the registered office of the company or at any other place. In addition, auditor of a holding company shall also have the right of access to the records of all its subsidiaries in so far as it relates to the consolidation of its financial statements with that of its subsidiaries. [Section 143(1)]
- b) Right to Obtain Information and Explanations: The auditor shall be entitled to require from the officers of the company such information and explanation as he may consider necessary for the performance of his duties as auditor. [Section 143(1)]
- c) Right to Inspect Branch Offices and Branch Accounts: The company auditor is also entitled to inspect the accounts of any branch office in case he considers it necessary in order to discharge his duties as the company auditor. He can do so even if a separate auditor has already been appointed to audit the branch accounts. [Section 143(8)]
- d) Right to Receive the Report of Branch Audit from the Branch Auditor: In case a separate auditor has been appointed to audit the branch accounts, the company auditor has the right to receive the branch audit report from the branch auditor so appointed and use it to prepare the overall audit report. [Section 143(8)]
- e) Right to Receive Notices and Attend General Meetings: The company auditor is also entitled to receive all notices of, and other communications relating to, any general meeting and to attend such meetings either by himself or through his authorised representative, who shall also be qualified to be an auditor. The auditor shall also have the right to be heard at such meeting on any part of the business which concerns him as the auditor. [Section 146]
- f) Right to Sign the Audit Report and Other Documents: The company auditor also has the right to sign the auditor's report or sign or certify any other document of the company in accordance with the provisions of sub-section (2) of section 141. [Section 145]
- g) Right to Have Audit Report Read at the AGM: The company auditor has the right to have the report read before the company in the General Meeting (especially in case the qualifications, observations or comments on financial transactions or matters, mentioned in the auditor's report, have any adverse effect on the functioning of the company) and the same shall be opened to inspection by any member of the company. [Section 145]
- h) Right to Attend the Meeting of the Audit Committee: The auditors of a company shall have a right to attend the meetings of the Audit Committee and to be heard in the meetings when the Committee considers the auditor's report but shall not have the right to vote. [Section 177(7)]
- i) Right to be Indemnified: The auditor of a company shall also have the right to be indemnified for any expenses incurred by him in defending himself in case the judgement in any law suit (whether civil or criminal) against the company goes in favour of the auditor.

(b) Removal of Auditor before the Expiry of His Term:

The auditor appointed under section 139 may be removed from his office before the expiry of his term subject to the fulfillment of the following conditions under Section 140(1) read with Rule 7 of CAAR 2014.

- a) An application to the Central Government for removal of the auditor shall be made

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in Form ADT-2. The application shall be accompanied with fees as provided for this purpose under the Companies (Registration Offices and Fees) Rules, 2014.

- b) The application shall be made to the Central Government within thirty days of the resolution passed by the Board.
- c) The company shall hold the general meeting within sixty days of receipt of approval of the Central Government for passing the special resolution for removal of the said auditor.

The auditor concerned shall be given a reasonable opportunity of being heard.

9. (a) With reference to the Companies (Cost Records and Audit) Rules, 2014 as amended, discuss the following:

- (i) Submission of cost audit report to the Board of Directors by the Cost Auditor**
- (ii) Applicability of rotation to Cost Auditors**
- (iii) Remuneration of a Cost Auditor**

(b) "Disclaimer of Opinion and Adverse Report do not serve the same purpose". Discuss.

(2+2+3)+5=12

Answer:

9. (a) (i) Filing of cost audit report to the Board of Directors by the Cost Auditor:

As per sub-rule (4) of Rule 6 of the Companies (Cost Records and Audit) Rules 2014 as amended, a Cost Auditor is required to submit the Cost Audit Report along with his or its reservations or qualifications or observations or suggestions, if any, in form CRA-3 to Board of Directors of the company within a period of one hundred and eighty days from the closure of the financial year to which the report relates.

(ii) Applicability of rotation to Cost Auditors:

Section 148 also provides that qualifications, disqualifications, rights, duties and obligations applicable to auditors (financial) shall apply to a cost auditor appointed under this section. The eligibility, qualifications and disqualifications are provided in Section 141 of the Act and powers and duties are provided in Section 143.

Section 143(14) specifically states that the provisions of Section 143 shall mutatis mutandis apply to a cost auditor appointed under Section 148. There are no other provisions governing the appointment of a cost auditor.

Section 139(3) of the Act, applicable to appointment of auditors (financial), and Rule 6 of Companies (Audit and Auditors) Rules, 2014 deals with the provision of rotation of auditors and these provisions are applicable only to appointment of auditors (financial). The Act does not provide for rotation in case of appointment of cost auditors and the same is not applicable to a cost auditor. It may, however, be noted that though there is no statutory provision for rotation of cost auditors, individual companies may do so as a part of their policy, as is the practice with Public Sector Undertakings.

(iii) Remuneration of a Cost Auditor:

For the purpose of sub-section (3) of section 148 -

(a) in the case of companies which are required to constitute an audit committee -

- (i) the Board shall appoint an individual, who is a cost accountant in practice, or a firm of cost accountants in practice, as cost auditor on the recommendations of the Audit committee, which shall also recommend remuneration for such cost auditor;
- (ii) the remuneration recommended by the Audit Committee under (i) shall be considered and approved by the Board of Directors and ratified subsequently by the shareholders;

(b) in the case of other companies which are not required to constitute an audit committee, the Board shall appoint an individual who is a cost accountant in practice or a firm of cost accountants in practice as cost auditor and the remuneration of such cost auditor shall be ratified by shareholders subsequently.

(b) Disclaimer of Opinion

A Disclaimer of Opinion Report is given when the Auditor is unable to form an overall opinion about the matters contained in the Financial Statements.

A Disclaimer of Opinion should be expressed when the possible effect of a limitation on scope is so material and pervasive that the Auditor has not been able to obtain sufficient appropriate audit evidence and is, accordingly, unable to express an opinion on the Financial Statements.

It may happen in situations such as -- (a) when books of account of the Company seized by Income-Tax Authorities, (b) when it is not possible for the Auditor to obtain certain information or (c) when scope of audit work is restricted.

The Auditor will state in his Report that he is unable to form an opinion on the Financial Statements. Such Report is called as "Disclaimer of Opinion" Report.

Adverse Report

An Adverse or Negative Report is given when the Auditor concludes that based on his examination, he does not agree with the affirmations made in the Financial Statements / Financial Report.

An Adverse Opinion should be expressed when the effect of a disagreement is so material and pervasive to the Financial Statements, that the Auditor concludes that a qualification of the report is not adequate to disclose the misleading or incomplete nature of the Financial Statements.

The Auditor states that the Financial Statements do not present a true and fair view of the state of affairs and the working results of the organisation. The Auditor should state

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the reasons for issuing such a report.

Thus Disclaimer of Opinion and Adverse Report do not serve the same purpose, while the first is appropriate when the auditor is unable to form his opinion due to lack of information the latter is used when he thinks that the financial statements have failed to exhibit true and fair view of the performance and affairs of the company.

10. Write short notes (any three):

4×3=12

- (i) Auditor's duty regarding interim dividend
- (ii) Audit of Property, Plant and Equipment
- (iii) Audit of a Charitable Trust
- (iv) Audit of alteration of Share Capital

Answer:

10. (a) Auditor's duty regarding Interim Dividend:

In connection with the payment of interim dividend, the auditor must consider the following points:

- a) The auditor should examine the Articles of Association of the company to ascertain whether payment of interim dividend is permitted by the articles or not.
- b) The auditor should also examine the minute book of directors' meeting to verify resolution approving the payment of interim dividend.
- c) The amount of interim dividend shall be deposited in a scheduled bank in a separate account within five days from the date of declaration of such dividend.
- d) Based on the particulars of Dividend Register, the auditor must verify whether the dividend warrants have been issued to rightful owners. In case of payment through electronic mode (ECS), he must verify from the bank statements that the payment has been properly credited to the account of shareholder.
- e) The auditor should verify the Dividend Register and returned dividend warrants to determine the amount of interim dividend that could not be paid. He shall also to enquire the reason for such dividend remaining unpaid and ensure that the legal requirement, in this context, has been duly complied with.

(b) Audit of Property, Plant and Equipment:

An auditor should follow the procedure mentioned below while performing an audit of PPE.

- (i) The auditor must ensure physical verification of the assets to confirm that they exist and are under the possession of the client. He shall ensure that PPE additions up to the date of verification have been updated in the register.
- (ii) He shall specifically ensure that assets that are not in the working condition have been accounted for as deletions.
- (iii) He shall also verify the PPE schedule (asset class wise) maintained by the management and tally the closing balances to the entity's books of accounts.
- (iv) He should also check the arithmetical accuracy of the movement in PPE schedule and reconcile the opening balance with the closing balance of each class of asset by considering the additions and disposals during the year.

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- (v) He shall also verify whether appropriate internal processes and procedures like inviting competitive quotations or floating tenders were done before finalising the vendor.
- (vi) The auditor shall check that PPE purchase invoices are in the name of the client that entails the legal ownership.
- (vii) In relation to all deletions, he shall verify management's rationale for deletion. He may also seek any report from the technical expert, if any, that led to such decision of deletion.
- (viii) The auditor shall see that all items of PPE have been carried at cost less accumulated depreciation less accumulated impairment loss.
- (ix) The auditor shall verify whether depreciation has been charged on all items except the freehold land. In case of company, the auditor shall also ensure that depreciation has been calculated in compliance with Schedule II of the Companies Act 2013.
- (x) In case of a company, the auditor should ensure that the all items of PPE have been disclosed in the balance sheet of the company under the head 'Non-current Assets' and subhead 'Fixed Assets' as 'Tangible Asset' as per Schedule III of the Companies Act 2013. (ii) He shall also ensure that all the relevant information has also been disclosed in the 'Notes to Accounts' section.

Alternative Answer:

The term Property, plant and equipment in respect of those entities which are required to comply with the relevant Revised AS refers to such tangible items that: (a) are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and (b) are expected to be used during more than one period.

An asset can be classified as a Property, Plant, Equipment (PPE) or otherwise, depending upon the use to which it is put or intended to be put. For example, assets which are classified as PPE in one type of business may be considered as current assets in another. Similarly, the same asset may be classified differently in an entity at different points of time. The recognition of Property, Plant and Equipment should be done as per the principles laid down in the "relevant applicable AS".

Audit:

- (1) Auditor should review internal controls over acquisition like authorization, capital budgeting etc.
 - (2) Physical verification of Property, Plant and Equipment.
 - (3) Check whether proper records are maintained.
 - (4) Check whether proper depreciation of Property, Plant and Equipment is done, where required.
 - (5) Check supporting documents of acquisition disposal.
 - (6) Check whether scrapping or retirement of Property, Plant and Equipment is properly authorised.
 - (7) Check whether sale proceeds of Property, Plant and Equipment are properly accounted.
 - (8) Check title needs of ownership of Property, Plant and Equipment.
- (c) When conducting the audit of a charitable institution, the auditor should consider the following matters:
- (i) Constitution: The auditor should study the constitution of the charitable

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institution, for example, whether it is set up under the Societies Registration Act or as per section 8 of the Companies Act or as a trust.

- (ii) Interest of members: He should obtain a list of members of the governing body. This will help the auditor in identifying whether any of the members of the governing body has any interest in the charitable institution.
 - (iii) Budget: The auditor should obtain a copy of the budget sanctioned or the financial statement.
 - (iv) Internal Check: He should examine the system of internal check, especially as regards to the accounting of the amounts collected.
 - (v) Collection & Deposit of income: He should also check that the amounts received towards income have been duly collected, received and deposited into the bank regularly and promptly.
 - (vi) Subscription and donation: The auditor should check the following with respect to the subscription:
 - The amount or the rate of the annual subscription.
 - Any instructions given by the donors as to the specific utilization of donation.
 - Adequacy of internal controls existing as regards unused receipt books, counter foils, etc.
 - Where subscriptions are received in advance these should be properly dealt with in the accounts.
 - (vii) Legacies received: He needs to verify the amounts of legacies received by reference to correspondence with any figures and other available information's.
 - (viii) Income from Investment: The amount of dividend and interest received should be properly vouched with reference to the counterfoils or dividend warrants received.
 - (ix) Rent: Rent received must be checked based on tenancy agreement and the rent slips.
 - (x) The auditor should be careful in conducting audit of income and expenditure associated with different concerts and other programmes organised by the institution. All the gross receipts and outgoings are to be properly vouched by him.
 - (xi) He should physically verify the cash in hand, inventories and fixed assets.
- (d)** While conducting the audit of **alteration of share capital of a company**, the auditor should
- (i) Confirm that alteration was authorised by articles.
 - (ii) Verify the minutes of the Board meeting and ordinary resolution passed in the general meeting in which the approval of members is obtained.
 - (iii) Verify that alteration had been effected in copies of Memorandum, Articles, etc.
 - (iv) Obtain the reasons for which the memorandum of the company is altered.
 - (v) Check whether there is any change in the voting percentage of shareholders due to consolidate and divide all or any of its share capital into shares of a larger amount than its existing shares.
 - (vi) To confirm that the altered share capital's denomination is more than Rupee 1.00.
 - (vii) Verify that proper accounting entries have been passed. Register of members may also be checked to see that the necessary alteration have been effected therein.

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- (viii) Must ensure that the alteration has been effected following all the provisions of Section 61 of the Companies Act 2013.