Paper – 12: Company Accounts and Audit

Full Marks: 100 **Time Allowed: 3 Hours**

This paper contains 4 questions. All questions are compulsory, subject to instruction provided against each question. All workings must form part of your answer. Assumptions, if any, must be clearly indicated.

1. **Answer all questions:** **[2×10=20]**

(a) Vikas sold 1,500, 10% debentures (face value ₹ 100 each) of Shiva Limited at ₹ 125 cum-interest on 01.12.2013. The interest is payable on 31st March and 30th September every year. Find out the actual amount received by Vikas (excluding interest) on account of sale of investment.

Answer:

Total amount received from sale of debentures (cum-Interest) = 1,500 x 125 = ₹ 1,87,500
Less: Interest from 01.10.2013 to 30.11.2013 (1,500 x 100 x 10% x 2/12) = ₹ 2,500
Actual amount received (excluding interest) on A/c of sale of Investments = ₹ 1,85,000.

(b) Journalise the following transaction:

FD Ltd. issued 4,000 shares of ₹100 each credited as fully paid to the promoters for their services.

Answer:

Journal Entry

Particulars	L.F.	Dr. (₹)	Cr.(₹)
Goodwill A/c Dr. To, Share Capital A/c [Being the issue of 4,000 shares of ₹100 each at par to promoters as per Board's Resolution dated…..]		4,00,000	 4,00,000

(c) What is meant by Cash equivalent?

Answer:

Cash equivalents means short-term highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value.

(d) State the disclosure requirement under revised schedule VI of the following items:
- **Debit balance of Profit & Loss account**
- **Unsecured Bank loan**

Answer:

- **Debit balance of Profit & Loss account -** To be shown as a negative figure under "Surplus".

- **Unsecured Bank loan -** If it is repayable after 12 months – to be sub-classified under "Long-term Borrowing" to be presented as a separate line item. Also state the terms of repayment, and If it is repayable within twelve months – to be sub – classified under "other current liabilities. To be shown as a separate line item.

(e) Mukta Ltd. in the past three year spent ₹ 45,00,000 to develop a Drug to treat Cancer, which was charged to Profit and Loss Account since they did not meet AS-8 criteria for capitalization. In the current year approval of the concerned Govt. Authority has been received. The Company wishes to capitalize ₹ 45,00,000 and disclose it as a prior period item. Is it correct? Give reason for your views.

Answer:

As per AS-26, expenditure on an intangible item that was initially recognised as an expense by a reporting enterprise in previous annual financial statements or interim financial reports should not be recognised as part of the cost of an intangible asset at a later date. Hence Mukta Ltd. cannot capitalize ₹45,00,000.

(f) A company follows a policy of refunding money to the dissatisfied customers if they claim within thirty days from the date of purchase and return the goods. It appears from the past experience that in a month only 0.30% of the customers claim refunds. The company sold goods amounting to ₹50 lacs during the last month of the financial year. Is there any contingency?

Answer:

There is a probable present obligation as a result of past obligating event. The obligating event is the sale of product. Provision should be recognized as per AS-29. The best estimate for provision is ₹ 15,00,000 (50,00,000 x 0.30%).

(g) List the steps involved in internal control.

Answer:

An effective internal control system consists of certain important steps, which are:

- **Control Environment:** Establish Integrity & ethical value.
- **Assessment of Risk:** Establishment of plan to prevent risks.
- **Control Activities:** Formulating policies & procedures.
- **Information & communication:** Evaluation of employee performance.
- **Monitoring:** Assessing overall performance of the Organisation.

(h) What we understand by the term 'Qualified Audit Report'?

Answer:

A Qualified Audit Report is one where an Auditor gives an opinion on the truth and fairness of Financial Statements, subject to certain reservations.

(i) State the meaning of Detailed audit.

Answer:

Detailed audit is also known as audit-in-depth. It involves checking of transactions from the time of their recording till their final effect on the Financial Statements. Every stage that a transaction goes through in the accounting process is closely examined by the auditor using various audit evidences.

(j) List the use of Interim Audit.

Answer:

Use of Interim Audit —

It is useful for:

- Early detection and rectification of errors & frauds;
- Publishing of interim results in some cases;
- Timely completion of records and final audit;
- Moral checks on employees.

2. (Answer any 2 questions)

(a) Amit purchased a computer for ₹44,000 and leased out it to Sumit for four years on leases basis, after the lease period , value of the computer was estimated to be ₹ 3,000; which he realized after selling it in the second hand market. Lease amount payable at the beginning of each year is ₹ 22,000; ₹13,640;₹6,820 & ₹3,410. Depreciation was charged @ 40% p.a. You are required to pass the necessary journal entries in the books of Sumit. [8]

Answer:

Journal Entries
In the books of Sumit

Date	Particulars		Dr.(₹)	Cr.(₹)
?	**Purchase of Computer:**		**No Entry**	
	Payment of First Year's Lease: Lease Rent A/c To, Bank A/c	Dr.	22,000	22,000
	Depreciation for First Year:		**No Entry**	
?	**Transfer to Profit & Loss Account:** Profit and Loss A/c To, Lease Rent A/c	Dr.	22,000	22,000
?	**Payment of Second Year's Lease:** Lease Rent A/c To, Bank A/c	Dr.	13,640	13,640
	Depreciation for Second Year:		**No Entry**	
?	**Transfer to Profit & Loss Account:** Profit and Loss A/c To, Lease Rent A/c	Dr.	13,640	13,640
?	**Payment of Third Year's Lease:** Lease Rent A/c To, Bank A/c	Dr.	6,820	6,820
	Depreciation for Third Year:		**No Entry**	

?	**Transfer to Profit & Loss Account:** Profit and Loss A/c Dr. To, Lease Rent A/c	6,820	6,820
?	**Payment of Fourth Year's Lease:** Lease Rent A/c Dr. To, Bank A/c	3,410	3,410
	Depreciation for Fourth Year:	**No Entry**	
?	**Transfer to Profit & Loss Account:** Profit and Loss A/c Dr. To, Lease Rent A/c	3,410	3,410
	Sale of Lease Assets:	**No Entry**	

(b) (i) Best Wishes Ltd. has got the license to manufacture particular medicines for 10 years at a license fee of ₹ 400 lakhs, given below is the pattern of expected production and expected operating cash inflow.

Year	Production in bottles (₹In thousands)	Net operating cash flow (₹ in lakhs)
1	600	1,800
2	1,200	3,600
3	1,300	4,600
4	1,600	6,400
5	1,600	6,400
6	1,600	6,400
7	1,600	6,400
8	1,600	6,400
9	1,600	6,400
10	1,600	6,400

Net operating cash flow has increased for third year because of better inventory management and handling method. Suggest the amortization method. [6]

Answer:

As per Accounting Standard 26 on intangibles, the amortization method used should reflect the pattern in which economic benefits are consumed by the enterprise. If pattern cannot be determined reliably, then straight-line method should be used.

In the instant case, the pattern of economic benefit in the form of net operating cash flow vis-a-vis production is determined reliably. Initially net operating cash flow per thousand bottles is ₹ 3 lakhs for first two years and ₹ 4 lakhs from fourth year onwards, the pattern is established and therefore the Best Wishes Ltd. should amortize the license fee of ₹ 400 lakhs as under :

Year	Net operating Cash inflow	Ratio	Amortize amount (₹in lakhs)
1	1,800	0.03	12
2	3,600	0.06	24
3	4,600	0.08	32
4	6,400	0.12	48
5	6,400	0.12	48

6	6,400	0.12	48
7	6,400	0.12	48
8	6,400	0.12	48
9	6,400	0.12	48
10	6,400	0.11 (balance)	44
	54,800	**1.00**	**400**

(ii) What should be disclosed for defined contribution pension plans? **[2]**

Answer:

An enterprise should disclose —

- The amount recognized as an expense for defined contribution plan.
- Where required by AS-18, "Related Party Disclosure" an enterprise discloses information about contributions to defined contribution plans for key management personnel.

(c) (i) From the following information compute diluted earnings per share.

Net profit for the year 2013	**₹12,00,000**
Weighted average number of equity shares outstanding during year 2013	**5,00,000 shares**
Average fair value of one equity share during the year 2013	**₹20**
Weighted average number of shares under option during the year 2013	**1,00,000 shares**
Exercise price per share under option during the year 2013	**₹15**

[4]

Answer:

Particulars	**Earnings ₹**	**Shares**	**Earning per share ₹**
Net profit for the year 2013	12,00,000		
Weighted average number of equity shares outstanding during the year 2013		5,00,000	
Basic earnings per share (12,00,0000/5,00,000)			2.40
Weighted average number of shares under option		1,00,000	
Number of shares that would have been issued at fair value (1,00,000 × 15.00)/20.00	*	(75,000)	
Diluted earnings per share (12,00,0000/5,25,000)	12,00,000	5,25,000	2,29

*The earnings have not been increased as the total number of shares has been increased only by the number of shares 25,000 deemed for the purpose of computation to have been issued for no consideration (AS 20).

(ii) State the disclosure requirement as per AS – 11. **[4]**

Answer:

Following are the matters to be disclosed as per AS – 11:

- Amount of exchange difference included in the net profit or loss.
- Amount accumulated in foreign exchange translation reserve.
- Reconciliation of opening and closing balance of foreign exchange translation reserve.
- If the reporting currency is different from the currency of the country in which entity is domiciled, the reason for such difference.
- A change in classification of significant foreign operation needs following disclosures —

  - Nature of change in classification;
    The reason for the change;
  - Effect of such change on shareholders fund;
  - Impact of change on net profit or loss for each prior period presented;
  - The disclosure is also encouraged of an enterprise's foreign currency risk management policy.

3. (Answer any 2 questions)

(a) (i) Emerald Ltd. agreed to absorb Ruby Ltd. on 31st March 2012, whose Balance Sheet stood as follows:

Liabilities	Amount ₹	Assets	Amount ₹
Share Capital: 1,60,000 shares of ₹ 100 each fully paid	**1,60,00,000**	**Fixed Assets**	**1,40,00,000**
Reserve and Surplus:		**Current Assets, Loans & Advances:**	
General Reserve	**20,00,000**	**Stock in Trade**	**20,00,000**
Secured Loan	**-**	**Sundry Creditors**	**40,00,000**
Unsecured Loan	**-**		
Current Liabilities and Provisions:			
Sundry Creditors	**20,00,000**		
	2,00,00,000		**2,00,00,000**

The consideration was agreed to be paid as follows :

i. A payment in cash of ₹ 50 per share in Ruby Ltd. and

ii. The issue of shares of ₹ 100 each in Emerald Ltd., on the basis of 2 Equity Shares (valued at ₹ 150) and one 10% Cumulative Preference Share (valued at ₹ 100) for every five shares held in Ruby Ltd.

It was agreed that Emerald Ltd. will pay in cash for fractional shares equivalent at agreed value of shares in Ruby Ltd. i.e., ₹ 650 for five shares of ₹ 500 paid.

The whole of the Share capital consists of shareholdings in exact multiple of five except the following holding:

Uma	**232**
Sunil	**152**
Ritam	**144**

Vinit	**56**	
Other individuals	**16**	**(sixteen members holding one share each)**
	600	

Prepare a statement showing the purchase consideration receivable by above shareholders in shares and cash. **[10]**

Answer:

WN # 1 : ***Statement of consideration paid for fraction shares***

	Particulars	Uma	Sunil	Ritam	Vinit	Others	Total
a.	Holding of shares	232	152	144	56	16	600
b.	Non-exchangeable shares (Payable in Cash)	2	2	4	1	16	25
c.	Exchangeable Shares [(a) - (b)]	230	150	140	55	—	575
d.	Above shares						
	i. in Equity shares (2:5)	92	60	56	22	—	230
	ii. in Preference shares (1:5)	46	30	28	11	—	115

WN # 2 : Number of shares to be issued

a. Exchangeable shares :

= Total shares – Non Exchangeable shares

= 1,60,000 – 25 = 1,59,975

b. Equity shares to be issued (2 shares for every 5 shares):

$$\frac{1{,}59{,}975}{5} \times 2 = 63{,}990$$

c. Preference shares to be issued(1 shares for every 5 shares):

$$\frac{1{,}59{,}975}{5} \times 1 = 31{,}995$$

WN # 3 : Cash to be paid

	Particulars	₹
a.	1,59,975 shares @ ₹ 50 each	79,98,750
b.	Consideration for non-exchangeable $[25 \times 100] \times \frac{650}{500}$ (i.e. ₹ 650 for five shares of ₹ 500 paid)	3,250
c.	Total	80,02,000

Statement of Purchase Consideration :

Particulars		₹
a. In Shares :		
i. 63,990 Equity shares @ ₹ 150 each	95,98,500	
ii. 31,995 Preference shares @ ₹ 100 each	31,99,500	1,27,98,000
b. In Cash (WN # 3)		80,02,000
c. Total (a+b)		2,08,00,000

(ii) From the following particulars of Pintop Ltd. you are required to calculate the Managerial Remuneration in the following situations:

- **There is only one Whole Time Director.**
- **There are two Whole Time Directors.**
- **There are two Whole Time Directors, a part time Director and a Manager.**

Particulars	**₹**
Net Profit before Income Tax and Managerial Remuneration, but after Depreciation and Provision for Repairs	**8,70,410**
Depreciation provided in the Books	**3,10,000**
Provision for Repairs for Machinery during the year	**25,000**
Depreciation Allowable under Schedule XIV	**2,60,000**
Actual Expenditure incurred on Repairs during the year	**15,000**

[6]

Answer:

A. Computation of Net Profits u/s 349 of the Companies Act

Particulars	₹
Net Profit before Provision for Income-tax and Managerial Remuneration, but after Depreciation and Provision for Repairs	8,70,410
Add: Depreciation provided in the Books	3,10,000
	11,80,410
Less: Depreciation allowable under Schedule XIV	(2,60,000)
Net Profits under Section 349	9,20,410

Note: While computing the Net Profit u/s 349:

- All usual working charges will be allowed.
- Expenses on repairs, whether to movable / immovable property provided the repairs are not of capital nature will be allowed.
- Provision for Repairs of Machinery are usual working charges and hence allowed for computing Net Profit u/s 349.

B. Computation of Managerial Remuneration u/s 309

Situation	% of Remuneration	Managerial Remuneration

One Whole Time Director	5%	₹ 46,020.50
Two Whole Time Directors	10%	₹ 92,041.00
Two Whole Time Directors and Part Time Director and a Manager	11%	₹ 1,01,245.10

(b) (i) OMR Limited recently made a public issue in respect of which the following information is available:

- **No. of partly convertible debentures issued 4,00,000; face value and issue price ₹100 per debenture.**
- **Convertible portion per debenture 60%, date of conversion on expiry of 6 months from the date of closing of issue.**
- **Date of closure of subscription lists 1.5.2013, date of allotment 1.6.2013, rate of interest on debenture 15% payable from the date of allotment, value of equity share for the purpose of conversion ₹ 60 (Face Value ₹ 10).**
- **Underwriting Commission 2.5 %.**
- **No. of debentures applied for 3,00,000.**
- **Interest payable on debentures half-yearly on 30th September and 31st March.**
- **Write relevant journal entries for all transactions arising out of the above during the year ended 31st March, 2014 (including cash and bank entries). [8]**

Answer:

In the books of OMR Ltd.

Journal Entries

Date	Particulars		Dr. (₹)	Cr. (₹)
1.5.13	Bank A/c	Dr.	300,00,000	
	To Debenture Application A/c			300,00,000
	(Application money received on 300,000 debentures @ ₹ 100 each)			
1.6.13	Debenture Application A/c	Dr.	300,00,000	
	Underwriters A/c	Dr.	100,00,000	
	To 15% Debentures A/c			400,00,000
	(Allotment of 3,00,000 debentures to applicants and 1,00,000 debentures to underwriters)			
	Underwriting Commission A/c	Dr.	10,00,000	
	To Underwriters A/c			10,00,000
	(Commission payable to underwriters @ 2.5 % on ₹4,00,00,000)			
	Bank A/c	Dr.	99,00,000	
	To Underwriters A/c			99,00,000
	(Amount received from underwriters in settlement of account)			
30.9.13	Debenture Interest A/c	Dr.	20,00,000	
	To Bank A/c			20,00,000
	(Interest paid on debentures for 4 months @ 15% on ₹ 400,00,000)			
30.10.13	15% Debentures A/c	Dr.	240,00,000	
	To Equity Share Capital A/c			40,00,000
	To Securities Premium A/c			200,00,000
	(Conversion of 60% of debentures into shares of ₹ 60 each with a face value of ₹ 10)			
31.3.14	Debenture Interest A/c	Dr.	15,00,000	
	To Bank A/c			15,00,000
	(Interest paid on debentures for the half year)			

Working Note :

Calculation of Debenture Interest for the half year ended 31st March, 2014

On ₹ 160,00,000 for 6 months @ 15%	= ₹ 12,00,000
On ₹ 240,00,000 for 1 months @ 15%	= ₹ 3,00,000
	₹ 15,00,000

(ii) Discuss the three types of Cash Flows in the context of AS - 3. [5]

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.

(iii) Explain Negative Goodwill in case of amalgamation in the nature of purchase. [3]

Answer:

If the consideration paid for amalgamation is less than the Net Assets of the transferor company, the difference is called Negative Goodwill. This should be recognised in the transferee company's financial statements as Capital Reserve,

Example: Mitra Ltd. acquired the Net Assets of Uma Ltd. for a total consideration of ₹500 lakhs. The fair value of Net Assets of Uma Ltd. is ₹800 lakhs. In the above case, the difference of ₹300 lakhs constitutes Negative Goodwill. This should be recognised as Capital Reserve in the Financial Statement of Mitra Ltd.

(c) (i) List the conditions to be fulfilled to attract the Pooling of Interest method in the case of Mergers and Acquisition? [6]

Answer:

Amalgamation in the nature of merger is an amalgamation, which satisfies all the following conditions:

- All the assets and liabilities of the transferor company become the assets and liabilities of the transferee company;
- Shareholders holding not less than 90% of the face value of the equity shares of the transferor company (other than transferee company and its nominees) become equity shareholders of the transferee company after amalgamation;
- The consideration is to be discharged by way of issue of equity shares in the transferee company to the shareholders of the transferor company on the amalgamation;
- The business of the transferor company is to be carried on by the transferee company;
- No adjustments are intended to be made to the book values of the assets and liabilities of the transferor company.

If any one or more of the aforesaid conditions are not satisfied then the amalgamation is in nature of purchase.

Amalgamation in the nature of merger is to be accounted as per the Pooling of Interest Method and in case of amalgamation in the nature of purchase accounting needs to be done as per the Purchase Method.

(ii) Following details are given for Prithvi Ltd. for the year ended 31st March, 2014:

(₹ in lakhs)

Sales:		
Food Products	**11,300**	
Plastic and Packing	**1,250**	
Health and Scientific	**690**	
Others	**324**	**13,564**
Expenses:		
Food Products	**6,670**	
Plastic and Packing	**850**	
Health and Scientific	**444**	
Others	**400**	**8,364**
Other Items:		
General corporate Expenses		**1,124**
Income from investments		**364**
Interest expenses		**130**
Identifiable assets:		
Food Products	**14,640**	
Plastic and Packing	**2,640**	
Health and Scientific	**2,100**	
Others	**1,330**	**20,710**
General Corporate Assets		**1,444**

Other Information:

- **Inter-segment sales are as below:**

(₹ in lakhs)

Food Products	**110**
Plastic and Packing	**144**
Health and Scientific	**42**
Others	**14**

- **Operating profit includes ₹66 lakhs on inter-segment sales.**
- **Information about inter-segment expenses are not available.**

You are required to prepare a statement showing financial information about Prithvi Ltd.'s operations in different industry segments. [10]

Answer:

Information about Prithvi Ltd.'s operations in different Industry segments is furnished in the following table :

	Food Products	Plastic & Packaging	Health & Scientific	Others	Inter-segment Elimination	Consolidated
External Sales	11,190	1,106	648	310	—	13,254
Inter-segment	110	144	42	14	310	-
Total	11,300	1,250	690	324	310	13,254
Segment Expenses	6,670	850	444	400	244	8,120
Operating Profit	4,630	400	246	(76)	66	5,134
General Corporate Expenses						(1,124)
Income from Invest.						264
Interest						(130)
Income from continuing operations						4,144
Identifiable assets	14,640	2,640	2,100	1,330		20,710
Corporate assets	—	—	—	—	—	1,444
Total assets						22,154

4. (Answer any 2 questions)

(a) (i) State the areas of operation that are involved in an internal audit. [5]

Answer:

According to the Institute of Internal Auditors, internal audit involves five areas of operations:

- **Reliability and integrity of financial and operating information:** Internal auditors should review the reliability and integrity of financial and operating information and the means used to identify, measure, classify and report such information.

- **Compliance with laws, policies, plans, procedures and regulations:** Internal auditor should review the systems established to ensure compliance with those policies, plan and procedures, law and regulations which could have a significant impact on operations and reports and should determine whether the organization is in compliance thereof.

- **Safeguarding of Assets:** Internal auditors should verify the existence of assets and should review the means of safeguarding assets.

- **Economic and efficient use of resources:** Internal auditor should ensure the economic and efficient use of resources available.

- **Accomplishing of established objectives and goals for operations:** Internal auditor should review operation or programmes to ascertain whether results are consistent with established objectives and goals and whether the operations or programmes are being carried out as planned.

(ii) List the disadvantages of Joint Audit. [3]

Answer:

The following may be the disadvantages of a joint audit:

- Sharing of fees;
- Psychological problem, where firms of different standing are associated in Joint audits;
- Superiority complex of some auditors may affect the work of co-auditor;
- Problem arises regarding co - ordination of the work;
- Areas of work of common concern being neglected;
- Uncertainty about the liability for the work done.

(iii) Describe 'Voucher' and 'Vouching'. [4]

Answer:

A voucher is a piece of substantiating evidence, in the form of a written record of expenditure disbursement, or completed transaction.
Examples of vouchers are: Cash Memo, Sale Invoice. Purchase Requisition Slip, Purchase Invoice Gate Keeper's Note, Bank Paying Slip, Bank Statements. Minutes Book, etc.

The act of examining all documentary evidences (vouchers) is referred to as vouching. Its basic objective is to establish the authenticity of the transactions recorded in the primary books of account. Vouching is said to be 'the essence of auditing" or may be termed as the 'backbone of auditing".
Importance of Vouching — Serves as evidence; Assurance; Preliminary for Verification; Establishes Authenticity.

(iv) Discuss cut off procedure. Explain its significance in the context of Auditing. [4]

Cut off procedure would mean a procedure adopted to give a delink between two time periods prompted by accounting procedure or a legal requirement. Example: Date of accounting closing to ascertain the profit or loss - for accounting procedure. Ascertain the profits between pre and post incorporation periods - legal requirement.

Possible areas where cut off procedure has significant impact is given below:

- Accounts receivable and accounts payable these are the most susceptible to recording of transactions in the inappropriate accounting period.

- Purchase bills or rising of sales invoice which requires to be linked to the accounting period for determining the profit or loss of the period.

It is the auditor's duty to examine cut off points and ensure that the transactions are recorded in the relevant period in which the commercial transactions relate to or take place.

(b) (i) Discuss Missing Vouchers. [6]

Answer:

Missing Vouchers:

A missing voucher can be any of the following:

Missing Cash Memo, missing page in a Cash Collection Statement, missing inward challan for goods received, missing Inspection Report for material, missing TDS Certificate for tax deducted at source, missing Resolution to authorize increase in borrowing power by the company, missing Bank Statement for a day or a month, etc.

A voucher could become missing due to:

- Wrong or careless filing of document. E.g., missing Bank Statement for a day or a month, missing TDS Certificate.
- Unintentional non-awareness of statutory requirements. e.g., missing Resolution to authorize increase in borrowing power by the company, or accidental fire, or lost otherwise.
- Intention to hide the misappropriation by a person. e.g., non-recording of Purchas Invoices received later for goods received and taken in stocks, missing Cash Memo, etc.

The auditor should be careful and should carry out cross verification processes from other sources and documents to be able to form a firm opinion in the case of missing vouchers.

The auditor should qualify his report or give a Disclaimer of Opinion in this case, or may give Vouching and Verification an adverse report with reasoning on a particular issue depending upon the materiality of the missing voucher as necessary evidence on the issue.

(ii) Discuss 'Expenditure Audit' in relation to the Government Audit. [6]

Answer:

Expenditure Audit: The basic standards set for audit of expenditure are to ensure that there is provision of funds authorized by competent authority fixing the limits within which expenditure can be incurred. Some standards are briefly explained below:

- **Audit against Rules & Orders:** It is also known as Regularity Audit. Under this, the auditor has to see that the expenditure incurred conforms to the relevant provisions of the statutory enactment and is in accordance with the financial rules and orders framed by the competent authority.

- **Audit of Sanctions:** The auditor has to ensure that each item of expenditure is covered by a sanction, either general or special, accorded by the competent authority, authorizing such expenditure. In case expenditure exceeds the sanctioned limit, objection is raised.

- **Audit against Provision of Funds:** It contemplates that there is a provision of funds out of which expenditure can be incurred and the amount of such expenditure does not exceed the sanctioned amount as well as examine whether the money has been spent for the specified purpose.

- **Audit of financial propriety:** The auditor has to ensure that the expenditure incurred are with respect to the recognized standards of financial propriety i.e. quantity, quality, morality and ethics.

(iii) State the procedure for removal of statutory auditor before the expiry of his term as per Companies Act, 2013. [4]

Answer:

Removal of auditor before expiry of his term [Section 140(1) of Companies Act, 2013]:

(a) Resolution : Such removal requires a special resolution.
(b) Approval: Previous approval of the Central Government must be obtained in the manner prescribed.
(c) Procedure for obtaining approval of the Central Government and passing Special Resolution (Rule 7).
(i) An application shall be made to the Central Government in Form ADT-2. The application shall be accompanied with the prescribed fees.
(ii) The application shall be made to the Central Government within 30 days of passing of the Board resolution.
(iii) The company shall hold the general meeting within 60 days of receipt of approval of the Central Government for passing the special resolution.
(d) Opportunity of being heard: Before taking any action for removal, the auditor shall be given a reasonable opportunity of being heard.

(c) (i) Whether an Auditor opinion in a financial statement is persuasive or a conclusive in nature? [2]

Answer:

Auditors opinion in a financial statement is persuasive and not a conclusive in nature. In the financial statement, auditors gives their conclusion but based on that conclusion, user of the financial statement can't conclude the future viability of the Company or firm and took a decision on the basis of that opinion.

(ii) Discuss the significance of audit working papers. [5]

Answer:

Working Papers are necessary to –

- Aid in planning and performance of the audit;
- Aid in the supervision and review of the audit work;
- Provide evidence of the audit work performed to support the Auditor's opinion;

- Record and demonstrate the audit work from one year to another;
- Plan the timing and extent of audit procedures to be performed;
- Draw conclusions from the evidence obtained;
- Standardize the Working Papers and audit procedures to improve the efficiency of the audit;
- Facilitate the delegation of work as a means to control quality of work performed;
- Provide guidance to the audit staff with regard to the manner of checking the schedules;
- Fix responsibility on the staff member who signs each schedule checked by him, and
- Act as evidence in a Court of law when a charge of negligence is brought against the auditor.

(iii) Barish Ltd. is holding 75% of Equity Shares of Akash Ltd. and prepares the financial statement applying AS - 21, As an auditor how would you verify the cost of control and the minority interest as stated in the Consolidated Financial Statement. [9]

Answer:

Following are the areas to be covered during verification of Cost of Control —

- The percentage of holding;
- Is there any type of purchase of Preference Shares or not?
- Date of acquisition, if there is any purchase in lot considering the same;
- Date of holding;
- Date of balance sheet;
- Date of Consolidation;
- Whether there is any bonus issue of shares, whether it is before holding or after holding, whether the issue of bonus properly accounted for or not?
- Whether there is any event affecting the value of reserves or not, like revaluation of fixed assets, acquisition of debentures etc;
- Whether there is any payment of dividend by the subsidiary company? Whether the dividend pre or post acquisition? In case of purchase in lot whether proper analysis is done considering the percentage of acquisition of shares?
- Whether there is any proposed dividend? If yes, whether the same has been properly accounted for or not?
- Whether there is any incident of disposal of shares or not?

Following are the areas to be covered during verification of Minority Interest —

- Percentage of shares held by the minority shareholders;
- Whether there is any incident of disposal of shares or not?
- Proportion and amount of profit to be received by the minority shareholders;
- Whether there is any type of up-stream transaction?
- Whether there is any type of unrealized profits to be adjusted?
- Proportion of dividend to be received by the minority holders etc.