Paper 12 -Company Accounts & Audit

Full Marks: 100

Section A

(1) Answer the following (compulsory) [2x2=4]

(i) Distinguish between Monetary items and Non – Monetary Items.

Answer:

Distinguish between Monetary items and Non – Monetary Items

Particulars	Monetary Items	Non – Monetary Items
Meaning	They are money held and assets and liabilities to be received or paid in fixed or determinable amounts of money.	They are assets and liabilities other than monetary items.
Example	Cash, receivables, payables.	Fixed Assets, Inventories, Investments in Equity Shares, etc.

(ii) Write short notes on accounting for Risk-Sharing Plans.

Answer:

Meaning: Defined Benefit plans that share risks between various enterprises under common control, e.g. a parent and its subsidiaries, are not MEP's. (These are called Risk Sharing plans.)

Accounting: The accounting for Risk sharing plans is as under -

Situation	Accounting
If there is a contractual agreement or stated policy for charging the Net defined Benefit Cost for the plan as a whole, to the individual Group Enterprises.	Each Enterprise should recognize, in its Separate Financial statements (SFS), the net Defined Benefit cost so charged under the agreement/ stated policy.
If there is no such agreement or policy for sharing or charging of cost to the individual group Enterprise.	The net Defined benefit Cost is recognised in the Separate Financial Statements (SFS) of the Group Enterprise that is legally the Sponsoring Employer for the plan. The other Group Enterprise recognize a cost equal to their contribution payable for the period, in their SFS.

(2) Answer any two Questions [2x8=16]

(a) B Ltd wishes to obtain a Machine Tool Costing ₹20 Lakhs by way of lease. The effective of life of the machine tool is 12 years but the Company required it only of the first five years. It enters into an agreement with M Ltd for a lease rental of ₹2 Lakhs p.a.

B Ltd is not sure about the treatment of these lease rentals, and hence requests your assistance in proper disclosure of the same. Assume Implicit Rate of Interest at 15%. PV Factors are: 0.87, 0.76, 0.66, 0.57 and 0.50. [8]

Answer:

Type of Lease:

(a) PV of Lease Rentals = ₹2,00,000 x (0.87 + 0.76 + 0.66 + 0.57 + 0.50) = ₹6,72,000, where Fair Value of Leased Asset = ₹20,00,000.
(b) Useful life of the Machine = 12 years whereas the period of lease = 5 years.

Based on the above facts, the Lease will be classified as an Operating Lease.

Disclosure Requirements:

Lease Rent for current year expensed off in P&L A/c	₹2,00,000
Balance Sheet Disclosures: Future Minimum Lease Payments - Not later than 1 year - Later than 1 year but not later than 5 years	 ₹2,00,000 ₹6,00,000

Note: Assumed that the Lease Rent is payable in the middle of the year. Excluding the Current Year lease Rental Payable, 2 installments are payable in future (1 in the forthcoming year and 3 in the rest of the future).

(b) In a reporting period (calendar Year), Pathanga Ltd, a listed Company, announced a scheme to buyback a maximum of 5% of its Equity Shares (of ₹10 each) at a price of ₹25 per Share. The market price of the Shares immediately prior to the buyback is ₹22. The following additional information is given. Compute the Basic EPS.

Particulars	**This year**	**Last year**
Net Profit	**₹8,00,000**	**₹6,00,000**
Number of Shares of January 1	**1,00,000**	**1,00,000**
Bought – back and cancelled on September 30	**(4,000)**	
Number of Shares at December 31	**96,000**	**1,00,000**

[8]

Answer:

Note: The impact of Buyback of Equity Share on the computation of Basic and Diluted EPS has not been specifically discussed in AS – 20. However, the Buyback of Shares at a value different from the Fair Value of the Shares is in effect an opposite (i.e., converse) of a Rights Issue with a bonus element. The treatment s as under –

Stage	Computation	Result
1	Determination of Theoretical Ex-Buy Back Fair Value / Price: $\frac{\text{(Base Shares Qty x Fair Value per Share Before Buy back) (less) (Buy Back Shares x Buy Back Price)}}{\text{Base Shares Quantity (less) No. of Shares Bought Back}}$ $= \frac{(1,00,000 \times ₹22) \text{ (less) } (4,000 \times ₹25)}{1,00,000 \text{ (less) } 4,000}$	₹21.875

2	Adjustment Factor (AF) = $\frac{\text{Fair Value before Buy Back}}{\text{Theoretical Ex - Buy Back Price (as per Stage 1)}}$ = $\frac{₹22}{₹21.875}$	1.0057
3	Weighted Average Number of Shares (WANES) Outstanding during the period (Note)	99,428 Shares
4	Basic EPS for Current Year = $\frac{\text{Equity Earnings}}{\text{WANES as per Stage 3}} = \frac{₹\ 8,00,000}{99,428\text{ Shares}}$	₹8.05
5	Basic EPS for Previous Year as originally reported $= \frac{\text{Previous Year's Equity Earnings}}{\text{Previous Year's WANES}} = \frac{₹6,00,000}{1,00,000}$	₹6.00
6	Adjusted Basic EPS for Previous Year $= \frac{\text{Previous Year's Equity Earnings}}{\text{Previous Year's WANES x AF}} = \frac{₹6,00,000}{1,00,000\text{ Shares x }1.0057}$	₹5.97

Note: Computation of Weighted Average Number of Equity Shares Outstanding for the current year

Period	Period (in mths)	Time Weighting Factor	Adjustment Factor	No. of Equity Shares	Weighted Average Number of Shares
(1)	(2)	(3)	(4)	(5)	(6)=(3)x(4)x(5)
1st Jan to 30th Sep	9	9/12	1.0057	Ope. Bal.= 1,00,000	75,428
1st Oct to 31st Dec	3	3/12	NA	(after Buy Back)=96,000	24,000
Weighted Average Number of Shares outstanding during the period					99,428

(c) (i) Due to the contribution of Great Men Ltd to the Society, the State Government has given a product licence at a nominal consideration of ₹40 lakhs. The market price of the license is however ₹3 Corres. The Company incurred ₹4 lakhs as expenditure in registration and initial operation of the licence. At what price should the license be recorded? [4]

Answer:

1. By applying Para 33 of AS – 26, the licence should be recorded in the books at ₹40 Lakhs (being the nominal consideration paid) + ₹4 lakhs (being the direct expenditure incurred).
2. Cost of Licence = ₹44 lakhs. The Market Value of ₹3 Crores is not relevant in this regard.

(ii) Foreign Currency Debtors at the end of the Financial Year are USD 10 Lakhs. Sales were recorded at the exchange rate USD 1 = 43.80. On the Balance Sheet date, the exchange rate is USD 1 = ₹46 which is not expected to be realised on the collection date. It has been estimated that around the collection time, the exchange rate will possibly be in the range of USD 1 = ₹45.50 to ₹45.80. At what value should the Debtors be recorded in the Balance Sheet? What is the treatment of unrealised foreign exchange gain? [4]

Answer:

Provisions:

(a) Foreign Currency Debtors being Receivables, i.e. monetary items denominated in foreign currency, should be reported using the Closing Rate, i.e. t' 46.00 per US Dollar, as per AS - 11.

(b) Sometimes, the closing rate may not reflect with reasonable accuracy the amount in reporting currency that is likely to be realized from, or required to disburse, a foreign currency monetary item at the Balance Sheet date.

(c) In such cases, the relevant monetary item i.e. Debtors in this question, should be reported in the reporting currency at the amount which is likely to be realized from, or required to disburse, such item on the Balance Sheet date.

Conclusion: Therefore, in the instant case -

(a) Debtors should be recorded at the expected realisable value, i.e. Average Expected Rate = (₹45.50 + ₹45.80)÷2 = ₹45.65 per USD. The amount of Debtors as per B/S shall be ₹45.65 x 10 Lakhs USD = ₹456.50 Lakhs.

(b) The Exchange Gain of (₹45.65 - ₹43.80) x 10 Lakhs USD = ₹18.50 Lakhs should be recognised as Income in the Profit & Loss Account.

Section B

(3) Answer the following (compulsory) [4x2=8]

(i) Write short notes on Creditors' Voluntary Winding up.

Answer:

Creditors' Voluntary Winding up:

A company may be wound up voluntarily by the creditors in the following situations:

(a) When 'declaration of solvency' is not made by the directors and is not filed to the Registrar, and the creditors passes a resolution for winding up of the company, it is called creditors' voluntary winding up. When the company is not in a position to meet its liabilities, the creditors take over the control to secure their interests.

(b) When 'declaration of solvency' is made by the directors and the winding up process continues as members' voluntary winding up but in course of winding up, the liquidator finds that the company is not solvent, he calls a meeting of the shareholders and creditors. Information is also furnished to the Registrar of Companies after which it continues as creditors' voluntary winding up.

(ii) Explain the disclosure requirement of Short term Borrowings.

Answer:

1. Short-Term Borrowings shall be classified as –
    - Loans Repayable on demand– (i) from Banks, & (ii) Other Parties,
    - Loans and Advances from Related Parties,
    - Deposits,
    - Others Loans and Advances (specify nature)
2. Security-wise Classification: Borrowings shall further be sub-classified as Secured and Unsecured. Nature of security shall be specified separately in each case.
3. Guarantees: Where Loans have been guaranteed by Directors or others, the aggregate amount of such Loans under each head shall be disclosed.
4. Default: Period & amount of default as on B/Sheet Date in repayment of Loans and Interest shall be separately in each case.

(iii) Explain the disclosure requirement of Non-Current Investments.

Answer:

Non-Current Investments shall be classified as Trade Investments and Other Investments, and further classified as Investments in –

(a) Property,
(b) Equity Instruments,
(c) Preference Shares
(d) Government / Trust Securities,
(e) Debentures or Bonds,
(f) Mutual Funds,
(g) Partnership Firms, and
(h) Other Non-Current Investments (specify nature).

Notes:

1. Under each classification, details shall be given of Names of Bodies Corporate (indicating separately whether such bodies are – (i) Subsidiaries, (ii) Associates, (iii) Joint Ventures, or (iv) Controlled Special Purpose Entities) in whom Investments have been made and the nature and extent of the Investment so made in each such Body Corporate (showing separately Investments which are partly-paid).
2. In regard to Investments in the capital of Partnership Firms, the Names of the Firms (with the names of all their Partners, Total Capital and the Shares of each Partner) shall be given.
3. Investments carried at other than at Cost should be separately stated specifying the basis for valuation thereof
4. The following shall also be disclosed-
    (a) Aggregate amount of Quoted Investments and Market Value thereof,
    (b) Aggregate Amount of Unquoted Investments,
    (c) Aggregate Provision for Diminution in value of Investments.

(iv) What are the types of Cash flow statement?

Answer:

Cash Flow Statement explains cash movements under three different heads, namely

- Cash flow from operating activities;
- Cash flow from investing activities;
- Cash flow from financing activities.

Sum of these three types of cash flow reflects net increase or decrease of cash and cash equivalents.

Operating activities are the principal revenue - producing activities of the enterprise and other activities that are not investing and financing. Operating activities include all transactions that are not defined as investing or financing. Operating activities generally involve producing and delivering goods and providing services.

Investment activities are the acquisition and disposal of long term assets and other investments not included in cash equivalents.

Financing activities are activities that result in changes in the size and composition of the owners' capital (including preference share capital in the case of a company) and borrowings of the enterprise.

(4) Answer any two Questions [2x16=32]

(a) Give journal entries for the following:

i) DK Ltd. forfeited 20,000 equity shares of ₹10 each for non payment of first call of ₹2 and final call of ₹3 per share. These shares were reissued at a discount of ₹3.50 per share.

ii) TP Ltd. forfeited 30,000 equity shares of ₹15 each (including ₹5 per share as premium), for non payment of final call of ₹3 per share. Out of these 15,000 shares were reissued at a discount of ₹4 per share.

iii) TP Ltd. forfeited 7,500 equity shares of ₹15 each (including ₹5 per share as premium), for non payment of allotment money ₹8 (including premium money) and first & final call of ₹5 per share. Out of these 5,000 shares were reissued at ₹14 per share.

iv) DK Ltd. forfeited 10,000 equity shares of ₹10 each issued at a discount of ₹1 per share, for non payment of first call of ₹2 and final call of ₹3 per share. Out of these 6,000 shares were reissued at ₹8 per share and the balance shares were re-issued at ₹7 per share. [16]

Answer:

Journal Entries

	Particulars		Dr. ₹	Cr. ₹
i)	Equity Share Capital Account To Equity Sh. First Call Account To Equity Sh. Final Call Account To Forfeited share Account (20,000 shares forfeited for non-payment of first and final call money)	Dr.	2,00,000	 40,000 60,000 1,00,000
	Bank Account Forfeited Share Account To Equity Share Capital Account (Reissue of 10,000 sh. @ ₹6.50 each)	Dr. Dr.	1,30,000 70,000	 2,00,000
	Forfeited Share Account To Capital Reserve Account (Balance of Forfeited share Account transferred)	Dr.	30,000	 30,000
ii)	Equity Share Capital Account To Equity Sh. Final Call Account To Forfeited share Account (30,000 shares forfeited for non-payment of final call money)	Dr	3,00,000	 90,000 2,10,000
	Bank Account Forfeited Share Account To Equity Share Capital Account (Re-issue of 15,000 sh. @ ₹6 each)	Dr. Dr.	90,000 60,000	 1,50,000
	Forfeited Share Account To Capital Reserve Account (Balance of Forfeited share A/c relating to 15,000 shares transferred)	Dr.	45,000	 45,000
iii)	Equity Share Capital Account Securities Premium Account To Equity Sh. Allotment Account To Equity Sh. First & Final Call Account To Forfeited share Account (7,500 shares forfeited for non-payment of allotment and first and final call money)	Dr. Dr.	75,000 37,500	 60,000 37,500 15,000
	Bank Account To Security Premium Account To Equity Share Capital Account (Reissue of 5,000 sh. @ ₹ 14 each)	Dr.	70,000	 20,000 50,000

	Particulars		Dr. ₹	Cr. ₹
	Forfeited Share Account To Capital Reserve Account (Balance of Forfeited share A/c on 10,000) shares transferred)	Dr.	10,000	 10,000
iv)	Equity Share Capital Account To Discount on issue of shares Account To Equity Sh. First Call Account To Equity Sh. Final Call Account To Forfeited share Account (10,000 shares forfeited for non-payment of first and final call money)	Dr.	100,000	 10,000 20,000 30,000 40,000
	Bank Account Discount on issue of shares Account Forfeited Share Account To Equity Share Capital Account (Reissue of 6,000 sh. @ ₹ 8 each)	Dr. Dr. Dr.	48,000 6,000 6,000	 60,000
	Forfeited Share Account To Capital Reserve Account (Balance of Forfeited share A/c on 6,000 shares transferred)	Dr.	18,000	 18,000
	Bank Account Discount on issue of shares Account Forfeited Share Account To Equity Share Capital Account (Reissue of 4,000 sh. @ ₹ 7 each)	Dr. Dr. Dr.	28,000 4,000 8,000	 40,000
	Forfeited Share Account To Capital Reserve Account (Balance of Forfeited share A/c on 4,000 shares transferred)	Dr.	8,000	 8,000

(b) It has been decided that A Ltd. will absorb the entire undertaking of B Ltd. and C Ltd. as on 1.4.2010. The outside shareholders in the latter companies are to be issued equity shares in A Ltd. on the basis of an agreed issue price of ₹200 per share. For this purpose, the interests of such shareholders are to be determined according to the intrinsic values of the shares of the respective companies. D Ltd. is a subsidiary of C Ltd. and is also to be merged into A Ltd. appropriately.

The Balance Sheets of the companies as at 31.3.2013, stood as under:

(₹ in Lakhs)

	A	B	C	D
Sources of Funds:				
Share capital				
Equity shares @₹100 each	**1,500**	**1,000**	**800**	**400**
Reserves	**2,000**	**540**	**702**	**400**
Loans	**1,600**	**900**	**1,000**	**700**
Total	**5,100**	**2,440**	**2,502**	**1,500**

(₹ in Lakhs)

		A	B	C	D
Application of Funds:					
Land		**200**	**100**	**50**	**10**
Buildings		**500**	**400**	**100**	**200**
Machinery		**1,500**	**800**	**500**	**500**
Other Fixed Assets		**400**	**100**	**200**	**50**
Investments					
4 lakhs shares of B		**500**	**-**	**-**	**-**
2 lakhs shares of C		**300**	**-**	**-**	**-**
4 lakhs shares of D		**-**	**-**	**400**	**-**
Others		**100**	**-**	**-**	**-**
Net Current Assets		**1,600**	**1,040**	**1,252**	**740**
Total	**5,100**	**2,440**	**2,502**	**1,500**	

Note: Loans assumed to be of less than 12 months hence treated as short term borrowing (ignoring interest)

For the purpose of the scheme, it is agreed to give effect to the following value appreciations of the assets of the companies to be absorbed.

Land	**-**	**100%**
Buildings	**-**	**50%**
Machinery	**-**	**20%**

In order to obtain the consent of the creditors of C Ltd., it becomes necessary to accept a claim of ₹20 lakhs hitherto classified as contingent. 60% of the claim is accepted by C Ltd. and the balance is to be settled by A Ltd.

You are required to:

i. Compute the number of shares to be issued by A Ltd. to eligible outsiders

ii. Show journal entries.

iii. Draft the Balance sheet of A Ltd. after the absorption. [16]

Answer:

Part 1. Calculation of Purchase consideration

WN # 1: Calculation of Intrinsic value of shares.

(₹ in Lakhs)

	B	C	D
a. Land (↑100%)	200	100	20
b. Building (↑50%)	600	150	300
c. Machinery (↑20%)	960	600	600
d. Others Fixed Assets	100	200	50
e. Net current Asset	1040	1252	740

f.	Investment in D Ltd. (100% subsidiary company)	—	1010	—
	[4 Lakhs shares × ₹252.50]	2900	3312	1710
g.	Loans	(900)	(1000)	(700)
h.	Contingent loan (60% of 20)	—	(12)	—
i.	Value of Net Assets	2,000	2,300	1010
j.	No. of shares Outstanding	10	8	4
k.	Intrinsic value per share (i/j)	200	287.50	252.50

WN # 2: Purchase consideration

	Particulars	**B**	**C**
a.	No. of shares outstanding	10	8
b.	Less: Already held by A Ltd.	(4)	(2)
c.	No. of shares held by outsiders	6	6
d.	Value payable at intrinsic value [WN # 2(c) x WN # 1 (k)]	₹ 1,200	₹ 1,725
e.	No. of shares to be issued at value of ₹ 200	6	8.625
f.	Payment to be made for C Ltd. is: Shares	–	8
	Cash (for fractional shares)		0.625 x 200 = ₹125

Part II - In the books of purchasing Co. A Ltd.

A. Take over of B Ltd.

- Nature of Amalgamation - Purchase
- Method of Accounting - Purchase

(₹ in Lakhs)

	Particulars		**Debit**	**Credit**
a.	For Purchase Consideration Due :			
	Business Purchase A/c (6 × 200)	Dr.	1,200	
	To Liquidator of B Ltd's A/c			1,200
b.	For Assets and liabilities takeover:			
	Land A/c	Dr.	200	
	Building A/c	Dr.	600	
	Machinery A/c	Dr.	960	
	Other Fixed Assets A/c	Dr.	100	
	Net Current Assets A/c	Dr.	1040	
	To Capital Reserve A/c (balancing figure)			300
	To Loans A/c			900
	To Business purchase A/c			1,200
	To Investments in B Ltd			500
c.	Discharge of consideration			
	Liquidator of B Ltd A/c	Dr.	1,200	
	To Equity Share Capital A/c (6 x 100)			600
	To Securities Premium A/c (6 x 100)			600

B. Take over of C Ltd.

- Nature of Amalgamation - Purchase
- Method of Accounting - Purchase

₹ in Lakhs

	Particulars		Debit	Credit
a.	For Purchase Consideration Due :			
	Business Purchase A/c	Dr.	1,725	
	To Liquidator of C Ltd A/c			1,725
b.	For takeover of assets and liabilities:			
	Land A/c	Dr.	120	
	Building A/c	Dr.	450	
	Machinery A/c	Dr.	1200	
	Other Fixed Assets A/c	Dr.	250	
	Net Current Assets A/c	Dr.	1992	
	To Capital Reserve A/c (balancing figure)			267
	To Loans A/c			1712
	To Contingent loan payable A/c			8
	To Business purchase A/c			1725
	To Investments in C Ltd A/c			300

	Particulars		Debit	Credit
c.	Settlement of contingent liability:			
	Contingent liability payable A/c	Dr.	8	
	To Net current asset (cash)			8
d.	For discharge of consideration:			
	Liquidator of C Ltd A/c	Dr.	1,725	
	To Equity Share Capital A/c (8 × 100)			800
	To Securities Premium A/c (8 × 100)			800
	To Cash A/c			125

Name of the Company: A Ltd.

Balance Sheet as at 31.03.2013

Ref No.	Particulars		Note No.	As at 31st March, 2013	As at 31st March, 2012
				₹	₹
	I.	Equity and Liabilities			
	1	Shareholders' funds			
		(a) Share capital	1	2,900	
		(b) Reserves and surplus	2	3,967	
		(c) Money received against share warrants			

	2	Share application money pending allotment			
	3	Non-current liabilities			
		(a) Long-term borrowings			
		(b) Deferred tax liabilities (Net)			
		(c) Other Long term liabilities			
		(d) Long-term provisions			
	4	Current Liabilities			
		(a) Short-term borrowings	3	4,212	
		(b) Trade payables			
		(c) Other current liabilities			
		(d) Short-term provisions			
		Total (1+2+3)		11,079	
	II.	Assets			
	1	Non-current assets			
		(a) Fixed assets			
		(i) Tangible assets	4	6,480	
		(ii) Intangible assets			
		(iii) Capital work-in-progress			
		(iv) Intangible assets under development			
		(b) Non-current investments		100	
		(c) Deferred tax assets (Net)			
		(d) Long-term loans and advances			
		(e) Other non-current assets			
	2	Current assets			
		(a) Current investments			
		(b) Inventories			
		(c) Trade receivables			
		(d) Cash and cash equivalents			
		(e) Short-term loans and advances			
		(f) Other current assets	5	4,499	
		Total (1+2)		11,079	

		(₹)
Note 1. Share Capital	As at 31st March, 2013	As at 31st March, 2012
Authorized, Issued, subscribed and fully paid up equity shares of ₹10 each [Out of the above 6 lakhs shares to B Ltd. and 8 lakhs shares to C Ltd. Were issued for consideration other than cash]	2,900	
Total	2,900	

RECONCILATION OF SHARE CAPITAL				
FOR EQUITY SHARE:-	As at 31st March, 2013		As at 31st March, 2012	
	Nos	Amount (₹)	Nos	Amount (₹)
Opening Balance as on 01.04.12	15	1,500.00	NIL	NIL
Add: Fresh Issue (Incld. Bonus shares, Right shares, split shares, shares issued other than cash)	14	1,400.00	NIL	NIL
	29	2,900.00	NIL	NIL
Less: Buy Back of shares	-	-	-	-
	29	2,900.00	NIL	NIL

2. Reserves and Surplus	As at 31st March, 2013	As at 31st March, 2012
Capital Reserve (300 + 267)	567	
Securities Premium (600 + 800)	1,400	
Other Reserves	2,000	
Total	3,967	

3. Short-term Loans	As at 31st March, 2013	As at 31st March, 2012
Loans(1,600 + 900 + 1,012 + 700)	4,212	
Total	4212	

4. Tangible Assets	As at 31st March, 2013	As at 31st March, 2012
Land (200 + 200 + 100 + 20)	520	
Buildings (500 + 600 + 150 + 300)	1,550	
Machinery (1,500 + 960 + 600 + 600)	3,660	

Other Fixed assets (400 + 100 + 200 + 50)	750	
Total	6,480	

5. Other Current Assets	As at 31st March, 2013	As at 31st March, 2012
Net Current assets (1,600+1,040 + 1,252 + 740 + 740 - 8 -125)	4,499	
Total	4,499	

Note: Loan are assumed to be of less than 12 months. Hence, Short term (ignoring interest)

(c) The following was the Balance Sheet of A Limited as on 31.3.2013:

Balance Sheet of A Limited as at 31.3.2013

Liabilities	₹	Assets	₹
Share Capital		**Fixed Assets**	
14%, 80,000 preference shares of		**Land**	**80,000**
₹100 each fully paid up	**8,00,000**	**Buildings**	**3,20,000**
16,000 equity shares of ₹100 each,		**Plant and Machinery**	**10,80,000**
₹60 per share paid up	**9,60,000**	**Patents**	**80,000**
Reserves and Surplus	**NIL**	**Investments**	**NIL**
Secured Loans		**Current assets, loans and advances**	
1. 14% debentures	**4,60,000**	**A. Current Assets**	
(Having a floating charge		**Stock at cost**	**2,00,000**
on all assets)		**Sundry debtors**	**4,60,000**
Interest accrued on above		**Cash at bank**	**1,20,000**
debentures	**64,400**	**B. Loans and Advances**	**NIL**
(Also having a floating		**Miscellaneous expenses**	
charge as above)		**Profit and Loss A/c**	**4,80,000**
2. Loan on mortgage of land			
and building	**3,00,000**		
Unsecured Loan	**NIL**		
Current Liabilities and provisions			
3. Current liabilities			
Sundry creditors	**2,35,600**		
	28,20,000		**28,20,000**

On 31.3.2013 the company went into voluntary liquidation. The dividend on 14% preference shares was in arrears for one year. Sundry creditors include preferential creditors amounting to ₹60,000.

The assets realised the following sums

Land ₹ 1,60,000; Buildings ₹ 4,00,000; Plant and machinery ₹ 10,00,000; Patent ₹ 1,00,000; Stock ₹3,20,000; Sundry debtors ₹ 4,00,000.

The expenses of liquidation amounted to ₹58,868. The liquidator is entitled to a commission of 2% on all assets realised (except cash at bank) and 2% on amounts among unsecured creditors other than preferential creditors. All payments on the 30th June, 2013. Interest on mortgage loan shall be ignored at the time of payment.

Prepare the liquidator's final statement of account. [16]

Answer:

A Ltd.

Liquidator's Final Statement of Account

Receipts	Value Realised	Payments		Payment
	₹			₹
Assets Realised:				
Cash at Bank	1,20,000	Liquidator's Remuneration (W.N. 1)		51,112
Sundry Debtors	4,00,000	Liquidation Expenses		58,868
Stock	3,20,000	Debenture-holders:		
Plant and Machinery	10,00,000	14% Debentures	4,60,000	
Patents	1,00,000	Interest Accrued (W.N. 2)	80,500	5,40,500
Surplus from Securities	2,60,000	Creditors : Preferential	60,000	
(W.N. 3)		Unsecured	1,75,600	2,35,600
		Preference Shareholders:		
		Preference Share Capital	8,00,000	
		Arrears of Dividend	1,12,000	9,12,000
		Equity Shareholders (W.N.4):		
		₹25.12 per share on 8,000 shares		4,01,920
	22,00,000			22,00,000

Working Notes:

		₹
1.	Liquidator's remuneration:	
	2% on assets realised (2% of ₹23,80,000)	47,600
	2% on payments to unsecured creditors (2% on ₹1,75,600)	3,512
		51,112
2.	Interest accrued on 14% Debentures:	
	Interest accrued as on 31.3.2013	64,400
	Interest accrued upto the date of payment i.e. 30.6.2013	16,100
		80,500
3.	Surplus from Securities:	
	Amount realised from Land and Buildings (₹1,60,000 + ₹4,00,000)	5,60,000
	Less: Mortgage Loan	3,00,000
		2,60,000
4.	Amount payable to Equity Shareholders:	
	Equity share capital (paid up)	9,60,000
	Less: Amount available for equity shareholders	4,01,920
	Loss to be borne by equity shareholders	5,58,080

Loss per equity share (₹5,58,080/ 16,000)	34.88
Amount payable to equity shareholders for each equity share (60 - 34.88)	25.12

Notes:

(1) Commission due to the liquidator has been calculated on the total realisation on the supposition that the securities (land and buildings) are realised by the liquidator on behalf of the lender.

(2) Preference shares have been taken as cumulative.

Section C

(5) Answer the following (compulsory) [4x2=8]

(i) What are the differences between statutory audit and forensic audit?

Answer:

Difference between statutory audit and forensic audit

Sl. No.	Statutory Audit	Forensic Audit
i.	Express an opinion on the truthfulness and fairness of the Financial Statements.	Determine if any fraud has been committed in the client's business.
ii.	Substantive and compliance procedures are used.	Substantive procedures, audit-in depth, trend, and past-data analysis are used.
iii.	Accounts relating to the relevant accounting year are checked.	Accounts may be checked for as many numbers of years as required to detect the cause of the fraud, if any.
iv.	Check the arithmetical accuracy and compliance with procedures.	Propriety aspect is focused on.
v.	Qualifications may be given in case of adverse findings.	The amount of fraud, the persons behind it and the legal implication are mentioned in the audit report.

(ii) Explain the advantages of Cost Audit.

Answer:

Advantage of cost Audit

(a) To the Management –

- Management gets reliable data for its day-to-day operations like price fixing, control, decision making, etc.

- A close and continuous check an all wastage's will be kept through a proper system of reporting to management.
- Inefficiencies in the working of the company will be brought to light to facilitate corrective action.
- Management by exception becomes possible through allocation of responsibilities to individual managers.
- System of budgetary control and standard costing will be greatly facilitated.
- Reliable check on valuation of closing stock and work-in-progress can be established.
- Helps in detection of frauds and errors.

(b) To the shareholders –

Cost Audit ensures that proper records are kept as to purchases and utilisation of material and expenses incurred on wages, etc. It also makes sure that the valuation of closing stock and work-in-progress is on a fair basis. Thus, the shareholders are assured of a fair return on their investment.

(iii) Give a brief notes on advantages of Audit Programme.

Answer:

The main advantages of an audit programme are as follows:

- It serves as a ready check list of audit procedures to be performed.
- The audit work can be properly allocated to the audit assistants or the article clerks.
- The auditor may easily know the extent of work done at any point of time. Thus, the progress of work done can be under the supervision and control of the auditor.
- Audit programme would not only be useful for the audit assistants in carrying the audit work but for the principal too as he would be in a position to account for the individual responsibilities.
- A uniformity of the work can be attained as the same programme would be followed from time to time.
- It is a useful basis for planning the programme for the following year.
- It may be used as evidence by the auditor in the event when any charge is brought against him. He can prove that there has no negligence on his part and he exercised reasonable care and skill while performing the task.

(iv) Explain the significance of Opening paragraph.

Answer:

Significance of Opening Paragraph:

(a) The Opening or Introductory Paragraph identifies the Financial Statements of the entity that have been audited, including the date of and period covered by the Financial Statements.

(b) The 'Opening Paragraph' seeks to bring to the notice of the Users of Financial Statements, that preparation of the accounts is the responsibility of the Management of the enterprise, whereas the responsibility of the Auditor is to express an opinion on the said accounts based on the audit carried out by him.

(c) Through the Opening Paragraph, the Auditor communicates the basic message that the preparation of Financial Statements requires Management to make significant accounting estimates and judgements, as well as to determine the appropriate accounting principles and methods used in preparation of the said Financial Statements.

(6) Answer any one Question [1x8=8]

(i) State the differences between Audit Report and Audit Certificate. [8]

Answer:

Difference between Audit Report and Audit Certificate

(i) Meaning: Audit Report is a statement of collected and considered information so as to give a clear picture of the state of affairs of the business to the persons who are not in possession of the full facts. While Audit Certificate is a written confirmation of the accuracy of the information stated there in.

(ii) Opinion: Audit Report contains the opinion of the auditor on the accounts, while Audit Certificate does not contain any opinion but only confirms the accuracy of the figures with the books of accounts.

(iii) Basis: Audit Report is made out on the basis of information obtained & books of account verified by the auditor, while Audit Certificate is made out on the basis of the particular data capable of verification as regards accuracy.

(iv) Guarantee: Audit Report may not guarantee correctness of financial statement in absolute terms, while Audit Certificate guarantees absolute correctness of the figures & information mentioned in the certificate.

(v) Coverage: Audit Report always covers entire accounts of the concern, while Audit Certificate covers only certain part of the accounts of the concern.

(vi) Responsibility: Audit Report does not hold auditor responsible for anything wrong in the accounts, while Audit Certificate makes an auditor responsible if anything mentioned in the certificate found as wrong later on.

(vii) Suggestion: Audit Report may provide certain suggestions for improvement while Audit certificate does not provide any such suggestion.

(viii) Nature: Audit Report is based on the vouching & verification of books of accounts, voucher, assets & liabilities, while Audit Certificate is based on checking arithmetical accuracy of the facts.

Scope: Audit Report covers all transactions done during the year, while the Audit Certificate is very specific.

(x) Characteristics: Audit Report is subjective as it is opinion oriented, while Audit certificate is objective as it is fact oriented.

(xi) Form: Audit Report is required to be presented in the prescribed format, while Audit Certificate, except in few cases, is not required to be presented in any standard format.

(xii) Address: Audit report is addressed to the members of the company at large or appointing authority, while Audit Certificate is addressed to particular person or sometimes may include the words like "To Whomsoever it may concern".

(ii) What are the rights of Companies retiring auditor? [8]

Answer:

A retiring auditor, for whom it has been proposed that he shall not be reappointed or that a person other than him be appointed, has been given certain rights under the provisions of natural justice. The rights are as follows:-

(a) Right to receive notice of the resolution;
(b) Right to make a written representation to the company and request its notification to the members of the company;
(c) Right to get his representation circulated among the members;
(d) Right retiring to get his representations read out at the meeting, if it has not been sent to the members because these were received too late or because of default on the part of the company;
(e) Right to be heard at the meeting.

Thus, in light of the above provision a new incoming auditor should consider the following points before accepting the appointment as an auditor of the company:

(a) Special notice u/s 225(1) was duly received by the company from a member at least 14 days before AGM containing a proposal for appointing a sole auditor expressly;
(b) Verify notice sent to all the members at least 7 days before the AGM [190(2)];
(c) Verify that special notice has been sent to retiring auditor forthwith[225(2)];
(d) Any representation received from the retiring auditor was sent to the members[225
(e) Verify from the minutes whether the representation received from the retiring auditor was considered at the AGM;
(f) Examine that proposed resolution was properly passed;
(g) Ensure that provisions of section 224(2) are fully complied with;
(h) Ascertain special resolution u/s 224A, if any, is passed accordingly;
(i) Obtain a certified copy of the relevant minutes of AGM and a written communication of the appointment within 7 days.

(7) Answer any two Questions [2x12=24]

(a) (i) Explain the basic elements of an Internal Control. [8]

Answer:

Basic Elements of Internal Control

An effective system of internal control should have the following basic elements:

1. Financial and other Organizational Plans: This may take the form of manual suitably classified by flow charts. It should specify the various duties and responsibilities of both management and staff, stating the powers of authorisation that reside with various members. This is important as in the event of staff absence or otherwise the correct flow of work and the internal control system could be vitiated by any wrong implementation of procedures by staff either unintentionally or willfully.

2. Competent Personnel: In any internal control system, personnel are the most important element. When the employees are competent and efficient in their assigned work, the internal control system can be worked and operated efficiently and effectively even if some of the other elements of the internal control system are absent.
3. Division of Work: this refers to the procedure of division of work properly among the employees of the organization. Each and every work of the organization. Each and every work of the organization should be divided in different stages and should be allocated to the employees in accordance with quality and skill.
4. Separation of operational responsibility from record keeping: If each department of an organization is being assigned to prepare its own records and reports, there may be a tendency to manipulate results for showing better performance. So in order to ensure reliable records and information, record-keeping function is separated from the operational responsibility of the concerned department.
5. Separation of the custody of assets from accounting: To protect against misuse of assets and their misappropriation, it is required that the custody of assets and their accounting should be done by separate persons. When a particular person performs both the functions, there is a chance of utilizing the organisation's assets for his personal interest and adjusting the records to relieve himself from the responsibility of the assets.
6. Authorization: In a internal control system, all the activities must be authorized by a proper authority. The individual or group which can grant either specific or general authority for transaction s should hold a position commensurate with the nature and significance of the transactions and the policy for such authority should be established by the top management.
7. Managerial supervision and review: The internal control system should be implemented and maintained in conformity with the environmental and elemental changes of the concern. By adapting any specific control system permanently, the extent to which the procedures of flexible controls have been followed in real practice should be observed and re-examined.

Importance: Good internal control is essential for assuring the accomplishment of goals and objectives. It provides reliable financial information for management decisions. It ensures compliance with applicable laws and regulations to avoid the risk of public scandals. Poor or excessive internal control reduces productivity, increases the complexity of processing transactions, increases the time required to process transactions and add no value to the activities. Good internal control helps ensure efficient and effective operations that accomplish the goals of the organisation and protects employees and assets. It helps in bringing to light any misuse or misappropriation of the company's assets and takes corrective measures in safeguarding assets. It creates appropriate climate for efficient organizational functioning. It prevents and detects frauds and errors and ensures timely preparation of financial statements and report for decision making.

(ii) "Auditor's assessment of materiality may be different of the time of planning the engagement than at the time of evaluating the results of his audit procedures". Comment [4]

Answer:

Planning the audit solely to detect individually material misstatements overlooks the fact that the aggregate of individually immaterial misstatements may cause the financial statements to be materially misstated, and leaves no margin for possible undetected misstatements. Performance materiality (which, as defined, is one or more amounts) is set to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements in the financial statements exceeds materiality for the financial statements as a whole. Similarly, performance materiality relating to a materiality level determined for a particular class of transactions, account balance or disclosure is set to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements in that particular class of transactions, account balance or disclosure exceeds the materiality level for that particular class of transactions, account balance or disclosure. The determination of performance materiality is not a simple mechanical calculation and involves the exercise of professional judgment. It is affected by the auditor's understanding of the entity, updated during the performance of the risk assessment procedures; and the nature and extent of misstatements identified in previous audits and thereby the auditor's expectations in relation to misstatements in the current period.

(b) (i) Give a brief difference between Internal Audit, Internal Control and Internal check. [8]

Answer:

Brief difference between internal audit, internal control and internal check

S No.	Basis	Internal Audit	Internal Control	Internal Check
a.	Meaning	It is a continuous critical review of financial and operating activities by a staff member of the auditor.	It consists of all the methods and procedures adopted to assist in achieving the objective of efficient conduct of business. It Includes internal checks and internal audit	A system of allocation of responsibility, division of work, and methods of recording transactions, whereby the work of an employee is checked continuously by another.
b.	Way of Checking	In an internal audit system, each component of work is checked .	In internal controls systems, work of one person is automatically checked by another.	It operates in routine to doubly check every part of a transaction at the time of occurrence and recording of the same
c.	Objective	Its objective is to evaluate the internal control system and to detect frauds and errors.	Its objective is to ensure adherence to manage-ment policies, safeguarding of assets, prevention and detection of frauds and errors, accuracy and completeness of accounting records.	Its objective is to ensure that no one employee has exclusive control over any transaction or group of transactions and their recording in the books

S No.	Basis	Internal Audit	Internal Control	Internal Check
d.	Point of Time	In an internal audit system, work is checked after it is done.	In an internal control system, checking is done simultaneously with the conduct of work. Every transaction is checked as soon as it is entered.	Methods of recording transactions are devised where work of an employee is checked continuously by correlating it with the work of others.
e.	Thrust of system	The thrust of internal system is to detect errors and frauds.	The thrust of internal check system is to prevent errors.	The thrust of internal control lies in fixing of responsibility and division of work to avoid duplication.
f.	Cost Involvement	In an internal audit system, work is checked specially; therefore cost is involved in addition to accounting	The system proves to be costly in case of small businesses because more number of employees are engaged	It is a part of internal control and a method of division of work, therefore does not add to the cost.
g.	Report	The internal auditor submits his report to the management	Internal Controls provide for built in MIS reports	The summary of day to day transactions work as report for the senior.

(ii) Summarize the auditor's duties in applying analytical procedures. [4]

Answer:

When designing and performing substantive analytical procedures, either alone or in combination with tests of details, as substantive procedures in accordance with SA 330, the auditor shall:

a. Determine the suitability of particular substantive analytical procedures for given assertions, taking account of the assessed risks of material misstatement and tests of details, if any, for these assertions;

b. Evaluate the reliability of data from which the auditor's expectation of recorded amounts or ratios is developed, taking account of source, comparability, and nature and relevance of information available, and controls over preparation;

c. Develop an expectation of recorded amounts or ratios and evaluate whether the expectation is sufficiently precise to identify a misstatement that, individually or when aggregated with other misstatements, may cause the financial statements to be materially misstated; and

d. Determine the amount of any difference of recorded amounts from expected values that is acceptable without further investigation.

The auditor shall design and perform analytical procedures near the end of the audit that assist the auditor when forming an overall conclusion as to whether the financial statements are consistent with the auditor's understanding of the entity.

If analytical procedures performed in accordance with this SA identify fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount, the auditor shall investigate such differences by:

a. Inquiring of management and obtaining appropriate audit evidence relevant to management's responses; and
b. Performing other audit procedures as necessary in the circumstances.

(c) What are the steps involved in the audit of an "Educational Institution"? [12]

Answer:

Audit of an Educational Institution

The special steps involved in the audit of an educational institution are the following:

(i) Examine the Trust Deed, or Regulations in the case of school or college and note all the provisions affecting accounts. In the case of a university, refer to the Act of Legislature and the Regulations framed thereunder.

(ii) Read through the minutes of the meetings of the Managing Committee or Governing Body, noting resolutions affecting accounts to see that these have been duly complied with, specially the decisions as regards the operation of bank accounts and sanctioning of expenditure.

(iii) Check names entered in the Students' Fee Register for each month or term, with the respective class registers, showing names of students on rolls and test amount of fees charged; and verify that there operates a system of internal check which ensures that demands against the students are properly raised.

(iv) Check fees received by comparing counterfoils of receipts granted with entries in the cash book and tracing the collections in the Fee Register to confirm that the revenue from this source has been duly accounted for.

(v) Total up the various columns of the Fees Register for each month or term to ascertain that fees paid in advance have been carried forward and the arrears that are irrecoverable have been written off under the sanction of an appropriate authority.

(vi) Check admission fees with admission slips signed by the head of the institution and confirm that the amount had been credited to a Capital Fund, unless the Managing Committee has taken a decision to the contrary.

(vii) See that free studentship and concessions have been granted by a person authorised to do so, having regard to the prescribed Rules.

(viii) Confirm that fines for late payment or absence, etc., have either been collected or remitted under proper authority.

(ix) Confirm that hostel dues were recovered before students' accounts were closed and their deposits of caution money refunded.

(x) Verify rental income from landed property with the rent rolls, etc.

(xi) Vouch income from endowments and legacies, as well as interest and dividends from investment; also inspect the securities in respect of investments held.

(xii) Verify any Government or local authority grant with the relevant papers of grant. If any expense has been disallowed for purposes of grant, ascertain the reasons and compliance thereof.

(xiii) Report any old heavy arrears on account of fees, dormitory rents, etc, to the Managing Committee.

(xiv) Confirm that caution money and other deposits paid by students on admission have been shown as liability in the balance sheet and not transferred to revenue.

(xv) See that the investments representing endowment funds for prizes are kept separate and any income in excess of the prizes has been accumulated and invested along with the corpus.

(xvi) Verify that the Provident Fund money of the staff has been invested in appropriate securities.

(xvii) Vouch donations, if any, with the list published with the annual report. If some donations were meant for any specific purpose, see that the money was utilised for the purpose.

(xviii) Vouch all capital expenditure in the usual way and verify the same with the sanction for the Committee as contained in the minute book.

(xix) Vouch in the usual manner all establishment expenses and enquire into any unduly heavy expenditure under any head.

(xx) See that increase in the salaries of the staff have been sanctioned and minuted by the Committee.

(xxi) Ascertain that the system ordering inspection on receipt and issue of provisions, foodstuffs, clothing and other equipment is efficient and all bills are duly authorised and passed before payment.

(xxii) Verify the inventories of furniture, stationery, clothing, provision and all equipment, etc. These should be checked by reference to Stock Register and values applied to various items should be test checked.

(xxiii) Confirm that the refund of taxes deducted from the income from investment (interest on securities, etc.) has been claimed and recovered since the institutions are generally exempted from the payment of income-tax.

(xxiv) Verify the annual statements of accounts and while doing so see that separate statements of account have been prepared as regards Poor Boys Fund, Games Fund, Hostel and Provident Fund of Staff, etc.