INTERMEDIATE EXAMINATION

GROUP II

(SYLLABUS 2012)

SUGGESTED ANSWERS TO QUESTIONS

JUNE 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 stated.

1. Answer all questions: 2×10=20

(a) Neel Limited issued 10,000 debentures of ₹ 10 each redeemable at the end of 10 years, but reserves the right to redeem earlier from the end of 3rd year. The company decides at the end of 5th year to redeem 2,000 debentures out of its profits. Pass necessary journal entries in the books of Neel Limited on redumption of debentures.

(b) Explain when the research and development cost of a project can be deferred to future period as per AS-26.

(c) State the cases in which AS-29 does not get applicable.

(d) Net profit for the year 2013-14 is ₹ 25 lakhs and for the year 2014-15 is ₹ 75 lakhs. Number of equity shares outstanding until 31st December, 2014 is 20 lakhs. Bonus issue was made on 1st January, 2015 @ one equity share for each equity share outstanding as on 31st December, 2014. Calculate Basic Earnings per share for the year 2014-15 as per AS-20.

(e) Rukmani Limited purchased a plant for US $ 2,50,000 on 1st March, 2015, payable after three months. Company entered into a forward contract for three months @ ₹ 54.10 per dollar. Exchange rate per dollar on 1st March, 2015 was ₹ 53.74. Compute amount of profit or loss on forward contract as per AS-11. How will you recognise the same in the books of the company?

(f) What do the term 'Potential Equity Shares' signify?

(g) What do you understand by Information Security Audit?

(h) What is continuous Audit?

(i) What do you understand by test checking in Audit Work?

(j) What is vouching?

Answer:

1. (a)

Date	Particulars	Dr. (₹)	Cr. (₹)
5th year end	Debentures A/c To Debentures Redemption A/c	20,000	 20,000
	Debentures Redemption A/c To Bank A/c	20,000	 20,000
	P&L Appropriation A/c To Debentures Redemption Reserve A/c	20,000	 20,000

1. (b)

The expenditure incurred on account of research or development phase can be deferred to the subsequent years, if an enterprise can demonstrate all of the following, namely:

- The technical feasibility of completing the intangible asset so that it will not be available for use or sale
- The intention to complete the intangible asset and use or sell it
- The ability to use or sell the intangible asset
- How the Intangible asset will generate probable future economic benefits. Among other benefits, the enterprise should demonstrate the existence of a market for the output of the intangible asset
- availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset, and
- the ability to measure the expenditure attributable to the intangible asset during the development reliably

1. (c)

AS-29 does not get applicable in the following cases, namely

- Financial instruments carried at fair value
- Insurance enterprise
- Contract under which neither party has performed any of the obligations or both parties partially performed their obligations to an equal extent
- Those covered by another Accounting Standards -AS-7, AS-15, AS-18 and AS-22

1. (d)

$$\text{Basic EPS for 2014-2015} = \frac{75{,}00{,}000}{(20{,}00{,}000 + 20{,}00{,}000)} = ₹\ 1.875$$

1. (e)

Premium on Contract = 54.10 – 53.74 = ₹ 0.36

Total Loss = Contract amount $ 2,50,000 × 0.36 = ₹ 90,000

Contract period 3 months. Therefore loss to be recognized (90,000/3) × 1= ₹ 30,000 in 2014-15 Remaining ₹ 60,000 will be recognized in the following year.

1. (f)

The term "Potential Equity Shares" signify

- Potential Equity Shares signify mainly the following:
- Debt Instruments / Preference Share convertible into Equity Shares
- Share Warrants
- Employees and other stock option plans which entities them to receive equity shares as part of their remuneration and other similar plans
- Contingently issuable shares under contractual arrangements e.g. acquisition of a business / assets, loans converted to equity on default
- Share application pending allotment if not statutorily required to be kept separately and is being utilised for business is treated as potential (dilutive) equity shares.

1. (g)

Information Security Audit is an audit of the level of information security in an organization. The controls in any business organization can be classified as technical, physical and administrative controls. Thus, information security audit involves checking of security controls from the physical security of data centres to the logical security of databases.

1. (h)

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

1. (i)

Test checking is concerned with selecting and examining a representative sample from a large number of similar items. There is no hard and fast rule of selecting item for the test checking. The justification for the test checking lies in the theory of probability which states that a sample selected from a series of items will tend to exhibit the same characteristics as present in the full series of items.

1. (j)

"Vouching is the examination by the auditor of all documentary evidences, which are available to support the authenticity of the transaction entered in the client`s record" – Spicer and Pegler.

The act of examining all documentary evidences (vouchers) is referred to as vouching. Its basic objective is to establish the authenticity of the transactions recorded in the primary books of account. Vouching is said to be "the essence of auditing" or may be termed as the "backbone of auditing"

2. Answer *any two* questions: 8×2=16

(a) Makkhu Limited leased a machine to Gunu Limited on the following terms:

(i) Fair value of the machine	**₹ 72 lakhs**
(ii) Lease term	**5 years**
(iii) Lease rental per annum	**₹12 lakhs**
(iv) Guaranteed residual value	**₹ 2.40 lakhs**
(v) Expected residual value	**₹ 4.50 lakhs**
(vi) Internal rate of return	**15%**

Discounted rates at 15% for ₹ 1, 1st year to 5th year are 0.8696, 0.7561, 0.6575, 0.5718 and 0.4972 respectively.

Ascertain Unearned Finance Income. 8

(b) (i) As on 1st April, 2014, the fair value of plan assets was ₹ 2,00,000 in respect of a pension plan of Sagar Limited. 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 and acturial losses on the Defined Benefit Obligations for the year 2014-15 were ₹ 30,000. On 1st April, 2014, the company made the following estimates, based on its market studies, understanding and prevailing prices:

Interest and Dividend income, after tax payable by the fund 11.25% p.a. Realised and unrealised gains on plan assets (after tax) 3% p.a. Fund administrative costs 4% p.a. Calculate Net Acturial gains/losses for the year 2014-15. 5

(ii) Patta Ltd. purchased a piece of Land for ₹ 25,00,000 for which it received a grant from the State Government amounting to ₹ 6,00,000.

How will you treat Government grant in the accounts as per AS-12? Also pass the necessary journal entries of the above in the books of the company. 3

(c) (i) STF Ltd. with a turnover of ₹ 200 Cr. and an annual special advertising budget on TV channels of ₹ 5 Cr. had taken up the marketing of a new product. It was assumed that the company would have a turnover of ₹ 30 Cr. from the new product. The Company had debited to its Profit & Loss Account the total expenditure of ₹ 5 Cr. incurred on special advertisement for the new product.

As per AS-26, discuss whether the accounting treatment given by the Company is correct. 4

(ii) Net profit for the year 2014: ₹ 6,00,000

Weighted average number of equity share outstanding during the year 2014: 2,50,000

Average fair value of one equity share during the year 2014: ₹ 20

Weighted average number of shares under option during the year 2014: 50,000

Exercise price for shares under option during the year 2014: ₹ 15

Calculate Basic & Diluted Earnings per share for the year 2014. 4

Answer:

2. (a)

As per AS-19 on Leases, unearned financial income is the difference between (a) the gross investment in the lease and (b) the present value of minimum lease payments under a finance lease from the standpoint of the lessor; and any unguaranteed residual value accruing to the lessor, at the interest rate implicit in the lease. Where:

(1) Gross investment in the lease is the aggregate of (i) minimum lease payments from the stand point of the lessor and (ii) any unguaranteed residual value accruing to the lessor.

(2) Gross investment = Minimum lease payments + Unguaranteed residual value = [Total lease rent + Guaranteed residual value (GRV) + Unguaranteed residual value (URV)] = [(₹ 12,00,000 x 5 years) + ₹ 2,40,000] + ₹ 2,10,000 = ₹ 64,50,000 (a)

(2) Table showing present value of (i) Minimum lease payments (MLP) and (ii) Unguaranteed residual value

Year	MLP inclusive of URV ₹	Internal rate of return (Discount factor (5)15%)	Present Value
1	12,00,000	0.8696	10,43,520
2	12,00,000	0.7561	9,07,320
3	12,00,000	0.6575	7,89,000
4	12,00,000	0.5718	6,86,160
5	12,00,000	0.4972	5,96,640
	2,40,000 (GRV)	0.4972	1,19,328
	62,40,000	0.4972	41,41,968(i)
	2,10,000 (URV)		1,04,412(ii)
Total	64,50,000 (a)	(i)+(ii)	42,46,380(b)

Unearned Finance Income (a) - (b) = ₹ 64,50,000 - ₹ 42,46,380 = ₹ 22,03,620

Answer:

2. (b) (i)

A. Closing Balance of Fair Value of Plan Assets	₹ 3,00,000
B. Add Benefits Paid	₹ 25,000
C. Less: Contribution Received	(₹ 55,000)
D. Less: Opening Balance of Fair Value of Plant Assets	(₹ 2,00,000)
E. Actual Return on Plan Assets	₹ 70,000
F. Expected Return on Plan Assets [₹ 2,00,000 × 10.25% × 12/12]+ [(₹ 55,000 – ₹ 25,000) × 5%]	₹ 22,000
G. **Actual Gains on Plan Assets [E-F]**	₹ 48,000
H. Acturial losses on the obligations	₹ 30,000
I. **Net Acturial Gains [G+H]**	18,000
WORKING NOTES:	
1. Expected Rae of Return = 11.25% + 3% – 4% = 10.25% 2. Equivalent Half Yearly Compounding Interest Rate = $\sqrt{1+\text{Expected Rate of Return}} - 1 = \sqrt{(1+0.1025)} - 1$ = 0.05 or 5%	

3. **Assumptions:** (a) All Contributions are received and Benefits are paid in middle of the year (b) Expected Rate of Return is compounded half yearly.	

Answer:

2. (b) (ii)

As per AS-12, Accounting for Govt. Grants, grants related to non-depreciable asset (Land is a non-depreciable assets) should be credited to Capital Reserve.

Journal Entries

		₹	₹
On Purchase of Land	Land A/c	25,00,000	
	To Bank A/c		25,00,000

Answer:

2. (c) (i)

As per AS 26, expenditure on an intangible item should be recognised as an expense when it is incurred unless it forms part of the cost of an intangible asset.

Here, advertisement expenditure of ₹ 5 Cr. had been taken up for the marketing of a new product, which may provide future economic benefits by having a turnover of ₹30 Cr. Here, no intangible asset or other asset is acquired or created that can be recognized. So, the accounting treatment by the company is correct.

(ii) Computation of earnings per share:

	Earnings (₹)	Shares	Earnings/share (₹)
Net profit for the year 2014	6,00,000	-	-
Weighted average no. of shares during the year 2014	-	2,50,000	-
Basic earnings per share No. of shares under option	-	- 50,000	2.40
Less: No. of shares that would have been issued at fair value (50000x15)/20	-	37,500	-
Diluted earnings per share	6,00,000	2,62,500	2.29

3. Answer any two questions : 16×2=32

(a) (i) Jatin Ltd. was merged with Naitik Ltd. with effect from 01.04.2015. Summarised Balance Sheets of Naitik Ltd. and Jatin Ltd. as on 31.03.2015 are as follows:

Balance Sheets as on 31.03.2015 **(₹ in 000)**

Liabilities	Naitik Ltd.	Jatin Ltd.	Assets	Naitik Ltd.	Jatin Ltd.
Share Capital:			**Sundry Fixed Assets (Tangible)**	**2100**	**850**
Equity Share of ₹ 10 each	**1500**	**600**	**Investments (Non-trade)**	**360**	**90**

General Reserve	600	130	Stock	250	90
Profit & Loss A/c	420	140	Debtors	240	110
Export Profit Reserve	150	90	Bills Receivables	45	20
Sundry Creditors	70	90	Cash and Bank balances	230	95
Provision for Taxation	220	115	Preliminary Expenses	25	20
Proposed Dividend	290	110			
	3250	1275		3250	1275

Non-trade investments of Naitik Ltd. fetched @ 20%, while those of Jatin Ltd. fetched @ 15%. Profit (pre-tax) by Naitik Ltd. and Jatin Ltd. during 2012-13, 2013-14 and 2014-15 were as follows:

Years	Naitik Ltd. ₹	Jatin Ltd. ₹
2012-13	11,00,000	2,38,000
2013-14	12,65,000	3,10,000
2014-15	13,70,000	2,80,000

Goodwill may be calculated on the basis of capitalization method, taking 15% as the pre-tax normal rate of return.

Purchase consideration is discharged by Naitik Ltd. on the basis of intrinsic value per share.

You are required to calculate the purchase consideration and pass the necessary journal entries in the books of Naitik Ltd. **12**

(ii) Vikash Ltd. resolved by a special resolution to buy-back its 5,00,000 equity shares of ₹ 10 each (paid up value ₹ 8) at a premium of ₹ 15 per share. At the time of buy-back the following balances appeared in its books:

	₹
Securities Premium Account	60,00,000
General Reserve Account	50,00,000
Profit and Loss Account (Cr.)	45,00,000

The company utilized the whole of the securities premium for buy-back purpose.

You are required to pass the necessary journal entries in the books of the company. **4**

(b) (i) The following particulars relate to Kovid Limited Company which has gone into voluntary liquidation: Share capital issued:

10,000 Preference shares of ₹ 100 each fully paid up

1,00,000 Equity shares of ₹ 10 each fully paid up

1,00,000 Equity shares of ₹ 10 each, ₹ 8 paid up

60,000 Equity shares of ₹ 10 each, ₹ 5 paid up

Assets realized ₹ 53,34,136 excluding the amount realized by sale of securities held by partly secured creditors.

Other details are as follows:

	₹
Preferential creditors	**1,45,600**
Unsecured creditors	**31,00,000**
Partly secured creditors (Assets realized ₹ 3,20,000)	**5,50,000**
Debenture-holders having floating charge on all assets of the company	**7,75,000**
Expenses of liquidation	**19,400**

You are required to prepare the Liquidator's Final Statement of Account, allowing for his remuneration @ 3% on all assets realized and 2% on the amount paid to unsecured creditors, including preferential creditors. **10**

(ii) Enumerate the arguments against Segmental Reporting. **3**

(iii) State the guidelines which need to be followed for accounting of Employees Stock Option Plans. **3**

(c) (i) Following details are provided by Patasha Ltd:

Particulars	31.03.2015 (₹)	31.03.2014 (₹)
Liabilities:		
Share Capital	25,00,000	22,00,000
General Reserve	4,00,000	3,50,000
Profit and Loss Account	3,00,000	1,50,000
Debentures	5,00,000	3,00,000
Provision for taxation	2,00,000	1,50,000
Proposed dividend	4,00,000	3,50,000
Trade payables	9,00,000	11,50,000
	52,00,000	46,50,000
Assets:		
Plant and Machinery	15,00,000	11,00,000
Land and Building	10,00,000	8,00,000
Investments (Non trading)	3,00,000	1,50,000
Trade receivables	9,00,000	10,50,000
Inventories	10,00,000	12,00,000
Cash on hand/Bank	5,00,000	3,50,000
	52,00,000	46,50,000

(1) Depreciation @ 15% was charged on the opening value of Plant and Machinery.

(2) At the year end, one old machine costing ₹ 1,50,000 (WDV ₹ 70,000) was sold for? 1,10,000. Purchase was also made at the year end.

(3) ₹ 1,20,000 was paid towards Income tax during the year.

(4) ₹ 15,000 received as interest on investment during the year.

(5) Building under construction was not subject to any depreciation.

You are require to prepare Cash Flow Statement as per AS-3. **10**

(ii) Seth Co. Ltd. issued 20,000 shares which were underwritten as :

Ram : 12,000 shares, Raghu : 5,000 shares and Ravi: 3,000 shares.

The underwriters made applications for firm underwriting as follows:

Ram: 1,600 shares; Raghu: 600 shares; Ravi: 2,000 shares. The total subscriptions excluding firm underwriting (including marked applications) were 10,000 shares.

The marked applications were: Ram: 2,000 shares; Raghu: 4,000 shares; Ravi: 1,000 shares.

Show the net liability of underwriters (number of shares). **6**

Answer:

3. (a) (i) Working Notes :

1. Purchase Consideration:

(i) Shares outstanding in Jatin Ltd.	60,000
(ii) Intrinsic Value per Share of Jatin Ltd. (W.N. 2)	₹ 30.6666
(iii) Value of Shares (a x b)	₹ 18,40,000
(iv) Intrinsic value per share of Natik Ltd. (W.N. 2)	₹ 54.5333

(v) No. of shares to be issued by Naitik Ltd.

₹ 18,40,000/54.5333 = 33,740.85 shares

Shares	Cash for fractions
33740	0.85 x 54.5333 = ₹ 46

(vi) Purchase consideration

(a) 33,740 shares @ 54.5333		
Capital (₹ 10/Share)	3,37,400	
Premium (₹ 44.5333/Share)	15,02,554	=18,39,954
(b) Cash for fractional shares		= 46
(c) Total purchase consideration payable		= 18,40,000

2. Intrinsic Value per share: (₹ in '000)

	Naitik Ltd.		**Jatin**	**i Ltd.**
(i) Assets				
(a) Goodwill	5,245		790	
(b) Sundry Fixed assets	2,100		850	
(c) Investments	360		90	
(d) Stock	250		90	
(e) Debtors	240		110	
(f) B/R	45		20	
(g) Cash and Bank Balance	230	8470	95	2045
(ii) Liabilities				

(a) Sundry creditors	70		90	
(b) Provision for tax	220	290	115	205
(iii) Net Assets (I -ii)		8,180		1,840
(iv) No. of Outstanding Shares		1,50,000		60,000
(v) Intrinsic Value per share (iii/iv)		₹54.53333		₹30.6667

3. Valuation of Goodwill

A. Capital Employed

	Naitik Ltd.		Jatin Ltd.	
(i) Assets:				
Sundry Fixed assets	2,100		850	
Stock	250		90	
Debtors	240		110	
B/R	45		20	
Cash and Bank balance	230	2,865	95	1,165
(ii) Liabilities:				
Sundry creditors	70		90	
Provision for tax	220	290	115	205
(iii) Capital Employed: (i) - (ii)		**2,575**		**960**

B. Average Pre-tax profit: (₹ in '000)

Particulars	Naitik Ltd.	Jatin Ltd.
(i) 2012-13	1,100	238
(ii) 2013-14	1,265	310
(iii) 2014-15	1,370	280
(iv) Total (a + b + c)	3,735	828
(v) Simple Average {(iv)/3}	1,245	276
(vi) Less: Non-trading income	72	13.5
(vii) **Average pre-tax profit**	1,173	262.5

C. Computation of Goodwill: (₹ in '000)

Particulars	Naitik Ltd.	Jatin Ltd.
(a) Capitalised value of average profits $\frac{11,73,000}{15\%}, \frac{2,62,500}{15\%}$	7,820	1,750
(b) Capital Employed	2,575	960
(c) Goodwill (a – b)	**5,245**	**790**

Journal Entries:

Books of Naitik Ltd. (₹ in '000)

Particulars		Debit	Credit
a. For Business Purchase:			
Business Purchase A/c	Dr.	1840	
To Liquidator of Jatin Ltd. A/c			1840
b. For Assets and Liabilities taken over			

	Goodwill A/c Dr.	790	
	Fixed Assets A/c Dr.	850	
	Investments A/c Dr.	90	
	Stock A/c Dr.	90	
	Debtors A/c Dr.	110	
	Bills Receivable A/c Dr.	20	
	Cash and Bank A/c Dr.	95	
	To Creditors A/c		90
	To Provision for Taxation A/c		115
	To Business-Purchase A/c		1,840
c.	For Discharge of Purchase Consideration:		
	Liquidator of Jatin Ltd. Dr.	1,840	
	To Equity Share capital A/c		337.4
	To Securities premium A/c		1,502.554
	To Cash A/c		.046
d.	Contra Entry		
	Amalgamation Adjustment A/c Dr.	90	
	To Export Profit Reserve A/c		90

Answer:

3. (a) (ii) **Journal Entries**

E.S. Final Call A/c	Dr.	10,00,000	
To E. S. Capital A/c			10,00,000
(Final call due on 5,00,000 equity shares of ₹ 2 per share)			
Bank A/c	Dr.	10,00,000	
To E.S. Final Call A/c			10,00,000
(Call money received)			
Equity Share Capital A/c	Dr.	50,00,000	
Securities Premium A/c	Dr.	60,00,000	
General Reserve A/c	Dr.	15,00,000	
To Equity Shareholders A/c			1,25,00,000
(Amount due on buy-back)			
Equity Shareholders A/c	Dr.	1,25,00,000	
To Bank A/c			1,25,00,000
(Payment made)			
General Reserve A/c	Dr.	35,00,000	
Profit & Loss A/c	Dr.	15,00,000	
To Capital Redemption Reserve A/c			50,00,000

Answer:

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

	₹		₹
To Assets realized	53,34,136	By Liquidator's Remuneration:	
To Calls on Contributors:		3% on (53,34,136 + 3,20,000)	1,69,624
(Equity Shareholders)		2% on (1,45,600 + 33,30,000)	69,512
On 100000 E.S. of ₹ 8 paid @ ₹ 0.75=75,000 On 60000 E.S. of f 5 paid @ ₹ 3.75=2,25,000	3,00,000	By Liquidation Exp.	19,400
		By Debentures	7,75,000
		By Preferential Creditors	1,45,600
		By Unsecured Creditors (31,00,000 + 2,30,000)	33,30,000
		By Preference Shareholders	10,00,000
		By Equity shareholders of ₹10 each fully paid (1,00,000 x 1.25)	1,25,000
	5634136		56,34,136

Working notes:

1. Unsecured portion in partly secured creditors

   = 5,50,000 – 3,20,000 = ₹ 2,30,000.

2. Total Unsecured Creditors = 31,00,000 + 2,30,000 (as W.N. 1)

   = ₹ 3330,000

3.

Particulars	₹	₹
Amount realized from assets other than those held by secured creditors		53,34,136
Less:- Paid to Liquidator's remuneration (1,69,624+69,512)	2,39,136	
Liquidation expenses	19,400	
Debentures	7,75,000	
Preferential Creditors	1,45,000	
Unsecured Creditors	33,00,000	
Preference Shareholders	10,00,000	55,09,136
Deficiency		1,75,000
Surplus for Equity Shareholders		

Notional Call 1,00,000 × 2 60,000 × 5	 2,00,000 3,00,000	 5,00,000
Total Surplus		3,25,000
Deficiency per equity share ₹ 3,25,000 ÷ (1,00,000+1,00,000+60,000) =₹1.25		
Amount receivable or refundable on Equity Shares		
To the shareholders of 1,00,000 equity shares of ₹10 each fully paid up---- ₹1.25 per share		
From the shareholders of 1,00,000 equity shares of ₹10 each ₹8 paid up--- (₹1.25-₹2) = ₹0.75 per share to be received		
From the shareholders of 60,000 equity shares of ₹10 each ₹5paid up--- (₹1.25-₹5) = ₹3.75 per share to be received		

Answer:

3. (b) (ii) Arguments against Segmental Reporting

Arguments against Segmental Reporting can be illustrated as given below:

- It is generally viewed that segmental revenues and expenses are not distinguishable objectively in many cases. Revenues of a weak product line may be derived only because of the existence of a strong product. Also many joint products are only separable arbitrarily.
- Much of the segmental results depend on the inter - departmental transfer pricing which are not always logically established.
- Various segments of an enterprise may use common resources which makes it difficult to arrive at a segment wise performance ratio interpretation
- Since the users are in no position to know the proper base for cost allocation, the segment wise result would be less than meaningful.
- The last argument consists of the competitive implications of the firm. Some view that company's secret will be disclosed while others referred to the competitive hardships suffered by some firms if segmental data is required.
- Considering the problems of joint allocation, often it is suggested that a contribution margin approach for reporting segmental results. By this process, only identifiable costs are deducted from segment revenues and gross segment margins may only be indicated. But, for all practical purposes this becomes an useless exercise when proportion of identifiable cost is insignificant.

Answer:

3. (b) (iii) Guidelines which need to be followed for Accounting of Employees Stock Option Plan:

The relevant conditions are as follows:

- Some employees use share based payments as a part of remuneration package for their employees, such payments take the form of Employees Stock Option Plans. The guidance note recognises two methods of accounting for employees share based payments, namely the fair value method and the intrinsic value method and permits\ as an alternative to the intrinsic value method with full value disclosures.
- An enterprise should recognise as an expense (except where services received qualifies to be included as part of the cost of an asset) the services received in an equity settled employee share based plans when it receives the services with a corresponding credit to an appropriate equity account like " Stock Option Outstanding Account" . The account is transitional in nature as it gets ultimately transferred to another equity account such as share capital, securities premium account and / or general reserves as recommended by the Guidance Notes.
- If the shares or stock options granted get vested immediately, the employees are not required to complete a specified period of service before becoming unconditionally entitled to those instruments. In the absence of evidence to the contrary, the enterprise should presume that services rendered by the employees as a consideration for the instruments have been received. In this case on the grant date, the enterprise should recognise services received in full with a corresponding credit to equity account.
- If the shares or stock options granted do hot vest until the employees completes a specified period of service, the enterprise^ should presume, that the services to be rendered by the employee as a consideration for those instruments would be received in the future during the vesting period. The enterprise should account for these services as they are rendered by the employee during the vesting period on a time proportional basis, with a corresponding credit to the equity account.
- An enterprise should measure the fair value of shares or stock options granted at the grant date based on market prices available taking into account the terms and conditions upon which those shares or stock options were granted. If market prices are not available, the enterprise estimate the fair value of the instruments granted using a valuation technique to estimate what the price of those instruments would have been on the grant date in an arms length transaction between knowledgeable willing parties. The valuation technique should be consistent with generally accepted valuation methodologies for pricing financial instruments and should incorporate all factors and assumptions that knowledgeable willing market participants would consider in settling the price.

Answer:

3. (c) (i) Guidelines

Patasha Ltd.

Cash Flow Statement

For the year ended 31st March, 2015

Cash Flow from Operating Activities		
Increase in balance of Profit and Loss Account (3,00,000 – 1,50,000)	1,50,000	
Proposed Dividend	4,00,000	
Provision for taxation	1,70,000	
Transfer to General Reserve	50,000	
Depreciation (15% on 11,00,000)	1,65,000	
Profit on sale of Plant and Machinery (110000 - 70000)	(40,000)	
Interest on Investment	(15,000)	
Operating Profit before Working Capital changes	8,80,000	
Decrease in Inventories	2,00,000	
Decrease in Trade receivables	1,50,000	
Decrease in Trade payables	(2,50,000)	
Cash generated from operations	9,80,000	
Income tax paid	(120,000)	
Net Cash from operating activities		8,60,000
Cash Flow from Investing Activities		
Purchase of fixed assets	(6,35,000)	
Expenses on building	(2,00,000)	
Interest on investments	15,000	
Increase in investments	(1,50,000)	
Sale of old machine	1,10,000	
Net Cash used in investing activities		(8,60,000)
Cash Flow from Financing activities		
Proceeds from issue of shares	3,00,000	
Proceeds from issue of debentures	2,00,000	
Dividend paid	(3,50,000)	
Net cash used in financing activities		1,50,000
Net increase in cash or cash equivalents		1,50,000
Cash and Cash equivalents at the beginning of the year		3,50,000
Cash and Cash equivalents at the end of the year		5,00,000

Working Notes:

Provision for taxation account

	₹		₹
To Cash (Paid)	1,20,000	By Balance b/d	1,50,000
To Balance c/d	2,00,000	By Profit and Loss A/c (b/f)	1,70,000
	3,20,000		3,20,000

Plant and Machinery account

	₹		₹
To Balance b/d	11,00,000	By Depreciation	1,65,000
To Profit and Loss A/c	40,000	By Cash (sale of machine)	1,10,000
(Profit on sale of machine)	6,35,000	By Balance c/d	15,00,000
To Cash (b/f)	17,75,000		17,75,000

Answer:

3. (c) (ii)

Statement of Underwriters' Liability

(Firm underwriting shares are treated as unmarked applications)

(No. of Shares)

	Ram	Raghu	Ravi	Total
Gross Liability	12,000	5,000	3,000	20,000
Less: Marked-applications	2,000	4,000	1,000	7,000
Balance	10,000	1,000	2,000	13,000
Less: Unmarked applications in the ratio of gross liability (12:5:3)	4,320	1,800	1,080	7,200
Balance	5,680	(-800)	920	5,800
Credit of Raghu's over subscription to Ram &Ravi in the ratio of 12:3	(640)	+800	(160)	-
Net Liability	5,040	-	760	5,800
Add: firm underwriting	1,600	600	2,000	4,200
Total Liability	6,640	600	2,760	10,000

4. Answer any two questions : 16x2=32

(a) Comment on the following: 4x4=16

(i) An audit process involves significant collection of evidences.

(ii) Operational audit is merely an extension of Internal Audit.

(iii) There is no need to design better internal controls in an EDP or computerised system,

(iv) Internal check is a part and parcel of internal control.

(b) (i) What are the advantages of joint audit? 8

(ii) Briefly explain the audit working paper files. 4

(iii) Tabulate the differences between Clean Audit Report and Qualified Audit Report. 4

(c) (i) As an auditor of a company, how will you verify 'patents' appearing in the financial statements of the company? 4

(ii) Distinguish between Statutory Audit and Government Audit. 4

(iii) State the disqualifications of a company auditor. 4

(iv) What do you understand by Teeming and Lading with respect to misappropriation of cash? Explain the procedure that auditor has to follow for its timely detection. 4

Answer:

4. (a) (i)

"An audit process involves significant collection of evidences

In any audit, the auditor examines the available evidences to him and gives the opinion based on such examination. Moreover, he has to carry out the audit within the framework of standard auditing practices and that too with ethical conduct. The auditor has to proceed in a systematic manner so that he would be in a position to collect and review the purposeful evidences and also satisfy himself of the correctness of the financial operations of the business. Usually, the whole audit process involves the following aspects, namely:

- Defining the scope of the audit work, i.e. preparation of the audit engagement letter
- Obtaining the knowledge of the client's business and formulating the audit programme
- Evaluation of the accounting and internal control system existing in the auditee enterprise
- Determining the nature, timing and the extent of audit procedures keeping in mind the audit risk and the materiality involved
- Adequate documentation is also necessary i.e. preparation of audit note book and working papers
- Formulation of opinion about the financial statements
- Issuing of audit report.

An auditor resorts to the following techniques for collection of relevant evidences, namely

- Vouching
- Confirmation
- Physical examination and observation
- Analytical procedures
- Test checking
- Inquiry
- Electronic data processing
- Preparation of reconciliation statements

- Flow Charts
- Scanning

Further, the various provisions of the law governing the enterprise are complied with. He has to further examine the accounting principles followed and disclose the deficiencies and limitation of the scope if any. At the same time, it also a fact that the selection of the appropriate audit procedures is a matter of experience and judgement.

(ii) The statement is **true**. In operational audit function, the internal auditor goes beyond financial controls and looks into operational areas also. Operational auditing having scope and objectives similar to that of Internal Audit is therefore an extension of Internal Audit.

(iii) This is **not true** Computerization, automatically implies a constant review of the system to increase the efficiency in producing reliable data. As a result the internal controls are normally better designed under computerized systems. Automatic checks are instituted and the responsibilities of various people are clearly stated.

(iv) **Yes** Internal control is a plan of organization and covers all methods and procedures adopted by management to assist its objectives of ensuring the orderly and efficient conduct of business, its includes physical and financial control and covers internal check and internal audit also. Hence internal check is part of internal control.

Answer:

4. (b) (i)

The following advantages of Joint Audit:

i. Sharing of expertise

ii. Advantage of mutual consultation

iii. Lower work load

iv. Better quality of performance

v. Improved service to the client

vi. Displacement of the auditor of the company often obviated.

vii. 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. Lower staff deployment cost.

viii. Lower cost to carry out the work

viii. A sense of healthy competition towards a better performance

(ii) Working Papers are of two types: 1. Permanent Audit File, 2. Current Audit File

1. **Permanent Audit File:** These are the working papers which are helpful for auditor till he is doing audit of company. It contains such information which requires only updation. E.g. MOA, AOA, any legal documents which binds the company for long time, significant ratios and trends.

2. **Current Audit File:** These are prepared for a single period and are useful for that particular period only. E.g. Observations, WIP, Letter of Engagement, Management Representations, confirmation with third parties etc.

(iii)

Clean Report	Qualified Report
1. The Auditor issues a Clean Report when he does not have any reservation with regard to the matters contained in the Financial Statements.	1. A Qualified Report is one when an Auditor gives an opinion subject to certain reservations.
2. In a Clean Report, the Auditor states that the Financial Statements give a true and fair view of the slate of affairs and results for the period.	2. The Auditor's reservation is generally stated as-"subject to the above, we report that the Balance Sheet shows a true and fair view".
3. There is no specific duly of Management for Clean Reports.	3. Management is bound to give explanation & full details in respect of each qualification in the Auditors Report. [Sec. 217 (3)].

Answer:

4. (c) (i)

Verification of Patents:

(i) Examine the patents and verify them with the help of the certificate from the party granting the patents.

(ii) Ensure that the patents are duly registered in the name of the auditor.

(iii) Verify the voucher, pass book, agreement, authorization etc., in case of outright purchases of patents and see that the cost is fully capitalized.

(iv) Check the renewal fees, if any, paid is debited to Profit and Loss Account.

(v) In case of patents developed by the client, expenditure incurred on its development, should be capitalized.

Answer:

4. (c) (ii)

The following are the differences between Statutory Audit and Government Audit:

Statutory Audit	Government Audit
Applicable to (a) All private companies (b) All co-operative societies (c) Proprietorship and partnership concerns in some cases. E.g. Tax audit under Income Tax Act.	Applicable to (a) Government departments (b) Statutory corporations (c) Government companies
Appointment	**Appointment**
(a) In case of private companies: shareholders, (b) In case of sole proprietor and partnership: proprietor or partners, (c) In case of trust: trustee or Managing Committee, (d) In case of	(a) In case of government departments: Comptroller and Auditor General (b) In case of statutory corporation: as per the provisions of the special statute for that corporation, (c) In

co-operative societies: Managing Committee with prior approval of the Registrar.	case of government company: Company Law Board, on the advice of the Comptroller and Auditor General.
Report is submitted to the owners/ shareholders in a format prescribed by the Companies Act, 1956, in the case of Companies	Report is submitted to the shareholders and a copy is given to the Comptroller and Auditor General in a format prescribed by the CAG.

Answer:

4. (c) (iii)

None of the following persons shall be qualified for appointment as auditor of a company:

(a) A body corporate;

(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 is indebted to the company or has given any guarantee or provided any security in connection with the indebtedness of any third person to the company for amount exceeding ₹1000;

(e) A person holding any security of that company after a period of one year W.E.F. 13.12.2000. A person who is disqualified as above is also disqualified for appointment to be an auditor of

  (A) its holding Company

  (B) its subsidiary company

  (C) a subsidiary of its holding company.

Answer:

4. (c) (iv)

"Teeming and Lading is a commonly used verification method of misappropriation of cash".

Teeming and Lading may not amount to fraud but negligence on the part of the part of the management and weaknesses in Internal Checks or control may lead to substantial amounts being misappropriated by the cashier, this may result in a huge loss if he is not in a position to clear the debts when caught.

The auditor has to follow the following procedure for timely detection of teeming and lading,

- Ascertain if the Cash Memos are consecutively numbered and the dates name and amount as per the Daily Summary reconcile with relevant cash receipt records
- Reconcile individual cash amounts as per receipts with records in the Rough Cash Book
- Reconcile the records as recorded in the Rough Cash Book, main Cash Book, pre-numbered Cash Memos with counterfoils of the pay in slips
- Ensure whether cash receipts are deposited in the bank on a timely basis
- Examine the Debtors Ledger, especially entries showing part payments, to satisfy that the debtors concerned have indeed made part payments
- Confirmation may be obtained from the debtors from time to time.