Paper – 12: Company Accounts and Audit

The following table lists the learning objectives and the verbs that appear in the syllabus learning aims and examination questions:

	Learning objectives	Verbs used	Definition
LEVEL B	KNOWLEDGE What you are expected to know	List	Make a list of
		State	Express, fully or clearly, the details/facts
		Define	Give the exact meaning of
	COMPREHENSION What you are expected to understand	Describe	Communicate the key features of
		Distinguish	Highlight the differences between
		Explain	Make clear or intelligible/ state the meaning or purpose of
		Identity	Recognize, establish or select after consideration
		Illustrate	Use an example to describe or explain something
	APPLICATION How you are expected to apply your knowledge	Apply	Put to practical use
		Calculate	Ascertain or reckon mathematically
		Demonstrate	Prove with certainty or exhibit by practical means
		Prepare	Make or get ready for use
		Reconcile	Make or prove consistent/ compatible
		Solve	Find an answer to
		Tabulate	Arrange in a table
	ANALYSIS How you are expected to analyse the detail of what you have learned	Analyse	Examine in detail the structure of
		Categorise	Place into a defined class or division
		Compare and contrast	Show the similarities and/or differences between
		Construct	Build up or compile
		Prioritise	Place in order of priority or sequence for action
		Produce	Create or bring into existence

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]

(i) A Company has its Share Capital divided into Equity Shares of ₹10 each. On 01.10.2013, it granted 20,000 Employees' Stock Option at ₹50 per Share, when Market Price was ₹120 per Share. The Options were to be exercised between 10.12.2013 and 31.03.2014. The Employees exercised their options for ₹ 16,000 Shares only, and the remaining options lapsed. The Company closes its books on 31st March every year. Show Journal Entry (with narration) as would appear in the Company's books upto 31.03.2014.

Answer:

Journal Entry for ESOP

Particulars		Dr.(₹)	Cr. (₹)
Bank A/c (16,000 Shares × ₹ 50)	Dr.	8,00,000	
Employees' Compensation Expense A/c [16,000 Shares × (₹120 - ₹50) i.e.₹ 70]	Dr.	11,20,000	
To Equity Share Capital A/c (16,000 Shares × ₹ 10)			1,60,000
To Securities Premium A/c [16,000 Shares × ₹ (120 - 10)			17,60,000
(Being 16,000 Shares allotted to Employees under ESOP at a Premium of ₹ 110 per Share)			

(ii) RadhaKanta set up a new factory in the backword area and purchased Plant for ₹600 Lakhs for the purpose. Purchases were entitled for the CENVAT Credit of ₹12 Lakhs and also the Government agreed to extend 20% Subsidy for Backward Area Development. Determine the Depreciable Value of the Asset.

Answer:

Particulars	₹ Lakhs
Cost of the Plant	600
Less: CENVAT Credit available	(12)
Balance	588
Less: Subsidy at 20% of 588 Lakhs	117.60
Depreciable value of the plant	470.40

(iii) Compute the Weighted Average Number of Equity Shares in the following case:

		No of Shares
1st April 2014	**Balance of Equity Shares**	**4,80,000**
31st August 2014	**Equity Shares issued for cash**	**3,60,000**
1st February 2015	**Equity Shares bought back**	**1,80,000**
31st March 2015	**Balance of Equity Shares**	**6,60,000**

Answer:

Computation of Weighted Average Number of Shares outstanding during the period

Date	No. of Equity Shares	Period Outstanding (upto 31st Dec.)	Time Weighting Factor	Weighted Average Number of Shares
(1)	**(2)**	**(3)**	**(4)**	**(5) = (2) × (4)**
1st Apr	4,80,000	12 months	12/12	4,80,000
31st Aug	3,60,000	7 months	7/12	2,10,000
1st Feb	1,80,000	2 months	2/12	(30,000)
Weighted Average Number of Equity Shares Outstanding during the period				6,60,000

(iv) An Oil Company causes contamination but does not clean up because there is no legislation requiring cleaning up. The Enterprise has been contaminating land for several years. On 31st March, it is virtually certain that a law requiring a clean-up of land already contaminated will be enacted shortly after the year end — Analysis.

Answer:

- Obligating event is the contamination of the land because of the virtual certainty of legislation requiring cleaning up.
- Outflow of resources is probable.
- In this case best estimate of the liability can be made.

Hence, provision is recognised for the best estimate of the costs of the cleanup.

(v) Distinguish between Amalgamation and Acquisition.

Answer:

Particulars	Amalgamation	Acquisition
1. Meaning	It means an **amalgamation** pursuant to the provisions of the Companies Act, 2013, or any other applicable statute.	**Acquisitions** arise when there is a purchase by one company of whole or part of the shares or assets of another company.
2. Parties	Transferor company & transferee company.	Acquired company & acquiring company.
3. Entity	Transferor company ceases to exist after amalgamation.	Acquired company is not dissolved. It continues to exist as a separate company.
4. AS - 14	Applicable.	Not Applicable.

(vi) The share capital of M Ltd. consists of 1,00,000 equity shares of ₹10 each, and

- **25,000 preference shares of ₹100 each, fully called up.**
- **Its Securities Premium account shows a balance of ₹40,000 and**
- **General Reserve of ₹7,00,000.**
- **The company decides to buy-back 30,000 equity shares of ₹12 each.**
- **For this purpose, it utilises the securities premium in full and general reserve to the extent necessary.**

Pass the necessary journal entry only showing the effects of buy-back (without showing the effect in Capital Redemption Reserve Account).

Answer:

Particulars		Dr. (₹)	Cr.(₹)
Equity Share Capital A/c	Dr.	3,00,000	
Securities Premium A/c	Dr.	40,000	
General Reserve A/c	Dr.	20,000	
To, Equity Shareholders A/c			3,60,000
(Being the amount due to equity shareholders for buying-back of 30,000 equity shares)			

(vii) State what is complete audit.

Answer:

A complete audit is an audit where the scope of audit is not confined to specific limits, which may be set by the management or any other authority. The auditor is required to check all the possible aspects of a business, including manufacturing operations, data flow processes, accounting records and procedures, etc. In general business practices, it is not feasible to get a complete audit conducted.

(viii) List the advantages of Final Audit.

Answer:

Advantages of Final Audit:

i. The work can be carried on at a stretch. Thus the thread of work is not lost.
ii. As the audit work commences only after the year end, there is no dislocation of client's work.
iii. Collusion among audit staff and client's staff can be avoided.
iv. Periodical audit is also suitable for small size concerns.

(ix) Discuss about remuneration of an auditor (Section 142 of the Companies Act,2013) .

Answer

(1) The remuneration of the auditor of a company shall be fixed in its general meeting or in such manner as may be determined therein.
Provided that the Board may fix remuneration of the first auditor appointed by it.
(2) The remuneration under sub-section (1) shall, in addition to the fee payable to an auditor, include the expenses, if any, incurred by the auditor in connection with the audit of the company and any facility extended to him but does not include any remuneration paid to him for any other service rendered by him at the request of the company.

(x) State the rules of Companies Act,2013 relating to the auditors to attend General Meeting .

Answer:

As per section 146 of the Companies Act,2013 — all notices of, and other communications relating to, any general meeting shall be forwarded to the auditor of the company, and the auditor shall, unless otherwise exempted by the company, attend either by himself or through his authorised representative, who shall also be qualified to be an auditor, any general meeting and shall have right to be heard at such meeting on any part of the business which concerns him as the auditor.

2.(a) (i) Shiva Ltd imported a machine on 04.01.2009 for Euros 12,000, on deferred payment basis, payment in six equal annual installments at every financial year end, commencing from 31.03.2009 onwards. Use AS - 11 provisions and determine the exchange differences and carrying amounts of the liability at the end of each financial year, if the following exchange rates are given. Take One Euro equals Indian Rupees on –

04.01.2009	31.03.2009	31.03.2010	31.03.2011	31.03.2012	31.03.2013	31.03.2014
₹64.0900	₹63.0900	₹62.0800	₹60.5600	₹63.2400	₹68.3403	₹70.1005

[6]

Answer:

A. Computation of carrying Amounts of Liability

Financial Year ending	EURO Amount due	Closing Rate	Carrying Amount in ₹
31st March 2009	10,000	63.0900	6,30,900
31st March 2010	8,000	62.0800	4,96,640
31st March 2011	6,000	60.5600	3,63,360
31st March 2012	4,000	63.2400	2,52,960
31st March 2013	2,000	68.3403	1,36,681
31st March 2014	Nil	70.1005	Nil

B. Computation of Exchange Differences

Fin. Year ending	Due to Settlement	Due to Reporting
31st Mar 2009	2,000 × (64.0900 - 63.0900) = 2,000 Gain	10,000 × (64.0900 - 63.0900) = 10,000 Gain
31st Mar 2010	2,000 × (63.0900 - 62.0800) = 2,020 Gain	8,000 × (63.0900 - 62.0800) = 8,080 Gain
31st Mar 2011	2,000 × (62.0800 - 60.5600) = 3,040 Gain	6,000 × (62.0800 - 60.5600) = 9,120 Gain
31st Mar 2012	2,000 × (60.5600 - 63.2490) = 5,360 Loss	4,000 × (60.5600 - 63.2400) = 10,720 Loss
31st Mar 2013	2,000 × (63.2400 - 68.3403) = 10,200 Loss	2,000 × (63.2400 - 68.3403) = 10,200 Loss
31st Mar 2014	2,000 × (68.3403 - 70.1005) = 3,520 Loss	Nil

Note: Exchange Difference gain is credited to P&L, while Loss is debited to P&L.

2.(a) (ii) State any two types of lease to which AS-19 is not applicable. [2]

Answer:

The Accounting Standard AS-19 is not applicable to the following types of Lease:

- Lease agreement to explore natural resources such as oil, gas, timber, metal and other material rights;
- Lease agreement to use land.

2.(b)(i) MahaLaya Ltd. borrowed ₹ 40,00,000 for purchase of Machinery on 01.06.20X1. Interest on Loan is 9% p.a. The Machinery was put to use from 01.01.20X2. Pass Journal Entry for the year ended 31.03.20X2 to record the Borrowing Cost of the Loan as per AS-16. [4]

Answer:

Notes and Assumptions:

- The Machinery purchased was not ready for its intended use on the date of acquisition. It was ready for intended use only on the date on which it was put to use. Hence, the Machinery is a "**Qualifying Asset**" for the period of 7 months from 01.06.20X1 to 01.01.20X2.
- Hence, Interest Cost for the period of construction, i.e. from 01.06.20X1 to 01.01.20X2 is capitalized as part of the asset. The amount to be capitalized = ₹ 40,00,000 × 9% × 7/12 = ₹ 2,10,000.

Particulars		Dr. (₹)	Cr. (₹)
Interest A/c To Interest payable A/c (Being total interest accrued for year, i.e. ₹40,00,000 × 9% × 10/12)	Dr.	3,00,000	 3,00,000
Machinery A/c To Interest A/c (Being amount of interest capitalized)	Dr.	2,10,000	 2,10,000
Interest payable A/c To Bank A/c (Being total Interest on loan paid)	Dr.	3,00,000	 3,00,000
Profit & Loss A/c To Interest A/c (Being balance amount of Interest debit to profit and Loss A/c)	Dr.	90,000	 90,000

2.(b)(ii) The Net Profit Before Tax of Mitra Ltd. was ₹200 Lakhs and the Income Tax rate was 37%. The Company's Preference Share Capital has the following classes –

12% Non-Cumulative Preference Share Capital	**₹ 200 Lakhs**
10% Cumulative Preference Share Capital	**₹ 300 Lakhs**

In its accounts, Mitra Ltd has provided / paid following dividends on Preference Capital:

- **On Non-Cumulative Preference Shares - fully provided for the current year.**
- **On Cumulative Preference Shares - fully provided for the past three years.**

The Company also provided for Dividend Distribution Tax at 12.75% and transferred ₹ 10 Lakhs to General Reserve. You are required to calculate the Net Profit for the period, attributable to Equity Shareholders. [4]

Answer:

Particulars	Computation	₹ Lakhs
Profit Before Tax	Given	200.00
Less: Tax Expense	200.00 × 37%	74.00
Profit After Tax		126.00
Less: Preference Dividend for the period		
On Non-Cumulative Preference Shared	200.00 × 12%	24.00
On Cumulative Preference Shares for the year only	300.00 × 10%	30.00
Dividend Distribution Tax Payable	(24.00 + 30.00) × 12.75%	6.89

Net Profit for the period attributable to Equity Shareholders	65.11

Note:

A. Dividend on Cumulative Preference Shares for prior years, and
B. Transfer to General Reserve should be ignored under AS - 20, in computing Net Profit for the period attributable to Equity Shareholders.

2.(c)(i) An engineering goods Company provides after-sales warranty for 2 years to its customers. Based on past experience, the Company has the following policy for making Provision for Warranties on the Invoice Amount, on the remaining balance warranty period:
Less than 1 year: 2% provision
More than 1 year: 3% provision

The Company has raised invoices as under –

Invoice date	Amount (₹)
19.01.2011	**40,000**
29.01.2012	**25,000**
15.10.2012	**90,000**

Calculate the Provision to be made for Warranty under AS-29 as at 31.03.2012 and 31.03.2013. Also compute amount to be debited to Profit and Loss Account for the year ended 31.03.2013. **[4]**

Answer:

A. Computation of Provision at year – end:

Invoice Date	Last Date of Warranty	Provision as on 31.03.2012	Provision as on 31.03.2013
19.01.2011	19.01.2013	40,000 × 2% = 800	(Warranty period has expired) Nil
29.01.2012	29.01.2014	25,000 × 3% = 750	25,000 × 2% = 500
15.10.2012	15.10.2014	(Invoice not yet raised) Nil	90,000 × 3% = 2,700
	Total	**1,550**	**3,200**

B. Amount to be debited to Profit & Loss A/c for the year ended 31.03.2013 = Balance of Provision as on 31.03.2013 Less: Balance of Provision as on 31.03.2012 = ₹3,200 - ₹1,550 = ₹ 1,650.

2.(c)(ii) State how you will deal with the following matter in the account for the year ended 31.3.2014 The company has spent ₹ 90 lakhs for publicity and research expenses on one of its new consumer product which was marketed in the accounting year 2013-14 but proved to be a failure. **[4]**

Answer:

As per AS 26, No intangible asset arising from research (or from the research phase of an internal project) should be recognised. Expenditure on research (or on the research phase of an internal project) should be recognised as an expense when it is incurred. So, in this case, the whole of the expenses which were incurred for publicity and research and which was found to be unsuccessful should be recognised as an expense for the year 2013-14. The same should be adjusted against current year's profit.

3.(a) Ting-Tong Ltd came up with an issue of 20,00,000 Equity Shares of ₹ 10 each, at par. 5,00,000 Equity Shares were issued to the Promoters and the balance offered to public was underwritten by 3 Underwriters - P, G and K - equally.
Excluding Firm Underwriting of 50,000 Shares each, subscriptions totaled 12,97,000 Shares including Marked Forms, which were as under: P-4,25,000 Shares, G-4,50,000 Shares, and K - 3,50,000 Shares.
Each of the Underwriters had applied for the number of Shares covered by Firm Underwriting. The amount payable on Application and Allotment were ₹ 2.50 and ₹ 2 respectively. The agreed commission was 5%.
Pass journal entries for (i) Allotment of Shares to the Underwriters, (ii) Commission due to each of them, and (iii) Net Cash Paid and/or Received.
(Unmarked Application is to be credited to the Underwriters equally.) [16]

Answer:

A. Statement of Underwriters' Liability (No. of Shares), and Amount Receivable/ Payable

Particulars	P	G	K	Total
Gross Liability	5,00,000	5,00,000	5,00,000	15,00,000
Less: Marked Applications	(4,25,000)	(4,50,000)	(3,50,000)	(12,25,000)
Less: Unmarked Applications	(24,000)	(24,000)	(24,000)	(72,000)
Less: Firm Underwriting	(50,000)	(50,000)	(50,000)	(1,50,000)
Net Balance	1,000	(24,000)	76,000	53,000
Adjust: G's Surplus transferred to P and K in Gross Liability Ratio (equally)	(12,000)	24,000	(12,000)	
Revised Net Liability	(11,000)	—	64,000	53,000
Adjust: P's Surplus transferred to K	11,000		(11,000)	
Net Final Liability	—	—	53,000	53,000
Add: Firm Underwriting	50,000	50,000	50,000	1,50,000
Total Liability = Shares to be taken up by Underwriters	50,000	50,000	1,03,000	2,03,000
Amount Due upto Allotment at 4.50 per Share (₹)	2,25,000	2,25,000	4,63,500	9,13,500
Less: Amount paid for Firm Underwriting for 50,000 Shares at ₹2.50 per Share (₹)	(1,25,000)	(1,25,000)	(1,25,000)	(3,75,000)
Balance Due from Underwriters	1,00,000	1,00,000	3,38,500	5,38,500
Less: Underwriting Commission payable by Company	(2,50,000)	(2,50,000)	(2,50,000)	(7,50,000)
Amount Due from / (Payable to) Underwriters	(1,50,000)	(1,50,000)	88,500	(2,11,500)

Note:

- Shares offered to Public = 20,00,000 - 5,00,000 (Issued to Promoters) = 15,00,000 Shares.
- Unmarked Applications, = 72,000, i.e. Total Applications 12,97,000 - Marked Applications (4,25,000 + 4,50,000 + 3,50,000 = 12,25,000). These are distributed in the ratio of Gross Liability, i.e. equally. Hence 72,000 ÷ 3= 24,000 each.
- Commission Payable is calculated on Shares issued to public at par value, i.e. [Gross Liability × ₹ 10 × 5%].

B. Journal entries in the Books of Ting-Tong Ltd. (relating to Underwriters only)

	Particulars	Dr. (₹)	Cr. (₹)
1	Bank A/c Dr. To Equity Share Application A/c (Being Application Money received on Firm undertaking for 50,000 Shares each at ₹ 2.50 per Share from P, G and K)	3,75,000	 3,75,000
2	P's A/c **(WN A)** Dr. G's A/c **(WN A)** Dr. K's A/c **(WN A)** Dr. Equity Share Application A/c Dr. To Equity Share Capital A/c (2,03,000 Shares × ₹4.50) (Being allotment of Shares to Underwriters - 50,000 to P, 50,000 to G and 1,03,000 to K, Application and Allotment money credited to Equity Share Capital A/c vide Board's Resolution No...dated....)	1,00,000 1,00,000 3,38,500 3,75,000	 9,13,500
3	Underwriting Commission A/c Dr. To P's A/c To G's A/c To K's A/c (Being Underwriting Commission payable to P, G and K at 5% of the Issue Price of Shares underwritten)	7,50,000	 2,50,000 2,50,000 2,50,000
4	P's A/c Dr. G's A/c Dr. To Bank A/c (Being amount paid to P and G in final settlement of Underwriting Commission Due **Less** amount receivable from them on Shares allotted)	1,50,000 1,50,000	 3,00,000
5	Bank A/c Dr. To K's A/c (Being amount received from K on Shares allotted, **Less** Underwriting Commission payable to him)	88,500	 88,500

3.(b)(i) OM Ltd. had ₹20,00,000, 8% Debentures of ₹100 each as on 31st March,2014. The company purchased Debentures in the Open Market following immediate cancellation:

On 01.07.2014: 2,000 Debentures at ₹97 (cum-interest).
On 29.02.2014: 3,600 Debentures at ₹99 (ex- interest).

Debenture Interest due dates are 30th September and 31st March.

Give Journal Entries in the books of the Company for the year ended 31st March, 2015. [10]

Answer:

Journal Entries

Date	Particulars	Dr.(₹)	Cr.(₹)
01.07.2014	Investment in Own 8% Debentures A/c Dr. Interest on Own 8% Debentures A/c Dr. To, Bank A/c [Being, 2,000 Debentures purchased at ₹97 cum-	1,90,000 4,000	 1,94,000

	interest. Payment = 1,94,000, Interest from 1st July to 30th September = 2,00,000 × 8% × ¼ = 4,000, hence, balance = Cost.]		
01.07.2014	8% Debentures A/c Dr. To, Investment in Own 8% Debentures A/c To, Profit on Cancellation of Own Debentures A/c [Being, Cancellation of Own Debentures.]	2,00,000	 1,90,000 10,000
30.09.2014	Interest Expense A/c Dr. To, Bank A/c (18,00,000 × 8% × ½) [Being, half yearly Debenture Interest paid on ₹18,00,000 for 6 months.]	72,000	 72,000
29.02.2015	Investment in Own Debentures A/c (3,600 × ₹99) Dr. Interest on Own 8% Debentures A/c Dr. To, Bank A/c [Being, 3,600 Debentures purchased at ₹99 ex-interest. Interest from 1st October to 29th February , i.e. for 5 months = 3,600 × 100 × 8% × $\frac{5}{12}$ = ₹12,000.]	3,56,400 12,000	 3,68,400
29.02.2015	8% Debentures A/c Dr. To, Investment in Own 8% Debentures A/c To, Profit on Cancellation of Own Debentures A/c [Being, cancellation of Own Debentures.]	3,60,000	 3,56,400 3,600
31.03.2015	Interest Expenses A/c Dr. To, Bank A/c (14,40,000 × 8% × $\frac{6}{12}$) [Being, Half-Yearly Interest paid on Debentures ₹14,40,000 for 6 months.]	57,600	 57,600
31.03.2015	Profit & Loss A/c Dr. To, Interest on Own 8% Debentures A/c To, Interest Expense A/c [Being, Interest Expense transferred to Profit & Loss A/c]	1,45,600	 16,000 1,29,600
31.03.2015	Profit on Cancellation of Owned Debentures A/c Dr. To, Profit & Loss A/c [Being, Profit on cancellation transferred to Profit & Loss A/c]	13,600	 13,600

- In the above case the Profit on Cancellation of Owned Debenture is routed through the **"Profit on Cancellation of Owned Debentures A/c"** .

3.(b)(ii) A Company grants 1,000 Employees Stock Options on 01.04.2011 at ₹40, when the Market Price is ₹160. The Vesting Period is 2½ years and the Maximum Exercise Period is 1 Year. 300 Unvested Options lapse on 31.03.2013. 600 Options are exercised on 30.06.2014.100 Vested Options lapse at the end of the Exercise Period. Compute the expenses to be recognised. [6]

Answer:

A. Computation of Expense to be recognised (venting Period = 2 ½ years)

	Particulars	Result
(a)	Fair Value of Option per Share = MPS on Grant Date ₹160 less Exercise Price ₹ 40	₹120
(b)	No. of Shares vesting under the Scheme = given	1,000 Shares
(c)	Total Fair Value of Options (a × b) to be recognised as Expense in 2 ½	₹1,20,000

	years on straight-line basis	
(d)	Expense to be recognised for Year 1 (2010 – 2012) (full year) ₹48,000 For year 2 (2012 – 2013) (full year) ₹48,000 For year 3 (2013 – 2014) (half year) ₹24,000	
(e)	Value of Active Options (after lapse of 300 Options) as on 31.03.2013 = 700 × ₹120	₹84,000
(f)	Cumulative balance in Employee Stock options O/s A/c at end of Yr 2 = ₹48,000 + ₹48,000	₹96,000
(g)	Hence, excess expenses to be reversed by transfer to General Reserve at the end of-Year 2 (f-e)	₹12,000

Note: Value of option: Intrinsic Value = MPS on Grant Date **Less** Exercise Price = ₹160 – ₹40 = ₹120. Options will vest finally on 30.09.2013 at the end of 2 ½ years. This can be exercised within one year from that date, i.e. before 30.09.2014. The Employees have exercised their Vested Options on 30.06.2014, and the balance will lapse on 30.09.2014.

3.(c)(i) The Balance Sheet of Manoj Limited as at 31st March is given below -

Liabilities	**₹**	**Assets**	**₹**
2,00,000 Equity Shares of ₹10 each, ₹5 paid	**10,00,000**	**Fixed Assets**	**11,40,000**
6,000 8% Preference Shares of ₹100 each		**Patents and Copyrights**	**80,000**
9% Debentures	**6,00,000**	**Investments at Cost (Mkt Value**	
Add: Interest accrued on Debentures	**6,00,000**	**₹ 55,000)**	**65,000**
Bank Overdraft	**1,08,000**	**Stock**	**4,00,000**
Add: Interest accrued on Bank Overdraft	**1,50,000**	**Debtors**	**4,39,000**
Current Liabilities: Creditors	**15,000**	**Bank**	**10,000**
	69,000	**Profit & Loss Account**	**4,08,000**
Total	**25,42,000**	**Total**	**25,42,000**

Note: Preference Dividend is in arrear for one year.

The following scheme is agreed upon -

- **Preference Shareholders to give up 30% of their claims, including Dividends, and desire to be paid off.**
- **Debentureholders give up their claims to interest in consideration of their interest being enhanced to 12%**
- **Bank agrees to give up 50% of its interest outstanding in consideration, of its being paid off at once.**
- **Creditors would like to grant a discount of 5% if they are paid immediately.**
- **Balance of Profit & Loss Account, Patents and Copyrights, and Debtors of ₹30,000 to be written off.**
- **Fixed Assets to be written down by ₹34,000 and Investments are to reflect their Market Value.**
- **To the extent not specifically stated, Equity Shareholders suffer on reduction of their rights.**
- **Cost of Reconstruction is ₹3,350.**

Draft Journal Entries in the books of the Company assuming that the scheme has been put through fully with the Equity Shareholders bringing in necessary cash to pay off the parties, and to leave a Working Capital of ₹30,000. [9]

Answer:

A. Cash/ Bank Account

(To compute Cash to be brought in by Equity Shareholders)

Particulars	₹	Particulars	₹
To balance b/d	10,000	By Preference Shareholders (70% × 6,48,000)	4,53,600
To Equity Share Capital **(Balancing Figure)**	7,00,000	By Bank Overdraft (1,50,000 + 7,500)	1,57,500
		By Creditors (95% × 69,000)	65,550
		By Reconstruction (Expenses)	3,350
		By balance c/d (Required)	30,000
Total	**7,10,000**	**Total**	**7,10,000**

Note: This amount of ₹ 7,00,000 will be collected as Call Money on the 2,00,000 Partly Paid Equity Shares. Hence, amount called up per Share additionally = ₹3.50.

B. Journal Entries in the books of Major Ltd.

S. No	Particulars	Dr. (₹)	Cr. (₹)
1.	8% Preference Share Capital A/c Dr.	6,00,000	
	To Preference Shareholders A/c		4,20,000
	To Reconstruction A/c		1,80,000
	(Being 30% of Claim given up by Preference Shareholders as per approved Reconstruction scheme dated....)		
2.	Reconstruction A/c Dr.	33,600	
	To Preference Shareholders A/c		33,600
	(Being 70% of arrear Preference Dividend payable to Preference Shareholders now provided for, balance 30% waived as per scheme) (₹ 6,00,000 × 8% × 70%)		
3.	9% Debentures A/c Dr.	6,00,000	
	Interest Accrued on Debentures A/c Dr.	1,08,000	
	To 12% Debentures A/c		6,00,000
	To Reconstruction A/c		1,08,000
	(Being 9% Debentures converted into 12% Debentures, in consideration of waiver of interest, which is transferred to Reconstruction A/c)		
4.	Bank Overdraft A/c Dr.	1,50,000	
	Interest Accrued on Bank Overdraft A/c Dr.	15,000	
	To Bank A/c		1,57,500
	To Reconstruction A/c		7,500
	(Being Bank Overdraft paid off including 50% of accrued interest as per Reconstruction Scheme, interest waived credited to Reconstruction A/c)		
5.	Creditors A/c Dr.	69,000	
	To Bank A/c		65,550
	To Reconstruction A/c		3,450
	(Being Creditors' claim discharged to the extent of 95% as per Scheme, the balance of 5% waived transferred to Reconstruction		

	A/c)		
6.	Reconstruction A/c Dr. To Bank A/c (Being expenses of Reconstruction paid)	3,350	 3,350
7.	Bank A/c Dr. To Equity Share Capital A/c (Being amount received on 2,00,000 Equity Shares at ₹ 3.50 per Share as per Reconstruction Scheme)	7,00,000	 7,00,000
8.	Preference Shareholders A/c Dr. To Bank A/c (Being the amount due to Preference Shareholders discharged)	4,53,600	 4,53,600
9.	Reconstruction A/c Dr. To Profit and Loss A/c To Patents & Copyright A/c To Debtors A/c To Investment A/c To Fixed Assets A/c (Being Debit Balance of P & L a/c, Patents & Copyrights, Value of Debtors, Investments and Fixed Assets written off as per Reconstruction Scheme)	5,62,000	 4,08,000 80,000 30,000 10,000 34,000
10.	Equity Share Capital A/c Dr. To Reconstruction A/c (Being balance amount reqd in Reconstruction A/c, provided by reducing Equity Capital, ₹ 3,00,000 over 2,00,000 Shares i.e. ₹1.50 per Share written off)	3,00,000	 3,00,000

Note: Equity Share Capital should be reduced by ₹3,00,000 for 2,00,000 Shares, i.e. ₹1.50 per Share. Hence, Net Amount Paid Up per Share = Already Paid Up ₹5.00 + Call Money ₹3.50 - Reduced ₹1.50 = ₹7.00

3.(c)(ii)The following is the Balance Sheet of Upset Ltd. as on 30th September:

Equity & Liabilities	**₹**	**Assets**	**₹**
Share Capital: 11% Preference Shares of ₹ 10 each	**1,00,000**	**Land and Building**	**1,20,000**
10,000 Equity Shares of ₹ 10 each, fully paid	**1,00,000**	**Sundry Current Assets**	**3,95,000**
5,000 Equity Shares of 10 each, 7.50 paid	**37,500**	**Profit & Loss Account**	**38,500**
13% Debentures	**1,50,000**	**Debenture Issue**	
Mortgage Loan	**80,000**	**Expenses not written off**	**2,000**
Bank Overdraft	**30,000**		
Creditors for Trade	**32,000**		
Arrears of Income Tax (Assessments concluded in July for 2 prior Assessment years) (21,000 + 5,000)	**26,000**		
Total	**5,55,500**	**Total**	**5,55,500**

Other Information -

- **Mortgage Loan was secured against Land and Buildings. Debentures were secured by a**

Floating Charge on all the other Assets.

- **The Company was unable to meet the payments and therefore the Debenture holders appointed a Receiver and this was followed by a resolution for Members Voluntary Winding Up.**
- **The Receiver for the Debenture holders brought the Land and Buildings to auction and realised ₹1,50,000. He also took charge of Sundry Assets of the value of ₹2,40,000 and realised ₹2,00,000.**
- **The Liquidator realised ₹1,00,000 on the sale of the balance of Sundry Current Assets.**
- **The Bank Overdraft was secured by a personal guarantee of two of the Directors of the Company, and on the Bank raising a demand, the Directors paid off the dues from their personal resources.**
- **Costs incurred by the Receiver were ₹ 2,000 and by the Liquidator ₹2,800.**
- **The Receiver was not entitled to any Remuneration, but the Liquidator was to receive 3% Fee on the value of Assets realised by him.**
- **Preference Shareholders had not been paid dividend for 2 years, and interest for the last half-year was due to Debenture holders.**

From the above information, prepare the Liquidator's Receipts and Payments Account. [7]

Answer:

A. Determination of Surplus received by Liquidator from Receiver

Receipts from Sale of	**₹**	**Payments towards -**		**₹**
Land and Buildings	1,50,000	Debenture Interest	(1,50,000 × 13% × 6/12)	9,750
Sundry Current Assets	2,00,000	Income Tax Arrears	(21,000 + 5,000)	26,000
		Expenses of Receiver	Given	2,000
		Mortgage Loan	Given	80,000
		Debentureholders	Principal Amount	1,50,000
		Balance Surplus handed over to Liquidator **(bal. fig.)**		**82,250**
Total	**3,50,000**	**Total**		**3,50,000**

B. Liquidator's Final statement of Account

Receipts	**₹**	**Payments**		**₹**
Surplus received from Receiver (WN A)	82,250	**Remuneration to Liquidator** (1,00,000 × 3%)		3,000
Sundry Assets realised	1,00,000	**Costs of Liquidation**		2,800
Calls on Contributories:		**Unsecured Creditors:**		
From 5,000 Partly Paid Shares at ₹ 2.17		Trade Creditors	32,000	
per Share	10,850	Directors (for Bank OD paid)	30,000	62,000
		Preference Shareholders:		
		Share Capital	1,00,000	
		Arrears of Dividend (2 years)	22,000	1,22,000
		Equity Shareholders:		
		(paid to Holders of 10,000 Fully Paid Shares		
		at ₹ 0.33 each)		3,300
Total	**1,93,100**	**Total**		**1,93,100**

C. Calls from Holders of Partly paid Shares

Particulars	₹
(a) Total Receipts before considering Call Money (82,250 + 1,00,000)	1,82,250
(b) Total Payments before final payment to Equity Shares (2,800 + 3,000 + 62,000 + 1,22,000)	1,89,800
(c) Surplus / (Deficit) from above before Calls made on Equity Shares **(a - b)**	(7,550)
(d) Notional Call on 5,000 Partly Paid Shares at ₹2.50 each	12,500
(e) Surplus Cash Balance after Notional Call **(c + d)**	**4,950**
(f) Number of Shares deemed fully paid (10,000 + 5,000)	15,000
(g) Hence, Refund on Fully Paid Shares (e ÷ f) = ₹ 4,950 ÷ 15,000 Shares	33 paise
(h) Therefore, **Required Call on Partly Paid Shares** = Notional Call ₹2.50 - Refund ₹0.33	**₹2.17**

4. (a) (i) Discuss the procedure of setting Auditing Standards. [6]

Answer:

The Auditing and Assurance Standards Board of the Institute formulates the auditing standards. Broadly, following is the procedure for formulating 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 account the comments received, the draft of the proposed auditing standard is finalised 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.

4. (a) (ii) Audit Opinion is not an assurance as to the future viability of the enterprise or the efficiency or effectiveness with which management has conducted the affairs of the enterprise — Comment. [4]

Answer:

The auditor's opinion does not assure, the future viability of the entity nor the efficiency or effectiveness with which management has conducted the affairs of the entity. The reasons for this statement is that the auditor's opinion on the financial statements deals with whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework. Such an opinion is common to all audits of financial statements. In some cases, however, the applicable laws and regulations may require auditors to provide opinions on other specific matters, such as the effectiveness of internal control, or the consistency of a separate management report with the financial statements. While the SAs include requirements and guidance in relation to such matters to the extent that they are relevant to forming an opinion on the financial statements, the auditor would be required to undertake further work if the auditor had additional responsibilities to provide such opinions.

4. (a) (iii) Discuss the setup of a qualified and independent Audit Committee. [6]

Answer:

A qualified and independent audit committee shall be set up, giving the terms of reference subject to the following:

- The audit committee shall have minimum three directors as members. Two-thirds of the members of audit committee shall be independent directors.
- All members of audit committee shall be financially literate and at least one member shall have accounting or related financial management expertise.
- The Chairman of the Audit Committee shall be an independent director;
- The Chairman of the Audit Committee shall be present at Annual General Meeting to answer shareholder queries;
- The Audit Committee may invite such of the executives, as it considers appropriate (and particularly the head of the finance function) to be present at the meetings of the committee, but on occasions it may also meet without the presence of any executives of the company. The finance director, head of internal audit and a representative of the statutory auditor may be present as invitees for the meetings of the audit committee;
- The Company Secretary shall act as the secretary to the committee.

4. (b) (i) Discuss the matters to be considered for conducting an audit of a Hospital. [8]

Answer:

Following are the matters to be considered for conducting an audit of a Hospital:

- Check the letter of appointment to ascertain the scope of responsibilities.
- Study the Charter or Trust Deed under which the hospital has been set up and take a special note of the provisions affecting the accounts.
- Examine, evaluate and verify the system of internal check, internal control and determine the nature, timing and the extent of the audit procedures.
- Vouch the entries in the Patient's Bill Register with a copies of bill issued. Test check the selected bills to see that these have been correctly prepared taking into consideration the period of stay of each patient as recorded in the Attendance Schedule.
- Vouch the collection from patients with copies of bills and entries in Bills Register. Arrears of dues should be properly carried forward and where these are deemed to be irrecoverable, they should be written off under due authorizations.
- Interest and/ or dividend income should be vouched with reference to the Investment Register and Interest and Dividend warrants.
- In case of legacies and donations which are received for specific purposes, it should be ensured that any income there from is not utilized for any other purposes.
- Where receipts of subscription show a significant deviations from budgeted figures, it should be thoroughly inquired into and the matter be brought to the notice of the trustees or the Managing Committee.
- Government grants or grants from local bodies should be verifies with the reference to the correspondence with the concerned authorities.
- Clear distinction should be made between the items of capital and revenue nature.
- The capital expenditure should be incurred under proper authorization by a valid resolution of the trustees or the Managing Committee.

- Verify the system of internal check as regards purchases and issue of stores, medicines etc.
- Examine that the appointment of the staff, payment of salaries etc. are duly authorized.
- Physically verify the investments, fixed assets and inventories.
- Check that adequate depreciation has been provided on all the depreciable assets.

4. (b) (ii) Write a note on duties of an auditor regarding issue of debentures. [4]

Answer:

Duties of an auditor regarding issue of debentures —

- The auditor should verify that the prospectus had been duly filed with the registrar before the date of allotment of debentures.
- He should check the amount collected in the cash book with the counterfoils of receipts issued to the applicants and also cross check the amount into the application and allotment book.
- He should examine the debenture trust deed and note the conditions contained therein as to issue and repayment.
- If the debentures are covered by a mortgage of a charge, it should be verified that the charge has been correctly recorded in the register of mortgage and charges and it has also been registered with the registrar of the companies.
- Compliance with SEBI guidelines should also be ensured.
- Where debentures have been issued as fully paid up to vendors as a part of the purchase
  consideration, the contract in this regard should be checked.

4. (b) (iii) Discuss class of companies as per sub-section (2) of section 139 of the Companies Act,2013. [4]

Answer:

For the purposes of sub-section (2) of section 139, the class of companies shall mean the following classes of companies excluding one person companies and small companies:

(a) all unlisted public companies having paid up share capital of rupees ten crore or more;
(b) all private limited companies having paid up share capital of rupees twenty crore or more;
(c) all companies having paid up share capital of below threshold limit mentioned in (a) and (b) above, but having public borrowings from financial institutions, banks or public deposits of rupees fifty crores or more.

4. (c) (i) According to the Institute of Internal Auditors, internal audit involves five areas of operations — Discuss. [6]

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.

4. (c) (ii) Discuss the rules regarding transfer of dividend to the Unpaid Dividend Account as per Section 124 and the effect of non-transfer of such amount. [7]

Answer:

As per section 124 of the Companies Act,2013 if any dividend has been declared by a company but has not been paid or claimed within thirty days from the date of the declaration to any shareholder entitled to the payment of the dividend, the company shall, within seven days from the date of expiry of the said period of thirty days, transfer the total amount of dividend which remains unpaid or unclaimed to a special account to be opened by the company in that behalf in any scheduled bank to be called the Unpaid Dividend Account.

The company shall, within a period of ninety days of making any transfer of an amount under subsection (1) to the Unpaid Dividend Account, prepare a statement containing the names, their last known addresses and the unpaid dividend to be paid to each person and place it on the website of the company, if any, and also on any other website approved by the Central Government for this purpose, in such form, manner and other particulars as may be prescribed.

Effect of non-transfer:

If any default is made in transferring the total amount referred to in sub-section (1) or any part thereof to the Unpaid Dividend Account of the company, it shall pay, from the date of such default, interest on so much of the amount as has not been transferred to the said account, at the rate of twelve per cent. per annum and the interest accruing on such amount shall enure to the benefit of the members of the company in proportion to the amount remaining unpaid to them

4.(c)(iii) Discuss the scope of Efficiency-cum-performance Audit. [3]

Answer:

Following are the scope of Efficiency-cum-performance Audit:

i. **Economy Audit:** It ensures that entity has acquired the financial, human and physical resources economically. It implies that resources have been procured in appropriate quantity, quality and at minimum cost.

ii. **Efficiency Audit:** It ensures the economical execution of various schemes and policies. It refers to the relationship between inputs and output i.e. the goods and services produced and resources used to produce them, yielding the expected results.

iii. **Effectiveness:** It is an appraisal of the performance of schemes and projects with reference to the overall targeted objectives as well as efficiency of the ways and methods adopted for the attainment of objectives.