SUGGESTED ANSWERS

EXECUTIVE PROGRAMME

COMPANY ACCOUNTS AND AUDITING PRACTICES
(EP-CA&AP/2013)

THE INSTITUTE OF
Company Secretaries of India
IN PURSUIT OF PROFESSIONAL EXCELLENCE
Statutory body under an Act of Parliament
ICSI House, 22, Institutional Area, Lodi Road, New Delhi 110 003
Phones : 41504444, 45341000; *Fax* : 011-24626727
E-mail : info@icsi.edu; *Website* : www.icsi.edu

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EXECUTIVE PROGRAMME

COMPANY ACCOUNTS AND AUDITING PRACTICES

TEST PAPER 1/2013

Time allowed : 3 hours | *Max. Marks : 100*

PART A

[Answer Question No.1 which is COMPULSORY and any 3 Questions are to be attempted out of 4]

Question No. 1

(a) State, with reasons in brief, whether the following statements are correct or incorrect:

(i) The Accounting Standards are formulated by the Institute of Chartered Accountants of India.

(ii) In case the minimum subscription is not received, the company must return the amount so realised within 120 days from the date of issue of prospectus.

(iii) In internal reconstruction, the share capital is refunded to the shareholders.

(iv) In the event of amalgamation of companies, the existence of the amalgamating companies continue.

(v) In firm underwriting, the underwriter has a right to get the shares allotted to it as per underwriting agreement, even if the issue has been oversubscribed.

(3 marks each)

(b) Choose the most appropriate answer from the given options in respect of the following :

(i) Called-up capital of company is –

(a) Amount stated in the memorandum of association

(b) Amount of shares issued to public for subscription

(c) Amount of shares issued otherwise than cash

(d) Portion of subscribed capital which the applicants are required to pay on subscription.

(ii) Preference shares are those –

(a) Which have preference in voting right

(b) Can claim the dividend even if there is loss in the company

(c) Entitled to receive the dividend at a fixed rate prior to equity shares

(d) Entitled to receive the arrears of dividend in the absence of any provision in articles of association.

(iii) Issue of shares can be done at a discount by the public company if –

(a) At least one year has elapsed since the date of its incorporation

(b) At least one year has elapsed since the date of commencement of its business

(c) It is by a new company

(d) New class of shares are issued by old company.

(iv) Debentures of a company are also considered as –

(a) A loan capital of a company on interest

(b) Short-term borrowings

(c) Non-refundable deposits

(d) Amount refundable at the time of winding-up.

(v) Profit prior to incorporation is –

(a) Capital profit

(b) Distributable profit amount to shareholders

(c) To be credited to profit and loss account

(d) Amount payable to vendor. *(1 mark each)*

(c) Re-write the following sentences after filling-in the blank spaces with appropriate word(s)/figure(s):

(i) The subscription list for public issue should not be kept open for more than ____ days.

(ii) The accounts of a company shall be presented in general meeting at the end of every financial year but not exceeding fifteen months, which may be extended to __________months with special permission of the Registrar of Companies.

(iii) International Financial reporting Standards (IFRS) are issued by__________.

(iv) Full Form of EVA is ________________________.

(v) Schedule VI of Companies Act was recently revised in year ______.

(1 mark each)

Answer to Question No. 1(a)(i)

Correct

In India the Accounting Standards are formulated by the Institute of Chartered Accountants of India through its Accounting Standards Board.

Answer to Question No. 1(a)(ii)

Incorrect

If minimum subscription is not received within 120 days of the date of issue of prospectus the application money is to be refunded within next ten days.

Answer to Question No. 1(a)(iii)

Incorrect

In internal reconstruction share capital is reduced by cancelling any paid up share capital which is lost or not represented by available assets. This is done to write off the losses of the company.

Answer to Question No. 1(a)(iv)

Incorrect

In the event of amalgamation of companies, the existence of amalgamating companies does not continue. In amalgamation, two or more existing companies go into liquidation and a new company is formed.

Answer to Question No. 1(a)(v)

Correct

In case of firm underwriting, the underwriters get the priority over the general public, if shares or debentures are oversubscribed. Even if the issue is over subscribed, the underwriter has the right to get the shares or debentures allotted to it as per the underwriting agreement.

Answer to Question No. 1(b)(i)

(d) Portion of subscribed capital which the applicants are required to pay on subscription.

Answer to Question No. 1(b)(ii)

(c) Entitled to receive the dividend at a fixed rate prior to equity shares

Answer to Question No. 1(b)(iii)

(b) At least one year has elapsed since the date of commencement of its business

Answer to Question No. 1(b)(iv)

(a) A loan capital of a company on interest

Answer to Question No. 1(b)(v)

(a) Capital profit

Answer to Question No. 1(c)

(i) The subscription list for public issue should not be kept open for more than **10** days.

(ii) The accounts of a company shall be presented in general meeting at the end of every financial year but not exceeding fifteen months, which may be extended to **eighteen** months with special permission of the Registrar of Companies.

(iii) International Financial reporting Standards (IFRS) are issued by **International Accounting Standards Board**.

(iv) Full Form of EVA is **Economic Value Added**.

(v) Schedule VI of Companies Act was recently revised in year **2011**.

Question 2

(a) On 1st January, 2012, Manish Ltd. had outstanding in its books 1,000, 12% debentures of ₹ 500 each. In accordance with the agreement, the directors purchased debentures in the open market for immediate cancellation as follows:

1st March, 2012	:	*₹50,000 at ₹ 490 (cum-interest)*
1st August, 2012	:	*₹1,00,000 at ₹ 501.25 (cum-interest)*
15th December, 2012	:	*₹25,000 at ₹492.50 (ex-interest)*

Debentures interest is payable on 30th June and 31st December each year. Pass necessary journal entries for the above transaction. (8 marks)

(b) Laxmi Udyog Ltd., incorporated on 1st May, 2012, received certificate to commence business on 31st May, 2012. They had acquired the business from Mittal & Co. with effect from 1st January, 2012. The purchase consideration was ₹15,00,000 of which ₹3,00,000 was to be paid in cash and ₹12,00,000 in the form of fully paid-up shares. The company also issued shares for ₹12,00,000 for cash. Machinery costing ₹7,50,000 was then installed. Assets acquired from Mittal & Co. were – Machinery : ₹9,00,000; Stock : ₹1,80,000; and Patents : ₹1,20,000. During the year 2012, the total sales were ₹54,00,000. The sales per month in the first half-year were one-half of what they were in the later half-year. The net profit of the company after charging the following expenses was ₹3,00,000. Depreciation : ₹1,62,000; Audit fees : ₹22,500; Directors' fees : ₹75,000; Preliminary expenses : ₹18,000; Office expenses : ₹1,17,000; Selling expenses : ₹1,08,000; and Interest to vendor upto 31st May, 2012 : ₹7,500.

Ascertain the pre-incorporation and post-incorporation amount of profit. (7 marks)

Answer to Question No. 2(a)

JOURNAL ENTRIES

Date	*Particulars*		*Debit Amount ₹*	*Credit Amount ₹*
01/03/2012	12% Debentures A/c	Dr.	50,000	
	Debenture Interest A/c	Dr.	1,000	
	To Bank			49,000
	To Profit on Cancellation of Debentures A/c			2,000
	(Cancellation of 100 Debentures of ₹500 each by purchase in the open market at ₹490 cum-interest)			

Date	*Particulars*		*Debit Amount ₹*	*Credit Amount ₹*
30/06/2012	Debenture Interest A/c	Dr.	27,000	
	To Debentureholders A/c			27,000
	(Interest due on 900 outstanding debentures of ₹4,50,000 at 12% p.a. for 6 months)			
	Debentureholders A/c	Dr.	27,000	
	To Bank			27,000
	(Payment made for interest)			
01/08/2012	12% Debentures A/c	Dr.	1,00,000	
	Debenture Interest A/c	Dr.	1,000	
	To Bank			1,00,250
	To Profit on Cancellation of Debentures A/c			750
	(Cancellation of 200 Debentures of ₹500 each by purchase in the open market at ₹501.25-cum-interest)			
15/12/2012	12% Debentures A/c	Dr.	25,000	
	Debenture Interest A/c	Dr.	1,375	
	To Bank			26,000
	To Profit on Cancellation of Debentures A/c			375
	(Cancellation of 50 Debentures of ₹500 each by purchase at ₹492.5 ex-interest)			
31/12/2012	Debenture Interest A/c	Dr.	19,500	
	To Debentureholders A/c			19,500
	(Interest due on the outstanding 750 debentures of ₹500 each at 12% p.a. for 6 months)			
	Debentureholders A/c	Dr.	19,500	
	To Bank			19,500
	(Payment made for interest)			
	Profit and Loss A/c	Dr.	49,875	
	To Debenture Interest A/c			49,875
	(Transfer of Debenture Interest to Profit and Loss A/c)			

Date	Particulars	Debit Amount ₹	Credit Amount ₹
	Profit on Cancellation of Debentures A/c Dr.	3,125	
	To Capital Reserve A/c		3,125
	(Transfer of capital profit to Capital Reserve A/c)		

Note:

1st March	:	₹50,000 x 12/100 x 2/12	=	₹1,000
1st August	:	₹1,00,000 x 12/100 x 1/12	=	₹1,000
15th Dec	:	₹25,000 x 12/100 x 5.5/12	=	₹1,375

Answer to Question No. 2(b)

Statement showing profit prior to incorporation for the year ended 31st December 2012

Particulars	*Total Amount*	*Basis of Allocation*	*Pre-incorporation ₹*	*Post – incorporation ₹*
Depreciation	1,62,000	Time	54,000	1,08,000
Audit fees	22,500	Time	7,500	15,000
Director's fees	75,000	Post	-	75,000
Preliminary Expenses	18,000	Post	-	18,000
Office Expenses	1,17,000	Time	39,000	78,000
Selling expenses	1,08,000	Sales	24,000	84,000
Interest to vendors	7,500	Actual	6,000	1,500
Total expense	5,10,000		1,30,500	3,79,500
Gross profit	8,10,000	Sales	1,80,000	6,30,000
Less: Expenses	5,10,000		1,30,500	3,79,500
Net Profit	3,00,000		49,500	2,50,500

Working Notes:

(i) Calculation of Sales Ratio

Pre-incorporation period = ½ x 4 months

Post Incorporation period = (½ x 2 months) + (1x 6 months) = 7

Sales Ratio = 2:7

(ii) Time Ratio 1:2

(iii) Gross profit = Net Profit + Pre incorporation Expenses + Post incorporation expenses

= ₹3,00,000 + 1,30,500 + 3,79,500

= ₹8,10,000

Question No. 3

(a) What are the desirable conditions for internal re-construction ? *(5 marks)*

(b) The following particulars are available of Sorabji Ltd. :

(i) Capital : 45,000, 6% preference shares of ₹100 each fully paid-up; and 45,000 equity shares of ₹10 each fully paid-up.

(ii) External liabilities : ₹7,50,000.

(iii) Reserves and surplus : ₹3,50,000.

(iv) Annual average profit after tax : ₹8,50,500.

(v) The normal profit earned on the market value of equity shares, fully paid, on the same type of company is 9%.

(vi) Company transfers every year ₹1,00,000 to reserves.

Calculate the fair value of shares assuming that out of the total assets, assets worth ₹35,000 are fictitious. *(10 marks)*

Answer to Question No. 3(a)

When a company has been making losses for a number of years and the financial position does not present a true and fair view of the state of the affairs of the company. In such a company the assets are overvalued, the assets side of the balance sheet consists of fictitious assets, useless intangible assets and debit balance in the profit and loss account. Such a situation does not depict a true picture of financial statements and shows a higher net worth than what the real net worth ought to be. In short the company is over capitalized. Such a situation brings the need for reconstruction.

Reconstruction is a process by which affairs of a company are reorganized by revaluation of assets, reassessment of liabilities and by writing off the losses already suffered by reducing the paid up value of shares and/or varying the rights attached to different classes of shares. It means reconstruction of a company's financial structure. Reconstruction of company's financial structure can take place either with or without the liquidation of the company.

When the company reconstructs its financial structure internally without undergoing liquidation, it is internal reconstruction. Under this scheme company continues its legal existence. A scheme of re-organisation is prepared in which all parties sacrifice. It also means the reduction of capital to cancel any paid up share capital which is lost or not represented by available assets. This is done to write off the losses of the company.

Desirable conditions of internal reconstruction

Internal reconstruction is done by the company when:

— there is an overvaluation of assets and undervaluation of liabilities.

— there is a difficulty to meet the financial crisis and there are continuous losses.

Answer to Question No. 3(b)

(i) Intrinsic Value of Shares

		₹
Preference Share Capital		45,00,000
Equity Share Capital		4,50,000
Reserves and Surplus		3,50,000
External Liabilities		7,50,000
Gross Assets		60,50,000
Less : Fictitious Assets	35,000	
External Liabilities	7,50,000	7,85,000
Net assets available for shareholders		52,65,000
Less: Preference Share Capital		45,00,000
Net assets available for equity shareholders		7,65,000

$$\text{Intrinsic Value} = \frac{\text{Net Assets}}{\text{No.of shares}} = ₹\ \frac{7,65,000}{45,000} = ₹\ 17.00$$

(ii) Yield Value of Shares

		₹
Average profit after tax		8,50,000
Less : Transfer to reserves	1,00,000	
Dividend on preference shares @ 6%	2,70,000	3,70,000
Profit available for equity shareholders		4,80,500
Expected rate of return on capital (4,80,500 x 100 / 4,50,000)		106.8%

$$\text{Yield Value per Share} = \frac{\text{Expected rate of return on capital x paid up value}}{\text{Normal rate of return}}$$

$$= \frac{106.8 \times 10}{9}$$

$$= ₹\ 118.67$$

(iii) Fair Value of Shares

$$= \frac{\text{Intrinsic Value} + \text{Yield Value}}{2}$$

$$= \frac{17 + 118.67}{2}$$

$$= ₹\ 67.84$$

Question No. 4

(a) *What are 'bonus shares' ? In what circumstances, bonus shares can be issued?* *(5 marks)*

(b) *From the following balance sheets, prepare a consolidated balance sheet of Ram Ltd., and its subsidiary Shyam Ltd in the format as stipulated by revised Schedule VI . Shares were acquired on 1st October, 2011:*

Balance Sheets as on 31st March, 2012

Liabilities	*Ram Ltd. (₹)*	*Shyam Ltd. (₹)*
Share capital	*30,00,000*	*6,00,000*
General reserves	*4,00,000*	—
Profit and loss account	*6,00,000*	*2,10,000*
Sundry creditors	*5,00,000*	*1,90,000*
	45,00,000	*10,00,000*
Assets		
Land and building	*24,00,000*	*4,00,000*
Plant and machinery	*4,00,000*	*4,00,000*
Current assets	*11,60,000*	*2,00,000*
Investments (5,400 shares of ₹100 each in Shyam Ltd.)	*5,40,000*	—
	45,00,000	*10,00,000*

The profit and loss account of Shyam Ltd. has a credit balance of ₹90,000 on 1st April, 2011. *(10 marks)*

Answer to Question No. 4(a)

When the profits of the company is to be capitalized, then in addition to the normal dividend the company issues the additional shares to its existing shareholders without any payment and such capitalization is adjusted from the accumulated profits of the company and credited to capital account, such issue is called as issue of bonus shares by capitalization of profits. It can be issued under following circumstances :

(i) When the company has accumulated large reserves and it wants to capitalize those reserves by issuing bonus shares.

(ii) When a company is not in a position to give cash bonus as it adversely affects its working capital.

(iii) When the value of fixed assets far exceeds the amount of capital.

(iv) When higher rate of dividend is not advisable for distribution of dividend.

(v) When there is a big difference between the market value and paid-up value of shares of the company i.e. the rate of shares in the market is very high.

Answer to Question No. 4(b)

Consolidated Balance Sheet of Ram Ltd. and its subsidiary Shyam Ltd.
As on 31st March, 2012

Particulars	*Amount (₹)*
I. EQUITIES AND LIABILITIES	
1. Shareholder's Funds	
(a) Share capital	30,00,000
(b) Reserves and Surplus	
General Reserve	4,00,000
Capital Reserve	1,35,000
Profit & Loss A/c (Consolidated)	6,54,000
2. Minority Interest	81,000
3. Non Current Liabilities	0
4. Current Liabilities	
Trade payables	6,90,000
Total	49,60,000
II. ASSETS	
1. Non Current Assets	
(a) Fixed Assets	
Land and Building	28,00,000
Plant and Machinery	8,00,000
2. Current Assets	13,60,000
Total	49,60,000

Working Notes:

(i) Calculation of net Worth of Shyam Ltd.

	₹
Paid up Capital	6,00,000
Opening balance of Profit and Loss A/c	90,000
Pre acquisition profit for six months	60,000
Net Worth	7,50,000

(ii) Calculation of goodwill or capital reserve

Cost of Investments	5,40,000
Share in net worth of Shyam Ltd. (90%)	6,75,000
Capital Reserve	1,35,000

(iii) Calculation of minority shareholder's interest

Share in net worth (10%)	75,000
Add : Post Acquisition profit (₹60,000 x 10/100)	6,000
Minority shareholder's interest	81,000

(iv) Calculation of consolidated profit

Balance of Profit & Loss A/c of Ram Ltd.	6,00,000
Add : Share in post acquisition profit (90% of ₹60,000)	54,000
	6,54,000

Question 5

(a) Sam Limited invited applications from public for 1,00,000 equity shares of ₹10 each at a premium of 5 per share. The entire issue was underwritten by the underwriters A, B, C and D to the extent of 30%, 30%, 20% and 20% respectively with the provision of firm underwriting of 3,000, 2,000, 1,000 and 1,000 shares respectively. The underwriters were entitled to the maximum commission permitted by law.

The company received applications for 70,000 shares from public out of which applications for 19,000, 10,000, 21,000 and 8,000 shares were marked in favour of A, B, C and D respectively.

Calculate the liability of each one of the underwriters. Also ascertain the underwriting commission @ 2.5% payable to the different underwriters.

(10 marks)

(b) What are the objectives of corporate financial reporting ? *(5 marks)*

Answer to Question No. 5(a)

Liability of Underwriters (No. of shares)

	Total	*A*	*B*	*C*	*D*
Gross Liability	1,00,000	30,000	30,000	20,000	20,000
Less : Unmarked Applications	12,000	3,600	3,600	2,400	2,400
Balance	88,000	26,400	26,400	17,600	17,600
Less : Marked Applications	58,000	19,000	10,000	21,000	8,000
Balance	30,000	7,400	16,400	– 3,400	9,600
Less : Firm Underwriting	7,000	3,000	2,000	1,000	1,000
Balance	23,000	4,400	14,400	– 4,400	8,600
Adjustment	—	– 1,650	–1,650	+ 4,400	–1,100
Net Liability	23,000	2,750	12,750	—	7,500
Total Liability including firm underwriting	30,000	5,750	14,750	1,000	8,500

Note : The above answer is arrived at by treating 'firm underwriting shares' on par with marked applications. Alternatively, the 'firm underwriting shares' may be treated on par with un-marked applications. Then, the answer will be as follows:

	Shares	
Applications received including firm underwriting	77,000	(70,000 + 7,000)
Less : Marked Applications	58,000	
Un-marked Applications	19,000	

Liabilities of Underwriters (No. of shares)

	Total	*A*	*B*	*C*	*D*
Gross Liability	1,00,000	30,000	30,000	20,000	20,000
Less : Unmarked Applications	19,000	5,700	5,700	3,800	3,800
Balance	81,000	24,300	24,300	16,200	16,200
Less : Marked Applications	58,000	19,000	10,000	21,000	8,000
Balance	23,000	5,300	14,300	– 4,800	8,200
Adjustment	—	– 1,800	– 1,800	+ 4,800	1,200
Net Liability	23,000	3,500	12,500	—	7,000
Add : Firm Underwriting	7,000	3,000	2,000	1,000	1,000
Total Liability	30,000	6,500	14,500	1,000	8,000

Underwriting Commission

The underwriting commission is payable at the rate of 2.5% of the issue price of shares.

Thus, commission payable to

A $= 30{,}000 \times 15 \times \frac{2.5}{100} =$ ₹ 11,250

B = ₹11,250

C $= 20{,}000 \times 15 \times \frac{2.5}{100} =$ ₹7,500

D = ₹7,500

Answer to Question No. 5(b)

The objectives of financial reporting given by Financial Accounting Standard Board (FASB) are summarized as follows:

— Financial reporting should provide information that is useful to investors and creditors and other users in making rational investment, credit and similar decisions. The information should be useful to both, the present and potential investors.

— Financial reporting should provide information about the economic resources of an enterprise the claims to those resources (obligations of the enterprise to transfer resources to other entities and owners equity) and the effects of transactions event, and circumstances that change resources and claims to those resources.

— Financial reporting should provide information about the enterprise's financial performance during a period. Investors and creditors often use information about the past to help in assessing the prospects of an enterprise.

— Financial reporting should provide information about how management of an enterprise obtains and spends cash, its borrowing and repayment of borrowing, capital transactions including cash dividends and other distributions of enterprise resources to owners, and other factors that may affect an enterprise's liquidity or solvency.

— Financial reporting should provide information about how management of an enterprise has discharged its stewardship responsibilities to owners (shareholders) for the use of enterprise resource entrusted to it.

— Financial reporting should provide information that is useful to management and directors in making decisions in the interest of owners.

PART B

(Answer any two out of the three from this part.)

Question No. 6

(a) Explain the basic principles governing an audit in brief. *(5 marks)*

(b) Differentiate between "Auditing and Investigation". *(5 marks)*

(c) *Write any 6 basic elements of an Auditor's report.* *(5 marks)*

Answer to Question No. 6(a)

Basic Principles Governing an Audit : SA 200 "Basic Principles Governing an Audit", describes the basic principles which govern the auditor's professional responsibilities and which should be complied with wherever an audit is carried. They are described below:

(i) *Integrity objectivity and independence* : An auditor should be honest, sincere, impartial and free from bias. He should be a man of high integrity and objectivity.

(ii) *Confidentiality* : The auditor should respect confidentiality of information acquired during the course of his work and should not disclose the information without the prior permission of the client, unless there is a legal duty to disclose.

(iii) *Skill and competence* : The auditor must acquire adequate training and experience. He should be competent, skilful and keep himself abreast of the latest developments including pronouncements of ICAI on accounting and auditing matters.

(iv) *Work performed by others* : If the auditor delegates some work to others and uses work performed by others including that of an expert, he continues to be responsible for forming and expressing his opinion on the financial information.

(v) *Documentation* : The auditor should document matters which are important in providing evidence to ensure that the audit was carried out in accordance with the basic principles.

(vi) *Planning* : The auditor should plan his work to enable him to conduct the audit in an effective, efficient and timely manner. He should acquire knowledge of client's accounting system, the extent of reliance that could be placed on internal control and coordinate the work to be performed.

(vii) *Audit evidence* : The auditor should obtain sufficient appropriate evidences through the performance of compliance and other substantive procedures to enable him to draw reasonable conclusions to form an opinion on the financial information.

(viii) *Accounting System and Internal Control* : The management is responsible for maintaining an adequate accounting system incorporating various internal controls appropriate to the size and nature of business. He auditor should assure himself that the accounting system is adequate and all the information which should be recorded has been recorded. Internal control system contributes to such assurance.

(ix) *Audit conclusions and reporting* : On the basis of the audit evidence, he should review and assess the audit conclusions. He should ascertain:

— As whether accounting policies have been consistently applied;

— Whether financial information complies with regulations and statutory requirements; and

— There is adequate disclosure of material matters relevant to the presentation of financial information subject to statutory requirements.

The auditor's report should contain a clear written opinion on the financial information. A clean audit report indicates the auditor's satisfaction in all respects and when a qualified, adverse or a disclaimer of opinion is to be given or reservation of opinion on any matter is to be made, the audit report should state the reasons thereof.

Answer to Question No. 6(b)

Difference between Auditing and Investigation

Basis	*Auditing*	*Investigation*
Legal binding	Audit of annual financial statements of a company is compulsory under the Companies Act, 1956.	Investigation is not compulsory under the Companies Act, 1956 but voluntary depending upon necessity.
Object in view	Audit is conducted to ascertain whether the financial statements show a true and fair view.	Investigation is conducted with a particular object in view, to know financial position, earning capacity, prove fraud, invest capital, etc.
Period covered	Audit is conducted on annual basis.	Investigation may be conducted for several years at a time, say three years.
Parties for whom conducted	Audit is conducted on behalf of shareholders (or proprietor, or partners).	Investigation is usually conducted on behalf of outsiders like prospective buyers, investors, lenders, etc.
Documents	Audit is not carried out of audited financial statements.	Investigation may be conducted even though the accounts have been audited.
Extent of work	Audit is normally conducted on test verification basis.	Investigation is a thorough examination of books of accounts.
Report	Audit report of a company is addressed to shareholders (or proprietors or partners).	Investigation report is addressed to the party on whose instruction investigation was conducted.
Person performing work	Audit is to be conducted by a person having prescribed qualification i. e. Chartered accountant, Cost accountant.	No statutory qualification is prescribed for Investigation. It may be undertaken by any one.

Answer to Question No. 6(c)

Basic Elements of the Auditor's Report

The auditor's report includes the following basic elements, ordinarily, in the following layout:

(a) Title;

(b) Addressee;

(c) Opening or introductory paragraph

— identification of the financial statements audited;

— a statement of the responsibility of the entity's management and the responsibility of the auditor;

(d) Scope paragraph (describing the nature of an audit)

— a reference to the auditing standards generally accepted in India;

— a description of the work performed by the auditor;

(e) Opinion paragraph containing

— a reference to the financial reporting framework used to prepare the financial statements; and

— an expression of opinion on the financial statements;

(f) Date of the report;

(g) Place of signature; and

(h) Auditor's signature.

Question No. 7

(a) What are the Internal Control system of an entity. Explain in details. (10 marks)

(b) Explain the term Audit programme and distinguish it from Audit plan. (5 marks)

Answer to Question No. 7(a)

Internal controls are a system consisting of specific policies and procedures designed to provide management with reasonable assurance that the goals and objectives it believes important to the entity will be met. "Internal Control System" means all the policies and procedures (internal controls) adopted by the management of an entity to assist in achieving management's objective of ensuring, as far as practicable, the orderly and efficient conduct of its business, including adherence to management policies, the safeguarding of assets, the prevention and detection of fraud and error, the accuracy and completeness of the accounting records, and the timely preparation of reliable financial information. The internal audit function constitutes a separate component of internal control with the objective of determining whether other internal controls are well designed and properly operated. Internal control system consists of interrelated components as follows:

— Control (or Operating) environment

— Risk assessment

— Control Objective setting

— Event identification

— Control activities

— Information and communication

— Monitoring

— Risk response

There are two types of techniques used in internal control system Preventive internal control techniques and Detective internal control techniques controls. Both types of internal control techniques are essential to an effective internal control system. From a quality standpoint, preventive controls techniques are essential because they are proactive and emphasize quality. However, detective controls techniques play a critical role by providing evidence that the preventive controls techniques are functioning as intended

Preventive Controls techniques are designed to discourage errors or irregularities from occurring. They are proactive in nature that helps to ensure departmental objectives are being met. Examples of preventive controls techniques are:

(i) *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.

(ii) *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.

(iii) *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.

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

(i) *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.

(ii) *Reconciliations* : An employee relates different sets of data to one another, identifies and investigates differences, and takes corrective action, when necessary.

(iii) *Physical Inventories*

(iv) *Internal Audits*

Answer to Question No. 7(b)

Audit programme is nothing but a list of examination and verification steps to be applied set out in such a way that the inter-relationship of one step to another is clearly shown and designed, keeping in view the assertions discernible in the statements of account produced for audit or on the basis of an appraisal of the accounting records of the client.

In other words, an audit programme is a detailed plan of applying the audit procedures in the given circumstances with instructions for the appropriate techniques to be adopted for accomplishing the audit objectives. Businesses vary in nature, size and composition; work which is suitable to one business may not be suitable to others; efficiency and operation of internal controls and the exact nature of the service to be rendered by the auditor are the other factors that vary from assignment to assignment. Because of such variations, evolving one audit programme applicable to all business under all circumstances is not practicable. However it becomes a necessity to specify in detail in the audit programme the nature of work to be done so that no time will be wasted on matters not pertinent to the engagement and any special matter or any specific situation can be taken care of.

Audit programme contains step by step instructions to be carried out by team members i.e. it is simply a list of audit procedures to be executed by team members. Audit programmes are prepared on the basis of audit plan usually by the auditor – who in the audit team is either partner or manager. But sometimes, audit firms have a basic audit programme and the same is used by the auditor after making some modifications to it to make it according the audit engagement in hand.

An audit plan is a step-by-step, methodical approach that enables auditors to focus on important areas under review. Audit Planning steps run the gamut, from engagement preparation and staff appointment to testing financial accounts and internal processes.

In order to ensure a high standard of performance, it is important that the auditor should prepare adequately for his work. Planning for an audit, just like every human endeavour, is essential for the smooth performance of the audit work and its successful completion. Planning ahead for an audit work will not only guarantee a valid audit opinion but will also help the auditor to ensure that:

(a) The audit objective is established and achieved;

(b) The audit is properly controlled and adequately directed at all stages;

(c) High risk and critical areas of the engagement are not omitted but that adequate attention is focused on these areas; and

(d) The work is completed economically and expeditiously, hence, saving on audit resources.

Question No. 8

(a) What do you mean by flow chart? Explain its usefulness in Auditing?

(b) Write the distinction between verification and Vouching.

(c) Write a short note on Cost Audit. *(5 marks each)*

Answer to Question No. 8(a)

A flow chart is a graphical presentation of each part of the company's system of internal control. A flow chart is considered to be the most concise way of recording the auditor's review of the system. It minimizes the amount of narrative explanation and thereby achieves and consideration or presentation not possible in any other form. It gives bird's eye view of the system and the flow of transactions and integration and in documentation, can be easily spotted and improvements can be suggested. It is also necessary for the auditor to study the significant features of the business carried on by the concern: the nature of its activities and various channels of goods and materials as well as cash, both inward and outward, : and also a comprehensive study of the entire process of manufacturing, trading and administration. This will help him to understand and evaluate the internal controls in the correct perspective.

Answer to Question No. 8(b)

Difference between Verification and Vouching

Basis	*Verification*	*Vouching*
Meaning	Verification is the act of checking title, possession and valuation of assets.	Vouching is the act of checking the records with the help of evidential documents.
Nature	Verification is specially related to the assets and liabilities.	Vouching is related to all the accounting documents.
Person	Auditor himself performs the work of verification.	Generally, assistant staff or auditor performs the work of vouching.
Time	Verification is made at the end of auditing or at the time of checking balance sheet.	Vouching is made at the beginning of auditing.

Answer to Question No. 8(c)

Cost Audit is also a form of statutory audit. As per section 233B of Companies Act, manufacturing companies covered by cost audit report order are covered by the cost audit. The cost audit is to be conducted a practicing cost accountant or a firm of practicing cost accountants. The cost auditor under this section shall be appointed by the board of directors of the company in accordance with the provisions of sub- section (1B) of section 224 and with the previous approval of the Central Government. However, that before the appointment of any auditor is made by the Board; a written certificate shall be obtained by the Board from the auditor proposed to be so appointed to the effect that the appointment, if made, will be in accordance with the provisions of sub-section (1B) of section 224.

Acost audit conducted by an auditor under this section shall be in addition to the financial audit done under section 224. The cost auditor shall have the same powers and duties in relation to an audit conducted by him under this section as an auditor of a company has under sub-section (1) of section 227 and such auditor shall make his report to the Central Government in such form and within 180 days from the close of the Company's financial year to which the report relates. All other provision to ceiling on audit, Qualification and disqualification of auditor etc will apply as applicable for statutory audit.

TEST PAPER 2/2013

Time allowed : 3 hours | *Max. Marks : 100*

PART A

[Answer Question No.1 which is COMPULSORY and any 3 Questions are to be attempted out of 4]

Question No. 1

(a) State, with reasons in brief, whether the following statements are true or false:

(i) Rights shares mean the shares which are issued to promoters for their services.

(ii) Both underwriting commission and brokerage cannot be provided to an individual underwriter.

(iii) As per SEBI guidelines, an amount equal to 50% of the debenture issue must be transferred to debenture redemption reserve before redemption begins.

(iv) Preliminary expenses is an example of intangible asset.

(v) Interim dividend paid is a charge against the profits. (3 marks each)

(b) Write the most appropriate answer from the given options in respect of the following:

(i) Under section 205C of the Companies Act, 1956, the amount in the unpaid dividend account is transferred to the Investor Education and Protection Fund after the lapse of –

(a) 3 Years

(b) 5 Years

(c) 7 Years

(d) 10 Years.

(ii) Discount allowed on the re-issue of forfeited shares cannot exceed –

(a) 10% of the paid-up capital

(b) 10% of the capital re-issued

(c) The amount received on forfeited shares

(d) The amount not received on forfeited shares.

(iii) Redemption of preference shares of a company is –

(a) Compulsory

(b) Optional

(c) Conditional

(d) None of the above.

(iv) Which method is legally allowed for redemption of preference shares –

(a) Issue of fresh equity shares

(b) Sale of assets of the company

(c) Issue of debentures

(d) Loan from the bank.

(v) Profit prior to incorporation of a company is transferred to –

(a) General reserve

(b) Capital reserve

(c) Goodwill account

(d) Statement of profit and loss. *(1 mark each)*

(c) Re-write the following sentences after filling-in the blank spaces with appropriate word(s)/figure(s):

(i) Sections 349 and 350 of the Companies Act, 1956 contain the provisions relating to the manner of determination of net profits for the purpose of calculating the ___________.

(ii) A company may allot fully paid-up shares to promoters or any other party for the services rendered by them without payment is known as issue of shares ___________.

(iii) To determine whether an intangible asset is impaired, an enterprise applies Accounting Standard on ___________ .

(iv) International Accounting Standards (IAS)/International Financial Reporting Standards (IFRS) are issued by the ___________ .

(v) Deferred tax assets are shown under the head ___________ in the balance sheet of a company. *(1 mark each)*

Answer to Question No. 1(a)(i)

Incorrect

Right shares mean an issue of rights to a company's existing shareholders that entitles them to buy additional shares directly from the company in proportion to their existing holdings, within a fixed time period.

Answer to Question No. 1(a)(ii)

Incorrect

Both underwriting commission and brokerage can be paid to an individual underwriter.

Answer to Question No. 1(a)(iii)

Correct

According to the SEBI Guidelines, there must be a Debenture Redemption Reserve Account with a credit balance of 50% of the nominal value of the debenture issue before the commencement of redemption.

Answer to Question No. 1(a)(iv)

Incorrect

Preliminary expense is a fictitious asset. It is a miscellaneous expenditure.

Answer to Question No. 1(a)(v)

Incorrect

Interim dividend thus paid, is undoubtedly an appropriation of profits and as such, it has to be shown on the debit side of the Profit and Loss Appropriation Account.

Answer to Question No. 1(b)(i)

(c) 7 years

Answer to Question No. 1(b)(ii)

(c) the amount received on forfeited shares

Answer to Question No. 1(b)(iii)

(a) compulsory

Answer to Question No. 1(b)(iv)

(a) issue of fresh equity shares

Answer to Question No. 1(b)(v)

(b) Capital reserve

Answer to Question No. 1(c)

(i) Sections 349 and 350 of the Companies Act, 1956 contain the provisions relating to the manner of determination of net profits for the purpose of calculating the **managerial remuneration**.

(ii) A company may allot fully paid-up shares to promoters or any other party for the services rendered by them without payment is known as issue of shares **for consideration other than cash**.

(iii) To determine whether an intangible asset is impaired, an enterprise applies Accounting Standard on **AS 26** .

(iv) International Accounting Standards (IAS)/International Financial Reporting Standards (IFRS) are issued by the **International Accounting Standards Board**.

(v) Deferred tax assets are shown under the **separate** head in the balance sheet of Questia company.

Question No. 2

(a) *The summarized balance sheet of AB Ltd. as on 31st March, 2012 is as follows:*

Equity and Liabilities (₹)

Equity shares of ₹10 each ₹8 called up	*80,000*	
Less : calls in arrears ₹2 per share	*300*	*79,700*
1,000, 11% preference shares of ₹100 each fully paid-up	*1,00,000*	
Less : calls in arrears on 250 shares	*5,000*	
		95,000
Securities premium		*5,300*
Investment allowance		*55,000*
General reserve		*50,000*
Profit and loss (Surplus)		*90,000*
Trade payables		*25,000*
		4,00,000
Assets		
Land and building		*1,50,000*
Plants		*50,000*
Furniture		*25,000*
Investments (Face value ₹50,000)		*45,000*
Stock in trade		*20,000*
Trade receivables		*30,000*
Cash at bank		*80,000*
		4,00,000

The company resolved to :

(i) *Realise investments at ₹40,000.*

(ii) *Forfeit equity shares on which calls are in arrears.*

(iii) *Issue 500, 14% debentures of ₹100 each at premium of 5%.*

(iv) *Forfeit preference shares on which the call money remained unpaid immediately before the redemption of preference shares, holders of 200 shares paid their dues before forfeiture.*

(v) *Re-issue the forfeited preference shares at ₹50 each.*

(vi) *Re-issue the forfeited equity shares at ₹12 each as ₹8 paid-up. Pass necessary journal entries to give effect to the above.* *(10 marks)*

(b) *Laxmi Udyog Ltd., incorporated on 1st May, 2012, received certificate to commence business on 31st May, 2012. They had acquired the business from Mittal & Co. with effect from 1st January, 2012. The purchase consideration was ₹15,00,000 of which ₹3,00,000 was to be paid in cash and ₹12,00,000 in* *the form of fully paid-up shares. The company also issued shares for ₹12,00,000 for cash. Machinery costing ₹7,50,000 was then installed. Assets acquired from Mittal & Co. were – Machinery : ₹9,00,000; Stock : ₹1,80,000; and Patents : ₹1,20,000. During the year 2012, the total sales were ₹54,00,000. The sales per month in the first half-year were one-half of what they were in the later half-year. The net profit of the company after charging the following expenses was ₹3,00,000. Depreciation : ₹1,62,000; Audit fees : ₹22,500; Directors' fees : ₹75,000; Preliminary expenses : ₹18,000; Office expenses : ₹1,17,000; Selling expenses : ₹1,08,000; and Interest to vendor upto 31st May, 2012 : ₹7,500. Ascertain the pre-incorporation and post-incorporation amount of profit.*

(5 marks)

Answer to Question No. 2(a)

IN THE BOOKS OF AB LTD.

JOURNAL ENTRIES

Date	*Particulars*		*Debit Amount ₹*	*Credit Amount ₹*
	Bank A/c	Dr.	40,000	
	Profit and Loss Account	Dr.	5,000	
	To Investments			45,000
	(Being investments realized)			
	Equity share Capital A/c (150 x 8)	Dr.	1,200	
	To Share forfeited A/c (150 x 6)			900
	To calls in arrear A/c (150 x 2)			300
	(Being 150 shares forfeited on which calls are in arrears)			
	Bank A/c	Dr.	52,500	
	To 14% Debentures A/c			50,000
	To premium on debentures			2,500
	(Being debentures issued on premium)			
	Bank (200 x 20)	Dr.	4,000	
	To Calls in arrear			4,000
	(Being amount received from 200 preference shareholders)			
	11% Preference Shares Capital A/c (50 x 100)	Dr.	5,000	
	To Share forfeited A/c (50 x 80)			4,000
	To calls in arrear A/c (50x 20)			1,000
	(Being 50 shares forfeited on which calls are in arrears)			

Date	Particulars	Debit Amount ₹	Credit Amount ₹
	Bank (50 x 50)	2,500	
	Shares forfeited A/c	2,500	
	To 11% Preference Shares Capital A/c (50 x 100)		5,000
	(Being forfeited equity shares reissued)		
	Bank A/c (150 x 8)	1,200	
	Share forfeited A/c (150 x 4)	600	
	To Equity Share Capital (150 x 8)		1,200
	To securities premium reserve (150 x 4)		600
	(Being forfeited equity shares reissued)		
	Share forfeited A/c Dr.	1,800	
	To Capital Reserve A/c		1,800
	(Being amount transferred to capital reserve)		

Answer to Question No. 2(b)

Statement showing profit prior to incorporation for the year ended 31st December 2012

Particulars	*Total Amount*	*Basis of Allocation*	*Pre-incorporation* ₹	*Post–incorporation* ₹
Depreciation	1,62,000	Time	54,000	1,08,000
Audit fees	22,500	Time	7,500	15,000
Director's fees	75,000	Post	-	75,000
Preliminary Expenses	18,000	Post	-	18,000
Office Expenses	1,17,000	Time	39,000	78,000
Selling expenses	1,08,000	Sales	24,000	84,000
Interest to vendors	7,500	Actual	6,000	1,500
Total expense	5,10,000		1,30,500	3,79,500
Gross profit	8,10,000	Sales	1,80,000	6,30,000
Less : Expenses	5,10,000		1,30,500	3,79,500
Net Profit	3,00,000		49,500	2,50,500

Working Notes:

(i) Calculation of Sales Ratio

Pre-incorporation period = ½ x 4 months

Post Incorporation period = (½ x 2 months) + (1x6 months) = 7

Sales Ratio = 2:7

(ii) Time Ratio 1:2

(iii) Gross profit = Net Profit + Pre incorporation Expenses + Post incorporation expenses

= 3,00,000 + 1,30,500 + 3,79,500

= 8,10,000

Question No. 3

(a) *Astro Ltd. has authorised capital of ₹50,00,000 divided into 1,00,000 equity shares of ₹50 each. The company issued for subscription 50,000 shares at the premium of ₹10 each. The entire issue was underwritten as follows :*

Underwriter – X 30,000 shares (firm underwriting – 5,000 shares)

Underwriter – Y 15,000 shares (firm underwriting – 2,000 shares)

Underwriter – Z 5,000 shares (firm underwriting – 1,000 shares)

Out of the total issue, 45,000 shares including firm underwriting were subscribed.

The following were the marked forms :

Underwriter – X 16,000 shares

Underwriter – Y 10,000 shares

Underwriter – Z 4,000 shares

You are required to –

(i) Calculate the liability of each underwriter; and

(ii) Make the accounting entries required to be passed in this regard. (10 marks)

(b) Fortune Ltd. issued ₹70,000, 12% debentures of ₹100 each at a premium of 5% redeemable at 110%.

You are required to —

(i) Show by means of journal entries how you would record the above issue.

(ii) Also show how they would appear in the balance sheet. *(5 marks)*

Answer to Question No. 3(a)

Liability of Underwriters

		X	Y	Z	Total
Gross Liability as per agreement		30,000	15,000	5,000	50,000
Less :	Marked Applications	16,000	10,000	4,000	30,000
	Balance	14,000	5,000	1,000	20,000
Less :	Unmarked Applications 15,000 (i.e. ₹5,000-30,000 divided in the ratio of gross liability	9,000	4,500	1,500	15,000
	Balance	5,000	500	-500	5,000
Less :	Credit of Z's over subscription to X and Y in their Gross liability i.e. 30:15 or 2:1	-333	-167	+500	
Net Liability in respect of unsubscribed shares		4,667	333		5,000
Add :	Liability for firm underwriting	5,000	2,000	500	7,500
	Total liabilities	9,667	2,333	500	12,500

JOURNAL ENTRIES

Date	*Particulars*		*Debit Amount ₹*	*Credit Amount ₹*
	Bank	Dr.	27,00,000	
	To Equity Share application and allotment a/c			27,00,000
	(Being application received for 45,000 shares of ₹50 each at a premium of ₹10 each)			
	Equity Share application and allotment A/c	Dr.	27,00,000	
	To Equity Share Capital			22,50,000
	To securities premium reserve			4,50,000
	(Being shares allotted at a premium)			
	M/s X (4,667 x 60)	Dr.	2,80,020	
	M/s Y (333 x 60)	Dr.	19,980	
	To Equity Share Capital			2,50,000
	To Securities premium reserve			50,000
	(Allotment of 5,000 shares remaining unsubscribed to underwriters being their liability)			

Date	Particulars		Debit Amount ₹	Credit Amount ₹
	Underwriting Commission A/c	Dr.	75,000	
	To M/s X (30,000 x 60 x 2.5%)			45,000
	To M/s Y (15,000 x 60 x 2.5%)			22,500
	To M/s Z (5,000 x 60 x 2.5%)			7,500
	(Being underwriting commission due on issue price of share @2.5%)			
	Bank	Dr.	2,35,020	
	To M/s X			2,35,020
	(Receipt of balance amount from underwriters)			
	M/s Y	Dr.	2,520	
	M/s Z	Dr.	7,500	
	To Bank			10,020
	(Being balance paid to underwriters)			

Answer to Question No. 3(b)

In the books of Fortune Ltd.

Journal Entries

Date	Particulars		Debit Amount ₹	Credit Amount ₹
	Bank A/c	Dr.	73,50,000	
	Loss on issue of Debentures A/c	Dr.	7,00,000	
	12% Debentures A/c			70,00,000
	Securities premium A/c			3,50,000
	Premium on redemption of debentures A/c			7,00,000
	(Being 70,000 debentures of ₹100 each issued at premium of 5% redeemable at premium of 10%)			

Balance Sheet

	Particulars	Note No.	Amount ₹
I.	**EQUITY AND LIABILITIES**		
(1)	Shareholders' Funds		
	Securities premium		3,50,000
(2)	Share Application Money pending allotment		0

	Particulars	*Note No.*	*Amount ₹*
(3)	Non – Current Liabilities		
(a)	Long Term Borrowing		
	12% Debentures		70,00,000
	Premium on Redemption of Debentures		7,00,000
(4)	Current Liabilities		0
	Total		80,50,000
II.	**ASSETS**		
(1)	Non-current Assets		
(a)	Fixed Assets		
(b)	Other Assets		
	Loss on issue of debentures		7,00,000
(2)	Current Assets		
	Bank		73,50,000
	Total		80,50,000

Question 4

(a) *Following is the summarized balance sheet of Victory Ltd. as on 31st March, 2012 :*

Equity and Liabilities	*₹*
Share capital :	
30,000 Equity shares of ₹10 each	*3,00,000*
General reserve	*1,20,000*
Capital reserve	*40,000*
Profit and loss (Surplus)	*1,20,000*
Proposed dividend	*34,000*
Trade payables	*93,700*
Income-tax payable	*11,500*
Provision for tax	*82,500*
	8,01,700
ASSETS	
Freehold Property	*1,20,000*
Plant and Machinery	*50,000*
Stock	*3,10,000*
Trade receivables	*2,13,000*
Bank Balance	*1,07,000*
Cash	*1,700*
	8,01,700

Net profit (before taxation) for the past 3 years ended:

	₹
31-3-2010	*1,38,000*
31-3-2011	*1,83,000*
31-3-2012	*1,97,000*

31st March, 2012 freehold property was valued at ₹1,80,000 and plant and machinery at ₹80,000. Average yield in this type of business is 15% on capital employed. Goodwill of the company is ₹1,00,000. The company transfers 20% of net profits to general reserve, rate of tax is 50%.

You are required to find out –

(i) Value of each equity share; and

(ii) Fair value of each share. *(10 marks)*

(b) State the legal requirements relating to transfer of profits to reserves prior to declaration and payment of dividend. *(5 marks)*

Answer to Question No. 4(a)

Victory Ltd.

Valuation of shares

(i) Intrinsic value method

		₹
Assets:		
Freehold Property	1,80,000	
Plant and machinery	80,000	
Goodwill	1,00,000	
Stock	3,10,000	
Trade Receivables	2,13,000	
Bank balance	1,07,000	
Cash	1,700	
		9,91,700
Less : Liabilities:		
Trade Payables	93,700	
Income tax Payable	11,500	
		1,05,200
Net assets		8,86,500

$$\text{Intrinsic value of shares (each share)} = \frac{\text{Net Assets}}{\text{No. of shares}}$$

$$= ₹\frac{8,86,500}{30,000} = ₹\ 29.55$$

(ii) Yield value method

	₹
Total profit of last three years	5,18,000
Average profit (5,18,000/3)	1,72,666
Less : Tax (50%)	86,333
Net profit	86,333
Less : Transfer to reserve @ 20% of ₹86,333	17,267
Profit available for dividend	69,066

Rate of Dividend = (69,066 x 100 /300,000)

= 23.02%

Yield value of each share = (23.02 x 10) / 15

= 15.35

(iii) Fair value method

$$\text{Fair value of each share} = \frac{\text{Intrinsic Value} + \text{Yield Value}}{2}$$

= (29.55 + 15.34) / 2

= 22.44

Answer to Question No. 4(b)

Under Section 205(2A) of the Companies Act, 1956 before declaration and payment of dividend, a company is required to transfer such percentage of its profits for the year to reserves not exceeding 10%. The Central Government has prescribed such percentage by framing the Companies (Transfer of Profits to Reserves) Rules, 1975. Rule 2 of these rules provides that no dividend shall be declared or paid by a company for any financial year out of its profits for that year arrived at after providing for depreciation in accordance with the provisions of Sub-section (2) of Section 205 of the Act except after the transfer to reserves of the company of a percentage of its profits for that year as specified below:

(i) Not less than 2-1/2% of the current profits, if the proposed dividend exceeds 10% but not 12-1/2% of the paid-up capital.

(ii) Not less than 5% of the current profits, if the proposed dividend exceeds 12-1/2% but not 15% of thepaid-up capital.

(iii) Not less than 7-1/2% of the current profits, if the proposed dividend exceeds 15% but not 20% of the paid-up capital.

(iv) Not less than 10% of the current profits, if the proposed dividend exceeds 20% of the paid-up capital.

Where the proposed dividend is exactly 10% or less of the paid-up capital of the company, it is not obligatory on the part of the company to transfer a portion of its profits to the reserves. In such a case, it is entirely left to the discretion of the Board of directors of the company whether to transfer a portion of its profits to the reserves or not.

A company may voluntarily transfer more than 10% of the profits to the reserves for any financial year provided however that:

(i) where a dividend is declared:

(a) a minimum distribution sufficient for the maintenance of dividends to shareholders at a rate equal to the average of the rates at which dividends declared by it over the three years immediately preceding the financial year; or

(b) in a case where bonus shares have been issued in the financial year in which the dividend is declared or in the three years immediately preceding, the financial year, a minimum distribution sufficient for the maintenance of dividends to shareholders at an amount equal to the average amount (quantum) of dividend declared over the three years immediately preceding the financial year, is ensured:

Provided that in a case where the net profits after tax are lower by 20 per cent or more than the average net profits after tax of the two financial years immediately preceding, it shall not be necessary to ensure such minimum distribution.

(ii) where no dividend is declared, the amount proposed to be transferred to its reserves from the current profits shall be lower than the average amount of the dividends to the shareholders declared by it over the three years immediately preceding the financial year.

Question 5

(a) Journalise the following transactions:

(i) 950, 14% Debentures of ₹100 each, issued at par and redeemable at par, were converted into equity shares of ₹10 each issued at par.

(ii) 950, 14% Debentures of ₹100 each, issued at par and redeemable at par, were converted into equity shares of ₹10 each issued at a discount of 5%.

(iii) ₹95,000, 14% Debentures of ₹100 each, issued at par and redeemable at par, were converted into equity shares of ₹10 each issued at ₹9.5 paid.

(9 marks)

(b) What are the desirable conditions for internal re-construction ? *(6 marks)*

Answer to Question No. 5(a)

Journal entries

	Particulars		*Dr.(₹)*	*Cr.(₹)*
(i)	14% Debentures A/c	Dr.	95,000	
	To Debenture holders A/c			95,000
	(Being the amount due to debenture holders)			
	Debenture holders' A/c	Dr.	95,000	
	To Equity Share Capital A/c			95,000
	(Being the issue of 9,500 equity shares of ₹10 each at par on conversion of 950 debentures)			

	Particulars		*Dr.(₹)*	*Cr.(₹)*
(ii)	14% Debentures A/c	Dr.	95,000	
	To Debenture holders A/c			95,000
	(Being the amount due to debenture holders)			
	Debenture holders' A/c	Dr.	95,000	
	Discount on Issue of Shares A/c		5,000	
	To Equity Share Capital A/c			1,00,000
	(Being the issue of 10,000 equity shares of ₹10 each at 5% discount on conversion of 950 debentures)			
(iii)	14% Debentures A/c	Dr.	95,000	
	To Debenture holders A/c			95,000
	(Being the amount due to debenture holders)			
	Debenture holders' A/c	Dr.	95,000	
	To Equity Share Capital A/c			95,000
	(Being the issue of 10,000 equity shares of ₹10 each as ₹9.50 paid up on conversion of 950 debentures)			

Answer to Question No. 5(b)

When a company has been making losses for a number of years and the financial position does not present a true and fair view of the state of the affairs of the company. In such a company the assets are overvalued, the assets side of the balance sheet consists of fictitious assets, useless intangible assets and debit balance in the profit and loss account. Such a situation does not depict a true picture of financial statements and shows a higher net worth than what the real net worth ought to be. In short the company is over capitalized. Such a situation brings the need for reconstruction.

Reconstruction is a process by which affairs of a company are reorganized by revaluation of assets, reassessment of liabilities and by writing off the losses already suffered by reducing the paid up value of shares and/or varying the rights attached to different classes of shares. It means reconstruction of a company's financial structure. Reconstruction of company's financial structure can take place either with or without the liquidation of the company.

When the company reconstructs its financial structure internally without undergoing liquidation, it is internal reconstruction. Under this scheme company continues its legal existence. A scheme of re-organisation is prepared in which all parties sacrifice. It also means the reduction of capital to cancel any paid up share capital which is lost or not represented by available assets. This is done to write off the losses of the company.

Desirable conditions of internal reconstruction

Internal reconstruction is done by the company when:

- there is an overvaluation of assets and undervaluation of liabilities.
- there is a difficulty to meet the financial crisis and there are continuous losses.

PART B

(Answer any two out of the three from this part)

Question No. 6

(a) Explain the Materiality concept in Auditing. (5 marks)

(b) What do you mean by peer review in auditing ? Explain in brief. (5 marks)

(c) Explain the advantages of independent auditing. (5 marks)

Answer to Question No. 6(a)

Materiality is a concept or convention within auditing and accounting relating to the importance/significance of an amount, transaction, or discrepancy. The objective of an audit of financial statements is to enable the auditor to express an opinion whether the financial statements are prepared, in all material respects, in conformity with an identified financial reporting framework such as Generally Accepted Accounting Principles (GAAP). The assessment of what is material is a matter of professional judgment.

Materiality can be defined as the magnitude of an omission or misstatement of accounting information that, in the light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or misstatement.

SA 320 "Materiality in Planning and Performing an Audit", establishes standards on the concept of materiality and the relationship with audit risk while conducting an audit. Hence, the auditor requires more reliable evidence in support of material items. SA 320 defines material items as relatively important and relevant items, i.e., items the knowledge of which would influence the decision of the user of financial statements.

The auditor has to ensure that material items are properly and distinctly disclosed in the financial statements. The concept of materiality is fundamental to the process of accounting. It covers all the stages from recording to classification and presentation. It is very important for the auditor who has constantly to judge whether a particular item is material or not. There is an inverse relationship between materiality and the degree of audit risk. The higher the materiality level, the lower the audit risk and vice versa. For example, the risk that a particular account balance or class of transactions could be misstated by an extremely large amount might be very low but the risk that it could be misstated by an extremely small amount might be very high.

Answer to Question No. 6(b)

Peer Review means an examination and review of the systems and procedures to determine whether they have been put in place by the practice unit for ensuring the quality of attestation services as envisaged and implied/mandated by the Technical Standards and whether these were effective or not during the period under review. Practice Unit means members in practice, whether practising individually or a firm of Chartered Accountants. Attestation Services means services involving the auditing or verification of financial transactions, books, accounts or records, or the preparation, verification or certification of financial accounting and related statements as defined under section 2(2)(ii) of the Chartered Accountants Act, 1949. There are certain specific exclusions like Management Consulting Engagements, Representing a client before the Authorities, etc. Technical Standards mean and include:

- Accounting, Auditing and Assurance Standards issued by the ICAI;
- Statements issued by the ICAI;
- Guidance Notes issued by the ICAI;
- Notifications/Directions including those of Self Regulatory nature issued by the ICAI; and
- Various relevant Statutes and/or Regulations which are applicable.

Answer to Question No. 6(c)

The fact that audit is compulsory by law, in certain cases by itself should show that there must be some positive utility in it. The chief utility of audit lies in reliable financial statement on the basis of which the state of affairs may be easy to understand. Apart from this obvious utility, there are other advantages of audit. Some or all of these are of considerable value even to those enterprises and organization where audit is not compulsory, these advantages are given below:

(a) It safeguards the financial interest of persons who are not associated with the management of the entity, whether they are partners or shareholders.

(b) It acts as a moral check on the employees from committing defalcations or embezzlement.

(c) Audited statements of account are helpful in setting liability for taxes, negotiating loans and for determining the purchase consideration for a business.

(d) This are also use for settling trade disputes or higher wages or bonus as well as claims in respect of damage suffered by property, by fire or some other calamity.

(e) An audit can also help in the detection of wastage and losses to show the different ways by which these might be checked, especially those that occur due to the absence of inadequacy of internal checks or internal control measures.

(f) Audit ascertains whether the necessary books of accounts and allied records have been properly kept and helps the client in making good deficiencies or inadequacies in this respects. As an appraisal function, audit reviews the existence and operations of various controls in the organizations and reports weakness, inadequacy, etc., in them.

(g) Audited accounts are of great help in the settlement of accounts at the time of admission or death of partner.

(h) Government may require audited and certificated statement before it gives assistance or issues a licence for a particular trade.

Question No. 7

(a) What are the reasons of carrying out investigations? Is there any difference between "Auditing and Investigation". (10 marks)

(b) Explain the qualities of good working papers. *(5 marks)*

Answer to Question No. 7(a)

Reasons for carrying out investigation

The real objective of conducting an investigation by an auditor on behalf of his client is to provide him the desired information in the form of a report about the matter specified. Normally the objective of investigation is to collect, analyze and evaluate facts in respect of desired field of activity with a view on some special purpose as determined by the person on whose behalf the investigation is undertaken.

The common reasons of getting the investigation done are listed below:

(a) Proposed purchase of business.

(b) Proposed sale of business.

(c) Reasons for low profitability.

(d) Cause of high employee turnover.

(e) Reliability of business data.

(f) Proposed investment in particular securities.

(g) Suspected fraud.

(h) Joining in existing partnership business.

(i) Borrowing funds.

(j) Lending funds.

(k) Proposed purchase of controlling shares in a company.

(l) Suspected misfeasance against directors.

(m) Detection of undisclosed income for tax purposes.

(n) Suspected misappropriation by trustees.

Difference between Auditing and Investigation

1 *Legal binding* : Audit of annual financial statements of a company is compulsory under the Companies Act, 1956. However, Investigation is not compulsory under the Companies act, 1956 but voluntary depending upon necessity.

2 *Object in view* : Audit is conducted to ascertain whether the financial statements show a true and fair view. Investigation is conducted with a particular object in view, viz to know financial position, earning capacity, prove fraud, invest capital, etc.

3 *Period covered* : Audit is conducted on annual basis. Investigation may be conducted for several years at a time, say three years.

4 *Parties for whom conducted* : Audit is conducted on behalf of shareholders (or

proprietor, or partners). Investigation is usually conducted on behalf of outsiders like prospective buyers, investors, lenders, etc.

5 *Documents* : Audit is not carried out of audited financial statements. Investigation may be conducted even though the accounts have been audited.

6 *Extent of work* : Audit is normally conducted on test verification basis. Investigation is a thorough examination of books of accounts.

7 *Report* : Audit report of a company is addressed to shareholders (or proprietors or partners). Investigation report is addressed to the party on whose instruction investigation was conducted.

8 *Person performing work* : Audit is to be conducted by a person having prescribed qualification i.e. Chartered accountant, Cost accountant. No statutory qualification is prescribed for Investigation. It may be undertaken by any one.

Answer to Question No. 7(b)

Working papers are the property of the auditor. The auditor may, at his discretion, make portions of or extracts from his working papers available to his client.

The auditor should adopt reasonable procedures for custody and confidentiality of his working papers

General guidelines for the preparation of working papers are:

(a) *Clarity and Understanding* – As a preparer of audit documentation, step back and read your work objectively. Would it be clear to another auditor? Working papers should be clear and understandable without supplementary oral explanations. With the information the working papers reveal, a reviewer should be able to readily determine their purpose, the nature and scope of the work done and the preparer's conclusions.

(b) *Completeness and Accuracy* – As a reviewer of documentation, if you have to ask the audit staff basic questions about the audit, the documentation probably does not really serve the purpose. Work papers should be complete, accurate, and support observations, testing, conclusions, and recommendations. They should also show the nature and scope of the work performed.

(c) *Pertinence* – Limit the information in working papers to matters that are important and necessary to support the objectives and scope established for the assignment.

(d) Logical Arrangement – File the working papers in a logical order.

(e) *Legibility and Neatness* – Be neat in your work. Working papers should be legible and as neat as practical. Sloppy work papers may lose their worth as evidence. Crowding and writing between lines should be avoided by anticipating space needs and arranging the work papers before writing.

(f) *Safety* – Keep your work papers safe and retrievable.

(g) *Initial and Date* – Put your initials and date on every working paper.

(h) *Summary of conclusions* – Summarize the results of work performed and identify the overall significance of any weaknesses or exceptions found.

Question No. 8

(a) *What do you mean by Internal check? Explain the difference between Internal control and Internal checks ?*

(b) *Write a short note on the rights of a cost auditor of a company.*

(c) *Write a short note on Filling of Casual Vacancy of Auditors.* *(5 marks each)*

Answer to Question No. 8(a)

Internal check is best regarded as indicating checks on the day-to-day transactions which operate continuously as a part of the routine systems whereby work of one person is proved independently or is complementary to the work of another, the object being the prevention of or early detection of errors and frauds". The main objective of internal check is prevention of errors and frauds and/or detection of errors and frauds at the earliest. Internal check is a continuous process and is part of the day-to-day routine. It relates to all the transactions that take place every day. Internal check is achieved by complementary allocation of duties and by independent verification of the work of one person by another. Internal check is a part of internal control system. It ensures that all financial transactions are properly recorded. It also ensures efficiency of the accounting system followed by the organization and enables easy preparation of financial statements. It achieves its main object of minimizing errors and frauds. A sound system of internal check increases the reliability of financial statements. Internal check discourages fraud and collusion among employees by instilling a fear of detection in their minds. Internal check assigns responsibilities to persons and enables maintenance of records and documents properly and thereby ensures smooth flow of work.

In internal control system, controls other than the internal check system are internal audit system and other non-financial control systems like quality control, purchasing controls, marketing controls etc.

The essence of internal check system is that the check should be automatic, continuous and objective while the essence of internal control system is in implementation of Internal check and Internal audit.

Way of checking : In internal check system work is automatically checked whereas in internal audit system work is checked specially.

Cost involvement : in internal check system checking is done when the work is being done. Mistake can be checked at an early stage in internal check system.

Thrust of system : Thrust of internal check system is to prevent the errors and whereas the thrust of internal audit system is to detect the errors and frauds.

Time of checking : In internal check system checking is done when the work is being done whereas in internal audit system work is checked after it is done. Mistakes can be checked at an early stage in internal check.

Answer to Question No. 8(b)

Cost Audit is also a form of statutory audit. As per section 233B of Companies Act, manufacturing companies covered by cost audit report order are covered by the cost audit. The cost audit is to be conducted a practicing cost accountant or a firm of practicing cost accountants. The cost auditor under this section shall be appointed by the board of directors of the company in accordance with the provisions of sub- section (1B) of section 224 and with the previous approval of the Central Government. However, that before the appointment of any auditor is made by the Board, a written certificate shall be obtained by the Board from the auditor proposed to be so appointed to the effect that the appointment, if made, will be in accordance with the provisions of sub-section (1B) of section 224. An cost audit conducted by an auditor under this section shall be in addition to the financial audit done under section 224. The cost auditor shall have the same powers and duties in relation to an audit conducted by him under this section as an auditor of a company has under sub-section (1) of section 227 and such auditor shall make his report to the Central Government in such form and within 180 days from the close of the Company's financial year to which the report relates. All other provision to ceiling on audit, Qualification and disqualification of auditor etc will apply as applicable for statutory audit.

Answer to Question No. 8(c)

Filling of Casual Vacancy of Auditors

The expression 'casual vacancy' has not been defined in the Companies Act, 1956. In simple words, a casual vacancy in the office of an auditor means a vacancy caused in the office of an auditor by his death, disqualification, resignation, etc. It has been held in the case of the Institute of Chartered Accountants of India v Jnanendranath Saikia (1955) 25 Comp Cas 53, 56 (Assam) that casual vacancy is not a vacancy created by any deliberate omission on the part of the company to appoint an auditor at its annual general meeting. Section 224(6) governs this aspect and relevant provisions are stated hereunder:–

(a) The Board may fill any casual vacancy in the office of an auditor, but while any such vacancy continues, the remaining auditor or auditors, if any, may act.

(b) If any casual vacancy in the office of an auditor is caused by the resignation of an auditor, such vacancy shall only be filled by the company in general meeting.

(c) Any auditor appointed in a casual vacancy shall hold office until the conclusion of the next annual general meeting. It is worth mentioning that where a casual vacancy arises in the auditors appointed by a company due to death or disqualification, the Board of directors may appoint another auditor.

TEST PAPER 3/2013

Time allowed : 3 hours *Max. Marks : 100*

PART A

[Answer Question No.1 which is COMPULSORY and any 3 Questions are to be attempted out of 4]

Question No. 1

(a) *State, with reasons in brief, whether the following statements are correct or incorrect:*

(i) *The forfeited shares can be re-issued at a discount, but it cannot exceed the amount already realised at the time of forfeiture on such shares.*

(ii) *Cumulative preference shareholders can have the voting rights only, if the dividend has not been paid for more than two years.*

(iii) *Profit prior to incorporation can be used by the company for payment of dividend.*

(iv) *It is legally compulsory for every company registered under the Companies Act, 1956 to maintain its financial accounts on the basis of double account system.*

(v) *In case of firm underwriting, the underwriter has a right to get the allotment of that number of shares which has been firmly underwritten by him, though the issue has been oversubscribed by the public.* *(3 marks each)*

(b) *Choose the most appropriate answer from the given options in respect of the following :*

(i) *Subject to the permission of the Central Government, the maximum allowable discount on equity shares is :*

(a) *10%*

(b) *8%*

(c) *9%*

(d) *5%.*

(ii) *Profit on cancellation of own debentures is transferred to :*

(a) *Profit and loss account*

(b) *Profit and loss appropriation account*

(c) *General reserve*

(d) *Capital reserve.*

(iii) Interim dividend is always shown in :

(a) Profit and loss account

(b) Profit and loss appropriation account

(c) Asset side of balance sheet

(d) Liabilities side of balance sheet.

(iv) When shares are forfeited, the share capital account is debited by :

(a) Nominal value of the shares

(b) Called-up amount

(c) Paid-up amount

(d) None of these.

(v) The balance of sinking fund investment account after the realisation of investment is transferred to :

(a) Profit and loss account

(b) Profit and loss appropriation account

(c) Debentures account

(d) Sinking fund account. *(1 mark each)*

(c) Re-write the following sentences after filling-up the blank spaces with appropriate word(s)/figure(s) :

(i) The person who failed to pay the call-money is liable to pay the interest on calls-in-arrears at a rate not exceeding ________ per annum from the due date money called for payment upto the date of actual payment.

(ii) The maximum rate of commission to underwriters for underwriting the shares is ________ for amounts upto ₹5 lakh.

(iii) The maximum limit for managerial remuneration for all managerial personnel in a public limited company (except the fees for attending the meetings) is ________ per cent of net profit.

(iv) It is obligatory on the part of company to transfer to reserves of the company not less than _________ of current profit, if the proposed dividend exceeds 20% of paid-up capital.

(v) A company cannot issue redeemable preference shares for a period exceeding_________. *(1 mark each)*

Answer to Question No. 1(a)(i)

Correct

If forfeited shares are re-issued at a discount, the amount of discount can, in no case, exceed the amount credited to Shares Forfeited Account.

Answer to Question No. 1(a)(ii)

Correct

Section 87 of Companies Act says that a preference shareholder shall be entitled to vote on every resolution placed before the company at any meeting, if the dividend due on such capital or any part of such dividend has remained unpaid- in the case of cumulative preference shares, in respect of an aggregate period of not less than two years preceding the date of commencement of the meeting.

Answer to Question No. 1(a)(iii)

Incorrect

Profit prior to incorporation being of capital nature, cannot be credited to the Profit and Loss Account and thus it cannot ordinarily be used for the purpose of payment of dividend.

Answer to Question No. 1(a)(iv)

Incorrect

Section 209(3) of the Companies Act, 1956 requires that the books of accounts should be maintained on accrual basis and according to double entry system of accounting.

Answer to Question No. 1(a)(v)

Correct

In case of firm underwriting, the underwriters get the priority over the general public, if shares or debentures are oversubscribed. Even if the issue is over subscribed, the underwriter has the right to get the shares or debentures allotted to it as per the underwriting agreement.

Answer to Question No. 1(b)(i)

(a) 10%

Answer to Question No. 1(b)(ii)

(d) Capital reserve

Answer to Question No. 1(b)(iii)

(b) Profit and loss appropriation account

Answer to Question No. 1(b)(iv)

(b) Called-up amount

Answer to Question No. 1(b)(v)

(d) Sinking fund account

Answer to Question No. 1(c)

(i) The person who failed to pay the call-money is liable to pay the interest on calls-in-arrears at a rate not exceeding **5%** per annum from the due date money called for payment upto the date of actual payment.

(ii) The maximum rate of commission to underwriters for underwriting the shares is **2.5%** for amounts upto ₹5 lakh.

(iii) The maximum limit for managerial remuneration for all managerial personnel in a public limited company (except the fees for attending the meetings) is **11** per cent of net profit.

(iv) It is obligatory on the part of company to transfer to reserves of the company not less than **10%** of current profit, if the proposed dividend exceeds 20% of paid-up capital.

(v) A company cannot issue redeemable preference shares for a period exceeding **20 years**.

Question 2

(a) Indra Ltd. issued 10,000 debentures of ₹100 each at a discount of 6%. The expenses on issue amounted to ₹35,000. The debentures have to be redeemed at the rate of ₹1,00,000 each year commencing with end of fifth year. How much discount and expenses should be written off each year ? (5 mark)

(b) Given is the balance sheet of Kalpataru Construction Ltd.

Kalpataru Construction Ltd

BALANCE SHEET

AS AT 31st March , 2012

I. EQUITY AND LIABILITIES		
(1) Sources of Funds		
(a) Share Capital		
Authorized Share Capital		*…………*
Issued, Subscribed Called Up And Paid-Up Share Capital		
1,00,000 equity shares of ₹10 each;		
7.50 per share called-up	*7,50,000*	
Less : Calls unpaid	*7,500*	*7, 42,500*
20,000 12% preference shares of 50 each fully called-up	*10,00,000*	
Less : Calls unpaid (10 per share)	*20,000*	*9,80,000*
(b) Reserve & Surplus		
Securities premium		*50,000*
General Reserve		*6,00,000*
(2) Current Liabilities		
Calls in advance (final call on equity shares)		*2,500*
TOTAL		***23,75,000***

II. ASSETS

(1) Non-current assets	
(a) Fixed Assets	
Fixed Assets	*12,25,000*
(b) Non-Current Investment	
Investment	*2,00,000*
(2) Current Assets	
Cash and Bank Balance	*9,50,000*
TOTAL	***23,75,000***

On 1st April, 2012 the Board of directors decide that:

(a) The fully paid preference shares are to be redeemed at a premium of 5% in May, 2012 and for that purpose 50,000 equity shares of ₹10 each are to be issued at par in the month of April, 2012.

(b) The 1,000 equity shares owned by A an existing shareholder, who has failed to pay the allotment money and the 1st call money @ ₹2.50 each share are to be forfeited in the month of June, 2012.

(c) The final call of ₹2.50 per share is to be made in the month of July, 2012.

All the above are duly complied with according to the time schedule. The amount due on the issue of fresh equity shares and on final call are also duly received except from B who had failed to pay the 1st call money for his 1,000 shares holding, has again failed to pay the final call also. These shares of B have been forfeited, in the month of August, 2012. On the total shares forfeited, 1,500 shares are sold to X in September, 2012 credited as fully paid for ₹9 per share, the whole of A's shares being included.

Show the necessary journal entries and prepare the balance sheet of the company as on 30th September, 2012. *(10 mark)*

Answer to Question No. 2(a)

Total amount of discount and expenses is ₹95,000.

It should be written off each year according to the ratios of the amounts outstanding.

Years	*Ratio*
1	10
2	10
3	10
4	10
5	10

6	9
7	8
8	7
9	6
10	5
11	4
12	3
13	2
14	1
Total of ratios =	95

In each of the first five years, discount to be written off will be

$$= \frac{95,000 \times 10}{95} = ₹10,000$$

In 6th year $= \frac{95,000 \times 9}{95} =$ ₹9,000

In 7th year $= \frac{95,000 \times 8}{95} =$ ₹8,000

In 8th year $= \frac{95,000 \times 7}{95} =$ ₹7,000

In 9th year $= \frac{95,000 \times 6}{95} =$ ₹6,000

In 10th year $= \frac{95,000 \times 5}{95} =$ ₹5,000

In 11th year $= \frac{95,000 \times 4}{95} =$ ₹4,000

In 12th year $= \frac{95,000 \times 3}{95} =$ ₹3,000

In 13th year $= \frac{95,000 \times 2}{95} =$ ₹2,000

In 14th year $= \frac{95,000 \times 1}{95} =$ ₹1,000

Answer to Question No. 2(b)

Journal Entries in the books of Kalpataru Construction Ltd.

Date	*Particulars*		*Dr.(₹)*	*Cr.(₹)*
2012				
April 1	Bank	Dr.	5,00,000	
	To Equity Share Capital A/c			5,00,000
	(Issue of equity shares)			
May	Securities Premium A/c	Dr.	45,000	
	To Premium on Redemption of Preference Shares			45,000
	(Premium on redemption shares transferred)			
May	General Reserve A/c	Dr.	4,00,000	
	To Capital Redemption Reserve A/c			4,00,000
	(Transfer of the required amount from general reserve account)			
May	Preference Share Capital A/c	Dr.	9,00,000	
	Premium on Redemption of Preference Share A/c	Dr.	45,000	
	To Preference Shareholders A/c			9,45,000
	(The amount payable)			
May	Preference Shareholders A/c	Dr.	9,45,000	
	To Bank			9,45,000
	(Amount paid)			
June	Equity Share Capital A/c	Dr.	7,500	
	To Shares Forfeited A/c			2,500
	To Calls in Arrear A/c			5,000
	(A’s Shares forfeited)			
July	Equity Share Final Calls A/c	Dr.	2,47,500	
	To Equity Share Capital A/c			2,47,500
	(Amount due on final call i.e.99,000 shares x ₹2.50)			

Date	*Particulars*		*Dr.(₹)*	*Cr.(₹)*
July	Bank	Dr.	2,42,500	
	Calls in Arrear A/c	Dr.	2,500	
	Calls in Advance A/c	Dr.	2,500	
	To Equity Share Final Call A/c			2,47,500
	(Amount received)			
Aug.	Equity Share Capital A/c	Dr.	10,000	
	To Shares Forfeited A/c			5,000
	To Calls in Arrear A/c			5,000
	(B's shares forfeited)			
Sept.	Bank	Dr.	13,500	
	Share Forfeited A/c	Dr.	1,500	
	To Equity Share Capital A/c			15,000
	(1,500 shares re-issued @ ₹9)			
Sept.	Share Forfeited A/c	Dr.	3,500	
	To Capital Reserve A/c			3,500
	(Profit on reissue of forfeited shares)			

Dr. **Shares Forfeited Account** *Cr.*

Particulars	₹	*Particulars*	₹
To Equity Share Capital A/c	1,500	By Equity Share Capital A/c	
To Capital Reserve A/c		(A's shares)	2,500
(Balancing figure)	3,500	By Equity Share Capital A/c	
To Balance c/d		(B's shares)	5,000
(500 Shares @ ₹5)	2,500		
	7,500		7,500

Bank Account

Particulars	₹	*Particulars*	₹
To Balance b/d	9,50,000	By Pref. Shareholders	9,45,000
To Equity Share Capital A/c	5,00,000	By Balance c/d	7,61,000
To Equity Share Final Call A/c	2,42,500		
To Equity Share Capital A/c	13,500		
	17,06,000		17,06,000

KALPATARU CONSTRUCTION LTD.

BALANCE SHEET

AS ON 30 September, 2012

I.	**EQUITY AND LIABILITIES**		
(1)	**Sources of Funds**		₹
(a)	*Share Capital*		
	Authorized Share Capital:-		....
	Issued, Subscribed Called Up And Paid-Up Share Capital:-		
	1,49,500 Equity Shares @ ₹10		14, 95,000
	2,000 Preference shares of ₹50 each, fully called up	1, 00,000	
	Less Calls in arrears	20,000	80,000
	Equity Shares Forfeited Account		2,500
(b)	*Reserve & Surplus*		
	Capital Reserve	3,500	
	Capital Redemption Reserve	4, 00,000	
	Securities Premium Account	5,000	
	General Reserve	2,00,000	6,08,500
	TOTAL		**21,86,000**
II.	**ASSETS**		
1.	**Non-current assets**		
(a)	*Fixed Assets*		
	Fixed Assets		12, 25,000
(b)	*Non Current Investment*		
	Investment		2, 00,000
(2)	**Current Assets**		
	Cash and Bank Balance		7, 61,000
	TOTAL		**21,86,000**

Question No. 3

Thin & Co. Ltd. was absorbed by Thick & Co. Ltd., as on 30th June, 2012. All the assets and liabilities of Thin & Co. Ltd. was taken over by Thick & Co. Ltd. The consideration was agreed at ₹ 3,36,600 and was paid in so many fully paid equity shares of Thick & Co. Ltd. to be distributed to the equity shareholders of Thin & Co. Ltd. The following are the balance sheets of both the companies as on 30.6.2012.

		Thick & Co Limited		Thin & Co Limited	
		₹	₹	₹	₹
I	EQUITIES AND LIABILITIES				
1	Shareholders' funds				
	(a) Share Capital				
	Authorised, Issued subscribed and paid up capital				
	Equity shares of ₹10 each, fully called up and paid up		7,50,000		2,00,000
	(b) Reserve and surplus				
	General reserve	1,50,000		50,000	
	Profit and Loss account	20,502	1,70,502	12,900	62,900
2	Non-current liabilities				
	Workman compensation fund	12,000		9,000	
	Employee provident fund	10,000	22,000	4,000	13,000
3	Current Liabilities				
	Creditors	58,567		30,456	
	Provision for taxation	12,000	70,567	5,000	35,456
	TOTAL		10,13,069		3,11,356
II	ASSETS				
1	Non-current Assets				
	(a) Fixed Assets				
	(i) Tangible Assets Plant & machinery	3,12,000		1,00,000	
	(ii) Intangible Assets				
	Goodwill	2,00,000	5,12,000	60,000	1,60,000
2	Current Assets				
	Stock	2,65,000		80,000	
	Debtor	2,21,200		56,000	
	Cash in hand	869		356	
	Cash at bank	14,000	5,01,069	8,300	1,44,656
	Other current Assets				
	Prepaid Insurance	–	–		700
	Income Tax Refund claim	–	–		6,000
	TOTAL		10,13,069		3,11,356

You are required to:

(i) Show the necessary ledger accounts in the books of Thin & Co. Ltd.;

(ii) Show the necessary journal entries in the books of Thick & Co. Ltd.; and

(iii) Prepare the Balance Sheet of Thick & Co. after the amalgamation. (15 marks)

Answer to Question No. 3

Ledger of Thin & Co. Ltd.

Realisation Account

Dr.	₹		*Cr.* ₹
To Goodwill	60,000	By Sundry Creditors	30,456
To Plant and Machinery	1,00,000	By Staff Provident Fund	4,000
To Stock-in-Trade	80,000	By Provision for Taxation	5,000
To Sundry Debtors	56,000	By Thick & Co. Ltd.	3,36,600
To Income-tax Refund Claim	6,000		
To Prepaid Insurance	700		
To Cash in Hand	356		
To Cash at Bank	8,300		
To Equity Shareholders (Profit)	64,700		
	3,76,056		3,76,056

Thick & Co. Ltd.

	₹		₹
To Realisation A/c	3,36,600	By Equity Shares in Thick & Co. Ltd.	3,36,600

Equity Shares in Thick & Co. Ltd.

	₹		₹
To Thick & Co. Ltd.	3,36,600	By Equity Shareholders A/c	3,36,600

Equity Shareholders Account

	₹		₹
To Equity Shares in Thick & Co. Ltd. A/c	3,36,600	By Equity Share Capital A/c	2,00,000
		By General Reserve A/c	50,000
		By Profit and Loss A/c	12,900
		By Workmen Compensation Fund	9,000
		By Realisation A/c	64,700
	3,36,600		3,36,600

Journal Entries in the Books of Thick & Co. Ltd.

Particulars		*Dr. (₹)*	*Cr.(₹)*
Business Purchase A/c	Dr.	3,36,600	
To Liquidator of Thin & Co. Ltd.			3,36,600
(Being the amalgamation of business of Thin Co. Ltd. as per agreement dated......			
Goodwill	Dr.	60,000	
Plant and Machinery	Dr.	1,00,000	
Stock in Trade	Dr.	80,000	
Sundry Debtors	Dr.	56,000	
Prepaid Insurance	Dr.	700	
Income tax Refund Claim	Dr.	6,000	
Cash in Hand	Dr.	356	
Cash at Bank	Dr.	8,300	
General Reserve	Dr.	73,700	
To Workman Compensation Fund			9,000
To Sundry Creditors			30,456
To Staff Providend Fund			4,000
To Provision for Taxation			5,000
To Business Purchase A/c			3,36,600
(Being the assets, liabilities and reserves of Thin Ltd. at book value transferred and the difference in consideration and equity share capital being adjusted against in the general reserve of Thin Ltd.)			
Liquidator of Thin & Co. Ltd.	Dr.	3,36,600	
To Equity Share Capital			3,36,600
(Being the allotment of 33,360 equity shares of ₹10 each to the transferor company as consideration)			

Question No. 4

(a) *What is Value Added Statement (VAS)? State the merit and demerit of VAS.* *(5 mark)*

(b) *Z Limited is having the net profit before interest of ₹170 Lakhs. It has got Share Capital of ₹10 Crore and 5% debentures worth ₹500 Lakhs. The company cost of capital is 8%. Calculate the economic value added. Treat taxation as 30%.* *(10 mark)*

Answer to Question No. 4(a)

Value added can be defined as the value created by the activities of a firm and its employees, that is, sales less the cost of bought in goods and services. The value added statement (VAS) reports on the calculation of value added and its allocation among the stakeholders in the company. In general words, "value added can be defined as wealth generated by the entity through the collective efforts of capital providers, management and employees".

Merits of Value Added Statement

— It is an alternative performance measure to profit and therefore helps in the comparison of the performance of the company. Value added is superior performance measure because it pays attention on inputs which are under the control of the management.

— By employing various productivity measures like value added per rupee of capital employed, value added per rupee sales, value added per employee etc., it helps in judging the productivity of the company.

— Resource allocation decisions are normally based on the concept of maximizing profit but value added statement provides a better alternative by focusing on other factors rather than just profit.

— It also helps in devising the incentives schemes for the employees of the company in a better way.

— It reflects a broader view of the company's objectives and responsibilities rather than just focusing only on the small aspects about the company.

Demerits of Value added Statement

— The treatment of depreciation resulting in gross and net value added;

— The treatment of taxes like pay-as-you-earn, fringe benefits and other benefits in the employees' share of value added;

— The timing of recognition of value added - production or sales;

— The treatment of taxes such as VAT /GST and deferred tax; and

— The treatment of non-operating items.

— This has resulted in a company having more than one possible value added figure and that the allocation of value added between the various stakeholders can be presented in different ways.

Answer to Question No. 4(b)

Calculation of Economic Value Added

	₹ In Lakhs
Earnings before Interest and Taxes (EBIT)	170.00
Less : Interest (5% of ₹500 lakhs)	25.00
Net Operating Profit before taxes	145.00
Less : Taxes (30%)	43.50
Net Operating Profit after taxes	101.50
Less : Cost of Equity Capital (8% of ₹1000 lakhs)	80.00
Economic Value Added (EVA)	21.50

Question No. 5

(a) *The following particulars relate to a limited company which has gone into voluntary liquidation. You are required to prepare the Liquidator's Final Account, allowing for his remuneration @ 2% on the amount realised, and 2% on the amount distributed among unsecured creditors other than preferential creditors :–*

Preferential Creditors	*10,000*
Unsecured Creditors	*32,000*
Debentures	*10,000*
The assets realised the following sums:–	
Land and Buildings...	*20,000*
Plant and Machinery	*18,650*
Fixtures and Fittings	*1,000*

The liquidation expenses amounted to ₹1,000. *(10 mark)*

(b) *Okay Ltd. estimated its expenditure on repairs of machinery over a period of 10 years at ₹1,00,000 and decided to raise a Provision for Repairs and Renewals Account by debiting its Profit and Loss Account with a uniform figure every year. The actual repairs in the 1st, 2nd and 3rd years were respectively ₹3,000, ₹4,500 and ₹7,000. Prepare provision for Repairs & Renewals Account.* *(5 marks)*

Answer to Question No. 5(a)

Liquidator's Final statement of Account

Receipts	*Amount*	*Payments*	*Amount*
To Assets realised		By Liquidation Expenses	1,000
Land and Buildings	20,000	By Liquidators Remuneration	
Plant and machinery	18,650	(₹793 + 350) (Working Note)	1,143
Fixtures and Fittings	1,000	By Preferential Creditors	10,000
		By Debenture holders	10,000
		By Unsecured creditors	17,507
	39,650		39,650

Working Note:

	₹
Total of Receipts side	39,650
Less:	
Liquidation Expenses	1,000
By Liquidators Remuneration (2% on Total Receipts)	793
Preferential Creditors	10,000
Debenture holders	10,000
Amount available for Unsecured Creditors and Liquidators Remuneration	17,857

Liquidators commission on payment made to unsecured creditors
= 2/102 x ₹17857 = ₹350

Answer to Question No. 5(b)

Dr. *Cr.*

Date	*Particulars*	₹	*Date*	*Particulars*	₹
1st year	To Bank	3,000	1st year	By Profit and Loss A/c	10,000
	To Balance c/d	7,000			
		10,000			10,000
2nd year	To Bank	4,500	2nd year	By Balance b/d	7,000
	To Balance c/d	12,500		By Profit and Loss A/c	10,000
		17,000			17,000
3rd year	To Bank	7,000	3rd year	By Balance b/d	12,500
	To Balance c/d	15,500		By Profit and Loss A/c	10,000
		22,500			22,500

PART B

(Answer any two out of the three from this part.)

Question No. 6

(a) *Write a short note on the term Audit in depth.* *(5 marks)*

(b) *What do you mean by the term Vouching ? Explain the importance of vouching in Auditing.* *(5 marks)*

(c) *Explain the advantages of internal Audit in a Company.* *(5 marks)*

Answer to Question No. 6(a)

— Audit is undertaken by an independent person or body of persons who are duly qualified for the job.

— Audit is a systematic and scientific examination of the books of accounts of a business.

— Audit is a verification of the results shown by the profit and loss account and the state of affairs as shown by the balance sheet.

— Audit is a critical review of the system of accounting and internal control.

— Audit is done with the help of vouchers, documents, information and explanations received from the authorities.

— The auditor has to satisfy himself with the authenticity of the financial statements and report that they exhibit a true and fair view of the state of affairs of the concern.

— The auditor has to inspect, compare, check, review, scrutinize the vouchers supporting the transactions and examine correspondence, minute books of share holders, directors, Memorandum of Association and Articles of association etc., in order to establish correctness of the books of accounts.

Institute of Chartered Accountants of India (ICAI) defines Auditing as- Auditing is defined as a systematic and independent examination of data, statements, records, operations and performance of an enterprise for a stated purpose. In any auditing situation, the auditor perceives and recognizes the propositions before him for examination, collect evidence, evaluates the same and on this basis formulates his judgement which is communicated through his audit report". Thus the meaning of the term Audit contains

— An intelligent and critical examination of the books of accounts of business.

— It is done by an independent qualified person.

— It is done with the help of vouchers, documents, information and explanations received from the clients.

— The auditor satisfies himself with the authenticity of the financial accounts prepared for a particular period.

Answer to Question No. 6(b)

Vouching : Vouching means the examination of documentary evidence in support of entries passed in order to establish their arithmetic accuracy. When the auditor checks the entries with some documents it is called vouching. Vouching is the acid test of audit. It tests the truth of the transaction recorded in the books of accounts. It is an act of examining documentary evidence in order to ascertain the accuracy and authenticity of the entries in the books of accounts.

According to **Dicksee**, "Vouching consists of comparing entries in the books of accounts with documentary evidence in support thereof."

Thus, vouching means testing the truth of entries appearing in the primary books of accounts. In short, vouching means to examine the evidence in support of any transaction or entry recorded in the books of accounts. Vouching does not merely see that the entries and transactions are supported by proper documentary evidence. The auditor should be satisfied that they are properly maintained, they are supported by all evidence and they are correctly recorded in the books of accounts. Following points enumerate the importance of vouching in auditing:

- Ensures genuineness of the transactions
- Enables to know transactions
- Helps to know relevance of the transaction
- Facilitates proper allocation of capital & revenue, expenditure
- Detects frauds and errors
- Decides authenticity of transactions
- Ensures proper accounting
- Compliance with law
- Ensures proper disclosure

Answer to Question No. 6(c)

Advantages of internal audit in a company: Management is responsible for establishing and maintaining a system of internal controls within an organization. Internal controls are those structures, activities, processes, and systems which help management effectively mitigate the risks to an organization's achievement of objectives. Management is charged with this responsibility on behalf of the organization's stakeholders and is held accountable for this responsibility by an oversight body (e.g. board of directors, audit committee, elected representatives). A dedicated, independent and effective internal audit activity assists both management and the oversight body (e.g. the board, audit committee) in fulfilling their responsibilities by bringing a systematic disciplined approach to assessing the effectiveness of the design and execution of the system of internal controls and risk management processes. The objective assessment of internal controls and risk management processes by the internal audit activity provides management, the oversight body, and external stakeholders with independent assurance that the organization's risks have been appropriately mitigated. Because internal auditors are experts in understanding organizational risks and internal controls available to mitigate these risks, they assist management in understanding these topics and provide recommendations for improvements. Besides above, Internal Audit has become an important management tool for the following reasons:

— It ensures compliance of Companies (Auditors Report) Order, 2003.

— Internal Auditing is a specialized service to look into the standards of efficiency of business operation.

— Internal Auditing can evaluate various problems independently in terms of overall management control and suggest improvement.

— Internal Audit's independent appraisal and review can ensure the reliability and promptness of MIS and the management reporting on the basis of which the top management can take firm decisions.

— Internal Audit system makes sure the internal control system including accounting control system in an organization is effective.

— Internal Audit ensures the adequacy, reliability and accuracy of financial and operational data by conducting appraisal and review from an independent angle.

— Internal Audit is an integral part of "Management by System".

— Internal Audit can break through the power ego and personality factors and possible conflicts of interest within the organization.

— It ensures compliance of accounting procedures and accounting policies.

— Internal Auditor can be of valuable assistance to management in acquiring new business, in promoting new products and in launching new projects for expansion or diversification of business.

Question No. 7

(a) What are the reasons of carrying out review of internal control? Write a short internal control review checklist for review of management information system. *(10 marks)*

(b) Explain the objectives of internal control system in an organisation. *(5 marks)*

Answer to Question No. 7(a)

The auditor needs reasonable assurance that the accounting system is adequate and that all the accounting information which should be recorded has in fact been recorded. Internal control normally contributes to such assurance. The auditor should gain an understanding of the accounting system and related internal controls and should study and evaluate the operations of these internal controls upon which he wishes to rely in determining the nature, timing and extent of other audit procedures. The review of internal controls will enable the auditor to know:

— whether errors and frauds are likely to be located in the ordinary course of operations of the business;

— whether an adequate internal control system is in use and operating as planned by the management;

— whether an effective internal auditing department is operating;

— whether any administrative control has a bearing on his work (for example, if the control over worker recruitment and enrolment is weak, there is a likelihood of dummy names being included in the wages sheet and this is relevant for the auditor);

— whether the controls adequately safeguard the assets;

— how far and how adequately the management is discharging its function in so far as correct recording of transactions is concerned;

— how reliable the reports, records and the certificates to the management can be;

— the extent and the depth of the examination that he needs to carry out in the different areas of accounting;

— what would be appropriate audit technique and the audit procedure in the given circumstances;

— what are the areas where control is weak and where it is excessive; and

— whether some worthwhile suggestions can be given to improve the control system.

The auditor can formulate his entire audit programme only after he has had a satisfactory understanding of the internal control systems and their actual operation. If he does not care to study this aspect, it is very likely that his audit programme may become unwieldy and unnecessarily heavy and the object of the audit may be altogether lost in the mass of entries and vouchers. It is also important for him to know whether the system is actually in operation. Often, after installation of a system, no proper follow up is there by the management to ensure compliance. The auditor, in such circumstances, may be led to believe that a system is in operation which in reality may not be altogether in operation or may at best operate only partially. This state of affairs is probably the worst that an auditor may come across and he would be in the midst of confusion, if he does not take care.

A checklist for internal control review of Management information System is given below:

— Is there a separate EDP department within the company?

— Are all processing pre-scheduled and authorized by appropriate personnel?

— Are there procedures to evaluate and establish who has access to the data in the database?

— Are the EDP personnel adequately trained?

— Are systems analysts programmers denied access to the computer room and limited in their operation of the computer?

— Are operators barred from making changes to programs and from creating or amending data before, during, or after processing?

— Is the custody of assets restricted to personnel outside the EDP department?

— Is strategic data processing plan developed by the company for the chievement of long-term business plan?

— Are there any key personnel within IT department whose absence can leave the company within limited expertise?

— Are there any key personnel who are being over-relied?

— Is EDP audit being carried by internal audit or an external consultant to ensure compliance of policies and controls established by management?

Answer to Question No. 7(b)

Internal audit evaluates the organisation's system of internal control by accessing the ability of individual process controls to achieve seven pre-defined control objectives. The objectives of internal control system in an organisation include:

— *Authorization* - the objective is to ensure that all transactions are approved by responsible personnel in accordance with their specific or general authority before the transaction is recorded.

— *Completeness* - the objective is to ensure that no valid transactions have been omitted from the accounting records.

— *Accuracy* - the objective is to ensure that all valid transactions are accurate, consistent with the originating transaction data, and information is recorded in a timely manner.

— *Validity* - the objective is to ensure that all recorded transactions fairly represent the economic events that actually occurred, are lawful in nature, and have been executed in accordance with management's general authorization.

— *Physical Safeguards and Security* - the objective is to ensure that access to physical assets and information systems are controlled and properly restricted to authorized personnel.

— *Error Handling* - the objective is to ensure that errors detected at any stage of processing receive prompts corrective action and are reported to the appropriate level of management.

— *Segregation of Duties* - the objective is to ensure that duties are assigned to individuals in a manner that ensures that no one individual can control both the recording function and the procedures relative to processing a transaction.

Question No. 8

(a) What do you mean by Joint Audit? Explain the responsibilities of a joint auditor for a joint audit ?

(b) Write a short note on Standards on audit.

(c) Write a short note on duties of an auditor. *(5 marks each)*

Answer to Question No. 8(a)

Meaning of Joint Audit

When two or more auditors are appointed for the execution of same audit assignment, it is termed as joint audit. Joint auditors are mainly appointed for audit assignment of public enterprises and big companies.

Institute of Chartered Accountants of India (ICAI) has issued SA 299 on "Responsibility of Joint Auditors" w.e.f. April, 1996. In respect of audit work divided among the joint auditors, each joint auditor is responsible only for the work allocated to him, whether or not he has prepared as separate report on the work performed by him. On the other hand, all the joint auditors are jointly and severally responsible:

— In respect of the audit work which is not divided among the joint auditors and is carried out by all of them;

— In respect of decisions taken by all the joint auditors concerning the nature, timing or extent of the audit procedures to be performed by any of the joint auditors. It may, however, be clarified that all the joint auditors are responsible only in respect of the appropriateness of the decisions concerning the nature, timing or extent of the audit procedures agreed upon among them; proper execution of these audit procedures is the separate and specific responsibility of the joint auditor concerned;

— In respect of matters which are brought to the notice of the joint auditors by any one of them and on which there is an agreement among the joint auditors;

— For examining that the financial statements of the entity comply with the disclosure requirements of the relevant statute; and

— For ensuring that the audit report complies with the requirements of the relevant statute.

The issues such as appropriateness of using test checks or sampling should be decided by each joint auditor in relation to his own area of work. This responsibility is not shared by the other joint auditors.

Thus, it is the separate and specific responsibility of each joint auditor to study and evaluate the prevailing system of internal control relating to the work allocated to him. Similarly, the nature, timing and extent of the enquiries to be made in the course of audit as well as the other audit procedures to be applied are solely the responsibility of each joint auditor. In the case of audit of a large entity with several branches, including those required to be audited by branch auditors, the branch audit reports/returns may be required to be scrutinised by different joint auditors in accordance with the allocation of work. In such cases, it is the specific and separate responsibility of each joint auditor to review the audit reports/returns of the divisions/branches allocated to him and to ensure that they are properly incorporated into the accounts of the entity. In respect of the branches which do not fall within any divisions or zones which are separately assigned to the various joint auditors, they may agree among themselves as regards the division of work relating to the review of such branch returns. It is also the separate and specific responsibility of each joint auditor to exercise his judgement with regard to the necessity of visiting such divisions/branches in respect of which the work is allocated to him. A significant part of the audit work involves obtaining and evaluating information and explanations from the management. This responsibility is shared by all the joint auditors unless they agree upon a specific pattern of distribution of this responsibility.

Normally, the joint auditors are able to arrive at an agreed report. However, where the joint auditors are in disagreement with regard to any matters to be covered by the report, each one of them should express his own opinion through a separate report. A joint auditor is not bound by the view of the majority of the joint auditors regarding matters to be covered in the report and should express his opinion in a separate report in case of a disagreement. For the purpose of computation of the number of company audits held by an auditor pursuant to the ceiling rule introduced in the Companies Act, 1956 each joint auditor ship in a company will be counted as one unit.

Answer to Question No. 8(b)

Auditing standards refers to the code of best practices/procedures which an auditor is expected to follow during an audit to ensure consistency of findings. The auditing standard specifies a minimum level of performance. Auditing standards help the auditor in proper and optimum discharge of their profession duties. Auditing standards also promote uniformity in practice as also comparability. In India the Auditing and Assurance Standards Board of the Institute of Chartered Accountants of India formulates the auditing standards.

Procedure of issuing auditing standards

— The Auditing and Assurance Standards Board identifies the areas where auditing standards need to be formulated and the priority in regard to their selection.

— In the preparation of the auditing standards, the Board is normally, assisted by study groups comprising of a cross section of members of the Institute.

— On the basis of the work of the study groups, an Exposure Draft of the proposed auditing standard is prepared by the Board and issued for comments of the members.

— After taking into the comments received, the draft of the proposed auditing standard is finalized by the Board and submitted to the Council of the Institute.

— The Council considers the final draft of the proposed auditing standard and, if necessary, modifies the same in consultation with the Board. The auditing standard is then issued under the authority of the Council.

— While formulating the auditing standards, the Board also takes into consideration the applicable laws, customs, usages and business environment in the country.

Answer to Question No. 8(c)

Duties of an auditor

As per Section 227 (1A) it is the duty of the auditor to enquire

— Whether loans and advances given on security have been properly secured and the terms & conditions on which they have been made are harmful to the interest of the company.

— Whether transactions which are represented merely by book entries in fact have taken place and are prejudicial to the interest of the company. (E.g. In books purchases were recorded for. In reality no such transaction has taken place. The auditor's report should mention this fact).

— Whether any of the assets of the company consisting of shares, debentures etc. have been sold at a price less than the cost of such shares etc. (This is not applicable to an investment company or a banking company). (This doesn't prohibit the sale below cost. If the sale is bonafide and the price is reasonable having regard to the circumstances of the case, need not be reported.)

— Whether loans and advances made by the company have been shown as deposits.

— Whether personal expenses have been charged as business expenses.

— Where it is stated in the books of accounts that any shares have been allotted for cash, then the cash has been actually so received. (DCA notification Shares allotted against a debt payable by the company shall be taken as 'shares allotted for cash').

Note : The auditor is required to report on above matters only if the answers are negative.

As per Section 227(2) it is the duty of the auditor to make a report whether, in his opinion the financial statements gives a true & fair view

— In the case of the balance sheet of the financial position of the company at the end of the financial year

— In the case of the profit and loss account of the profit or loss for the year.

As per Section 227(3) it is the duty of the auditor to state the following in his audit report

— Whether he has obtained all the information and explanations which were necessary for the purposes of his audit.

— Whether the audit report on the financial statements of any branch office audited by a person other than the company's auditor has been forwarded to him and how he has dealt with the same in preparing the auditor's report.

— Whether the company's balance sheet and profit and loss account are in agreement with the books of accounts and branch returns.

— Whether any director is disqualified under Sec.274 (1) (g). (Sec.274(1)(g) provides that person is disqualified from being appointed as a director, if the company in which he is a director has not filed the annual returns for any continuous 3 financial years Or has failed to repay its deposit or interest thereon on due date Or redeem its debentures on due date Or pay dividend and such failure continues for 1 year.) In bold or in italics the observations of the auditors which have any adverse effect on the functioning of the company.

— Whether the cess payable under Sec. 441A has been paid and if not, the details of amount of cess not so paid.

— Whether, in his opinion, proper books of accounts, as required by law, have been kept by the company and proper returns adequate for the purposes of his audit have been received from the branches.

— Whether accounts give the information required by the act in the manner so required.

— Whether in his opinion, the balance sheet and the profit and loss account comply with the accounting standards referred to in Sec.211 (3C) of the Companies Act.

As per Sec.227 (4), where any matters referred in Sec. 227(2) and 227(3) are answered in negative, it is the duty of the auditor to state the reasons for such answers in his audit report.

As per Sec.227(4A), It is the duty of the auditor to include in his report a statement on such matters as may be specified by the CARO, 2003 (Companies Auditor's Report Order).

Other duties

— Duty to sign the auditor's report.

— Duty to certify the prospectus & Duty to certify the statutory report.

— Duty to attend audit committee meetings.