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]**

(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. Calculate the Profit.

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) Journalize the following transaction and calculate the number of shares issued.

FD Ltd. issued 7,000 shares of ₹100 each at a discount of 10% for purchase of asset costing ₹6,30,000.

Answer:

Journal Entry

Particulars		L.F.	Dr. (₹)	Cr.(₹)
Assets A/c	Dr.		6,30,000	
Discount on Issue of Shares A/c	Dr.		70,000	
To, Equity Share Capital A/c				7,00,000

(c) Income from Operating Activities is ₹70 lakhs;
Fixed Asset sold for ₹100 lakhs;
Machinery purchased for ₹130 lakhs;
Income from Financing Activities is ₹20 lakhs, compute the net effect on Cash Flow.

Answer:

Particulars	₹ in lakhs	₹ in lakhs
Cash flow from Operating Activities		70
Cash flow from Investing Activities Sale of Fixed Asset Purchase of Machinery	 100 130	 (30)
Cash flow from Financing Activities		20
Net increase Cash Flow		60

(d) State the disclosure requirement under schedule III 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) Pradip Ltd. in the past three year spent ₹ 56,00,000 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 Government Authority has been received. The Company wishes to capitalize ₹ 56,00,000 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 Pradip Ltd. cannot capitalize ₹56,00,000.

(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 0.35% of the customers claim refunds. The company sold goods amounting to ₹42.50 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 ₹ 14,875 (42,50,000 x 0.35%).

(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) Describe '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) List any two differences between Financial Audit and Management Audit.

Answer:

Financial Audit	Management Audit
Examination of Financial Statements to express an opinion thereon.	Review of the decisions and actions of Management to analyse performance.
Generally propriety aspect is not considered in detail.	Propriety and efficiency of decisions and managerial actions are studied.

(j) Vouch foreign travelling expenditure of a Director and list any two issues.

Answer:

Following are the two issues related to the vouching of foreign travelling expenditure of a Director:

- Visa for travel — which shows the purpose of travel.
- Amount of Foreign exchange — Sanctioned for the travel including the authenticity/jurisdiction of the sanctioning authority. Sanction given by the board , if any

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 Dr. To, Bank A/c	 22,000	 22,000
	Depreciation for First Year:	**No Entry**	
?	**Transfer to Profit & Loss Account:** Profit and Loss A/c Dr. To, Lease Rent A/c	 22,000	 22,000
?	**Payment of Second Year's Lease:** Lease Rent A/c Dr. To, Bank A/c	 13,640	 13,640

	Depreciation for Second Year:	**No Entry**	
?	**Transfer to Profit & Loss Account:** Profit and Loss A/c Dr. To, Lease Rent A/c	13,640	13,640
?	**Payment of Third Year's Lease:** Lease Rent A/c Dr. To, Bank A/c	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 ₹ 3,300 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	4,950	14,850
2	9,900	29,700
3	10,725	37,950
4	13,200	52,800
5	13,200	52,800
6	13,200	52,800
7	13,200	52,800
8	13,200	52,800
9	13,200	52,800
10	13,200	52,800

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 ₹ 3,300 lakhs as under :

Year	Net operating Cash inflow	Ratio	Amortize amount (₹in lakhs)
1	14,850	0.03	99
2	29,700	0.06	198
3	37,950	0.08	264
4	52,800	0.12	396
5	52,800	0.12	396
6	52,800	0.12	396
7	52,800	0.12	396
8	52,800	0.12	396
9	52,800	0.12	396
10	52,800	0.11 (balance)	363
	4,52,100	**1.00**	**3,300**

(ii) State any four Indian Accounting Standards which make use of Fair Value. **[2]**

Answer:

AS - 2, 10, 13, 15 make use of Fair Value.

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

Net profit for the year 2014	**₹28,80,000**
Weighted average number of equity shares outstanding during year 2014	**5,00,000 shares**
Average fair value of one equity share during the year 2014	**₹48**
Weighted average number of shares under option during the year 2014	**1,00,000 shares**
Exercise price per share under option during the year 2014	**₹36**

[4]

Answer:

Particulars	**Earnings ₹**	**Shares**	**Earning per share ₹**
Net profit for the year 2014	28,80,000		
Weighted average number of equity shares outstanding during the year 2014		5,00,000	
Basic earnings per share (28,80,000/5,00,000)			5.76
Weighted average number of shares under option		1,00,000	
Number of shares that would have been issued at fair value (1,00,000 × 36.00)/48.00	*	(75,000)	
Diluted earnings per share (28,80,000/5,25,000)	28,80,000	5,25,000	5.49

*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 2014, 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 198 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 198	9,20,410

Note: While computing the Net Profit u/s 198:

- 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 198.

B. Computation of Managerial Remuneration u/s 197

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 1.5.2014, date of allotment 1.6.2014, 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%.**
- **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, 2015 (including cash and bank entries). [8]**

Answer:

In the books of OMR Ltd.

Journal Entries

Date	Particulars	Dr. (₹)	Cr. (₹)
1.5.14	Bank A/c Dr. To Debenture Application A/c (Application money received on 300,000 debentures @ ₹ 100 each)	300,00,000	 300,00,000
1.6.14	Debenture Application A/c Dr. Underwriters A/c Dr. To 15% Debentures A/c (Allotment of 3,00,000 debentures to applicants and 1,00,000 debentures to underwriters)	300,00,000 100,00,000	 400,00,000
	Underwriting Commission A/c Dr. To Underwriters A/c (Commission payable to underwriters @ 2% on ₹4,00,00,000)	8,00,000	 8,00,000
	Bank A/c Dr. To Underwriters A/c (Amount received from underwriters in settlement of account)	92,00,000	 92,00,000
30.9.14	Debenture Interest A/c Dr. To Bank A/c (Interest paid on debentures for 4 months @ 15% on ₹ 400,00,000)	20,00,000	 20,00,000
30.10.14	15% Debentures A/c Dr. To Equity Share Capital A/c To Securities Premium A/c (Conversion of 60% of debentures into shares of ₹ 60 each with a face value of ₹ 10)	240,00,000	 40,00,000 200,00,000

31.3.15	Debenture Interest A/c To Bank A/c (Interest paid on debentures for the half year)	Dr.	15,00,000	 15,00,000

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) The following particulars relate to Ambar Ltd. for the year ended 31st March 2014 —

A. Fully paid 8% Preference Shares of Face Value of ₹10,00,000 were redeemed at 3% premium. In this connection, 60,000 Equity Shares of ₹10 each were issued at a premium of ₹2 per share, the entire money being received with applications.
B. Dividend was paid as follows -
On 8% Preference Shares ₹40,000
On Equity Shares for the year 20X1 - 2014 ₹1,10,000
C. Total Sales were ₹32,00,000 out of which cash sales were ₹11,50,000.
D. Total Purchases were ₹ 8,00,000 including cash purchase of ₹60,000.
E. Total Expenses were paid ₹12,40,000.
F. Taxes paid including Dividend Tax of ₹ 22,500 were ₹3,30,000.
G. Cash and Cash Equivalents as on 31st March, 2014 were ₹1,25,000.

Compute the Cash Flow from Operating Activity for the year ended 31st March, 2014 after taking into consideration the following also:

Particulars	On 31st March 2013 (₹)	On 31st March 2014 (₹)
Sundry Debtors	1,50,000	1,47,000
Sundry Creditors	78,000	83,000
Unpaid Expenses	63,000	55,000

[6]

Answer:

A. Sundry Debtors Account

Particulars	₹	Particulars	₹
To balance b/d To Sales (Credit) (32,00,000 - 11,50,000)	1,50,000 20,50,000	By Cash A/c (balancing figure) By balance c/d	20,53,000 1,47,000
Total	22,00,000	Total	22,00,000

B. Sundry Creditors Account

Particulars	₹	Particulars	₹
To Cash A/c (balancing figure) To balance c/d	7,35,000 83,000	By balance b/d By Purchases (credit) (8,00,000 - 60,000)	78,000 7,40,000
Total	8,18,000	Total	8,18,000

C. Unpaid Expenses Account

Particulars	₹	Particulars	₹

To Cash A/c To balance c/d	12,48,000 55,000	By balance b/d By Expenses A/c	63,000 12,40,000
Total	13,03,000	Total	13,03,000

D. Cash Flow Statement for the year ended 31st March 2014

Particulars		₹	₹
A. Cash Flow from Operating Activities			
Cash Sales		11,50,000	
Collection from Debtors		20,53,000	
		32,03,000	
Less: Cash Purchases	(60,000)		
Payment to Creditors	(7,35,000)		
Expenses Paid	(12,48,000)	(20,43,000)	
Cash Generated from Operations		**11,60,000**	
Less: Income Taxes paid (3,30,000 - 22,500)		(3,07,500)	
Net Cash Flow from / (used in) Operating Activities			8,52,500

(iii) State the impact of Negative Goodwill in case of amalgamation in the nature of purchase. [2]

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) AA Ltd. absorbs BB Ltd. and the liquidation expense is ₹20,000.
Give the journal entries in the books of if Transferor Company —

Case I: The expense is incurred by Transferor Company;
Case II: The expense is Incurred by Transferee Company;
Case III: The expense is Incurred by Transferor Company reimbursed by Transferee Company. [4]

Answer:

Case I — If the expense is incurred by Transferor Company

Particulars		L.F.	Dr. (₹)	Cr.(₹)
Realization A/c	Dr.		20,000	
To, Bank A/c				20,000

Case II — If the expense is Incurred by Transferee Company

Particulars	L.F.	Dr. (₹)	Cr.(₹)
No Entry			

Case III: The expense is Incurred by Transferor Company reimbursed by Transferee Company

Particulars		L.F.	Dr. (₹)	Cr.(₹)
i. **On incurring the expenses:**				
BB Ltd. A/c	Dr.		20,000	
To, Bank A/c				20,000
ii. **On reimbursement:**				
Bank A/c	Dr.		20,000	
To, Transferee Company A/c				20,000

(ii) Following is the Balance Sheet of Basudev Ltd. for the year ended 31st March,2014 —

Liabilities	Amount	Assets	Amount
Equity Shares of ₹100 each fully paid up	**40,00,000**	**Fixed Assets**	**38,00,000**
Reserves and Surplus	**8,00,000**	**Current Assets**	**22,00,000**
Current Liabilities	**12,00,000**		
	60,00,000		**60,00,000**

Amrita Ltd. takes over all the assets and liabilities of Basudev Ltd. at their books value except a machinery of ₹16 lakhs taken over at ₹12 lakhs.

Amrita Ltd. issued requisite number of equity shares at par for the assets and liabilities taken over.

Compute the purchase consideration and determine whether the above should be treated as an amalgamation in the nature of Merger or in the nature of Purchase. [4]

Answer:

As per Accounting Standard – 14 [Accounting for Amalgamation]:

The assets taken over should be recorded in the transferee company books at the same values at which they appeared in the books of transferor company the amalgamation will be treated as an amalgamation in the nature of Merger.

In the present case as all the assets and liabilities except one asset is taken over at their book value it will not be treated as an amalgamation in the nature Merger. Hence, this is an amalgamation in the nature Purchase.

Computation of Purchase Consideration:

Particulars	₹ in Lakhs
Fixed Assets (38,00,000 – 16,00,000 + 12,00,000)	34,00,000
Current Assets	22,00,000
	56,00,000
Less: Current Liabilities	12,00,000

	44,00,000

Number of Shares to be issued to Basudev Ltd. = ₹44,00,000/₹100 = 44,000 Shares.

(iii) Ambar Ltd. has eight segments A, B, C, D, E, F, G and H. The following information is available in relation to these segments.

(₹ in lakhs)

Particulars	A	B	C	D	E	F	G	H	Total
Segment Revenue									
• **External sales**	**Nil**	**510**	**30**	**20**	**30**	**100**	**40**	**70**	**800**
• **Inter- Segment Sales**	**200**	**120**	**60**	**10**	**Nil**	**Nil**	**10**	**Nil**	**400**
Total Revenue	**200**	**630**	**90**	**30**	**30**	**100**	**50**	**70**	**1200**
Segment result – Profit (Loss)	**10**	**(180)**	**30**	**(10)**	**16**	**(10)**	**10**	**14**	**(120)**
Segment Assets	**45**	**141**	**15**	**33**	**9**	**15**	**15**	**27**	**300**

Identify which of the above constitute Reportable Segments, if you were informed that A, B, C and were the Reported Segments in the last financial year. [8]

Answer:

Particulars	A	B	C	D	E	F	G	H	Total
1. Segment Revenue									
• External sales	Nil	510	30	20	30	100	40	70	800
• Inter- Segment Sales	200	120	60	10	Nil	Nil	10	Nil	400
2. Total Revenue	200	630	90	30	30	100	50	70	1200
3. Segment Revenue as percentage of total	**16.7%**	**52.5%**	**7.5%**	**2.5%**	**2.5%**	**8.3%**	**4.2%**	**5.8%**	**100%**
4. Segment Result – Profit	10		30		16		10	14	80
5. Segment Result – (Loss)		(180)		(10)		(10)			(200)
6. Percentage of Segment result on (200) i. e. Profit/Loss whichever is higher in absolute amount	**5%**	**90%**	**15%**	**5%**	**8%**	**5%**	**5%**	**7%**	**-**
7. Segment Assets	45	141	15	33	9	15	15	27	300
8. Percentage of segment Assets	**15%**	**47%**	**5%**	**11%**	**3%**	**5%**	**5%**	**9%**	**100%**
9. Condition satisfied (See note)	S, A	S, R, A	R	A	-	-	-	-	

Note: S = Sales Condition, R = Result Condition, A = Assets condition

- **10% Thresholds**: From the above , A, B, C and become Reportable Segments since they satisfy Revenue/Result/ Assets criteria.
- **Continuity Principle**: As Segment E was reported in the previous financial period, it is also identified as Reportable Segment for the current financial period.

- **75% revenue Principle**: Total Enterprise Revenue = ₹800 lakhs, Total revenue from **External sales** of A, B, C, D and E Segments = ₹590 Lakhs, which is only 73.75% of the total Enterprise Revenue.
- Hence, to meet 75% condition, any one of the other Segments F, G, H should be identified as an additional Reporting Segment. If the Company desires that Segment G should be reported to meet this 75% revenue Condition, the Reportable Segments are A, B, C, D, E, and G. In that case, F and H will be shown as reconciling items.

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) Differentiate between Physical Verification and Confirmation. [4]

Answer:

In the process of audit if the auditor is provided with any information that the quality and the value of say, stock is appropriate , by the management of the company then the auditor relies on their statement and prepares his report based on that information. In this case it means the auditor has received the confirmation from the management and there is no liability of the auditor for any mistake in this regard.

On the other hand if the auditor has to physically verify the stock and then again he has to verify the records personally, that will be a case of Physical Verification. In this case if there is any mismatch between the two the reconciliation statement is prepared.

(iv) Verify the revenue recognition process for a Movie Ticket. [4]

Answer:

The recognition of any revenue should be as per Accounting Standard – 9.

As per AS – 9, revenue from service is generally recognized as the service is performed.If at the time of rendering of services or sale there is significant uncertainty in ultimate collection of the revenue, then the revenue recognition is postponed and in such cases revenue should be recognized only when it becomes reasonably certain that ultimate collection will be made.

In the present case the revenue should be recognized on rendering the service of showing the movie and not on sale of the movie tickets.

(b) (i) List the steps to Sales os a manufacturing unit. [5]

Answer:

It can be verified from the sales records, the Credit Sales from the Credit Sales Records and the Cash Sales from the Cash Sales Records.

For Sale of Goods, it is more reasonable to verify and cross check Sales from different sources like:

1. Statement of Export Sales
2. Sales as per CST Returns
3. Sales as per VAT Returns
4. Exempted Sales

Here, [1+2+3+4] should be equal to Sales as per Income Tax Returns.

This can again be cross verified with the production of goods (Excisable Goods) which is available from the Central Excise Returns.

(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. [5]

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. [6]

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) X Ltd. is going for liquidation it has liabilities of ₹120 consisting of secured creditors of ₹30, Creditors of ₹20 and Unsecured Creditors of ₹70. Net Assets after payment of both secured and Preferential Creditors is ₹30.
Liquidator is entitled to a remuneration of 2% on the on the payment made to unsecured creditors.
Guide the Accountant on the procedure to estimate the remuneration of the liquidator. [6]

Answer:

Following are the steps involved in this process;

1. Ascertain the value of assets and liabilities
2. Ascertain the amount of Secured creditors
3. Ascertain the amount of Preferential Creditors
4. Verify the agreement with the Liquidators and the terms involved in it
5. Discharge the liabilities

In this case, the as there is insufficient fund the liquidator will receive a remuneration of ₹35 $\times \left[\frac{2}{102}\right]$ =₹0.69.

(iv) List the issues involved to verify the process of "Share Surrender" in case of Internal Reconstruction. [2]

Answer:

Following are the issues to be verified in case of surrender of shares. This arises in the course of Internal Reconstruction —

(i) Only fully paid shares are surrendered;
(ii) It can be equity shares or it can also be preference shares;
(iii) The amount of share capital has reduced as some shares are surrendered;
(iv) The amount of shares surrendered is transferred to Share Surrendered Account.