Paper 12 - Company Accounts & Audit

Full Marks: 100

Section A

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

(i) What do you mean by Integral & Non-integral foreign operation? Give one example of Integral & Non-integral foreign operation each.

Solution:

Integral Foreign Operation: An Integral Foreign Operation is an operation which is managed & finance in such a manner that any change in the exchange rate has almost immediate effects on the cash flow of the reporting enterprise. Further they are also seen as an extension of the operation of the reporting enterprise.

Example: Foreign Branch

Non-integral foreign operation: It is a Foreign Operation that is not an Integral Foreign Operation. The business of Non-integral foreign operation is carried on in a substantially independent manner by accumulating cash and other monetary items, incurring expenses, generating income and arranging borrowings, in its local currency. Change in the exchange rate affects the reporting enterprise's Net Investment in the Non-integral foreign operation, rather than the individual monetary and non-monetary items held by that Non-integral foreign operation.

Example: Subsidiaries in foreign Countries are called Non-integral foreign operation.

(ii) Foreign currency creditors at the end of the financial year are USD 10 Lakhs. Purchase were recorded at the exchange rate USD 1= ₹62. On the balance sheet date, the exchange rate is USD 1 = ₹64 which is not expected to be payable on the payment date. It has been estimated that around the payment time, the exchange rate will possibly be in the range of USD 1 - ₹65.00 to ₹66.50. At what value should the creditors be recorded in the balance sheet? What is the treatment of foreign exchange loss?

Solution:

Creditors should be recorded at the expected payable value, i.e. Average Expected Rate = (₹65.00 + ₹66.50) ÷ 2 = ₹65.75 per USD. The amount of creditors recognized in the B/S shall be ₹65.75 x 10 Lakhs USD = ₹657.50 Lakhs.

<u>Treatment of foreign exchange loss -</u>

The Exchange Loss of (₹65.75 – ₹62) x 10 Lakhs USD = ₹37.50 Lakhs should be recognized as loss in the Profit & Loss account.

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

(a) Tarun Ltd has taken an asset on lease from Barun Ltd for a period of 3 years. Annual Lease rental are ₹8 lakhs payable at the end of every year. The residual value guaranteed by Tarun is ₹3 lakhs whereas Barun expects the estimated salvage value to be ₹6 lakhs at the end of the lease term. If the fair value of the asset at the lease inception is ₹15 lakhs and the interest rate implicit in the lease is 18%, compute the Net Investment in the lease from the viewpoint of Barun Ltd and the annual finance income. [8]

Solution:

Minimum Lease Payment (MLP) = ₹8 Lakhs x 3 years= ₹24,00,000

Guaranteed Residual Value (GRV)= ₹3,00,000

MLP from the viewpoint of the Lessor (Barun) = MLP + GRV= ₹27,00,000

Unguaranteed Residual Value (URV) = Total Residual Value – GRV = ₹3,00,000

Gross Investment in the Lease = MLP for Lessor + URV = ₹30,00,000

PV of MLP, GRV and URV (working) = ₹21,04,600

Unearned Finance Income = ₹30,00,000 – ₹21,04,600 = ₹8,95,400

Net Investment in the Lease = ₹30,00,000 - ₹8,95,400 = ₹21,04,600

Working:-

Present Value (PV) of gross Investment in the Lease is computed as under –

PV of MLP = ₹8,00,000 x PVF at 18% for 3 years = ₹8,00,000 x (0.847+0.718+0.609) = ₹17,39,200

PV of (GRV+URV) = ₹6,00,000 x PVF at 18% for year 3 = ₹6,00,000 x 0.609 = ₹3,65,400

Total of the above = ₹21,04,600

Recognition of finance Income by Lessor

Year	Net Investment in the Lease = Receivable	Finance Income at 18% on NI	Total Lease Payments received from Lessee	Balance Reduction in Receivable (i.e. Principle)
(1)	**(2)**	**(3)= (2) x 18%**	**(4)**	**(5)= (4) – (3)**
1	₹21,04,600	₹21,04,600 x 18% = 3,78,828	₹8,00,000	₹8,00,000 - ₹3,78,828 =₹4,21,172
2	₹21,04,600 - ₹4,21,172 =₹16,83,428	₹16,83,428 x 18% = ₹3,03,017	₹8,00,000	₹8,00,000 - ₹3,03,017 = ₹4,96,983
3	₹16,83,428 - ₹4,96,983 = ₹11,86,445	₹11,86,445 x 18% = ₹2,13,560	₹8,00,000	₹8,00,000 - ₹2,13,560 = ₹5,86,440
3 (end)	₹11,86,445 - ₹5,86,440 = ₹6,00,005	Nil	₹6,00,000	Nil (difference ₹5 due to R/Off)

(b) (i) Moon Ltd. has entered into a sale contract of ₹4 crores with Poonam Ltd. during 2012-13 financial year. The profit on this transaction is ₹60 lakhs. The delivery of goods to take place during the first month of 2013-14 financial year. In case of failure of Moon Ltd. to deliver within the schedule a compensation of ₹1.20 crore is to be paid to Poonam Ltd. Moon Ltd planned to manufacture the goods during the last month of the 2012-13 financial year. As on Balance Sheet date 31.3.13, the goods were not manufactured and it was unlikely that Moon Ltd. will be in a position to meet the contractual obligation.

Should Moon Ltd. provide for contingency as per AS- 29? [4]

Solution:

The Company has not yet manufactured the product, and hence cannot recognize the sale transaction as at 31st March 2013. Sale and the resultant profit cannot be recognized unless and until the product is ready and delivered to the Customer (Assuming, transfer in property in goods takes place at the time of delivery, and not before). It is unlikely that Moon Ltd will be in a position to meet the contractual obligation, and it is more likely to pay the compensation and such payment is also quantifiable.

Moon Ltd should create a provision for the compensation payable, and not just disclose as a contingent liability, it is an obligation out of a past event. Provision should be measured at the total Compensation and not at the excess over the profit, since Profit can be booked only independently in the next year, upon actual occurrence of the sale transaction.

(ii) Treatment of refund of Government grants. **[4]**

Solution:

Treatment of refund of Government grants

When certain conditions are not fulfilled, the Government Grants should be refunded. A Grant that becomes refundable is treated as an Extra-ordinary Item.

(a) Revenue Grants: The amount refundable in respect of a revenue item is applied first against any unamortized Deferred Credit remaining in respect of the Grant. Any excess of Grant refundable over the Deferred Credited or when there is no Deferred Credit, it is immediately charged to the P&L Statement.

(b) Promoter's Contribution: Where a Grant in the nature of Promoters' Contribution become refundable, in part or in full, the relevant amount recoverable by the Government is deducted from Capital Reserve.

(c) Specific Fixed Asset: The amount refundable in respect of a specific Fixed Asset is recorded by increasing the Book Value of the asset, (wherein the depreciation on the Revised Book Value is provided prospectively over the residual life of the asset), or by reducing the Capital Reserve or the Deferred Income balance, as appropriate, by the amount refundable.

(c) (i) The fair value of plan assets of Akash Ltd. was ₹80,00,000 in respect of employee benefit pension plan as on 1st April, 2012. On 30th September, 2012 the plan paid out benefits of ₹10,00,000 and received inward contribution of ₹22,00,000. On 31st March 2013 the fair value of plan assets was ₹1,05,00,000. On 1st April, 2012 the company made the following estimates, based on its market studies and prevailing prices.

	%
Interest and dividend income (after tax) payable by fund	**10.15**
Realised gain on plan assets (after tax)	**3.00**
Fund administrative costs	**(1.50)**
Expected rate of return	**11.65**

Calculate the expected and actual return on plan assets as on 31st March, 2013, as per AS – 15. **[4]**

Solution:

Expected Return

Percentage of Expected Return as given in the question = 11.65% p.a at simple interest. Alternatively, it can be considered as 11.32% p.a. return compounded on half year basis. Amount of Expected Return is computed as follows-

Return at 11.65% on Opening Investment [₹80,00,000 x 11.65%]	= ₹9,32,000
Return at 5.66% on incremental investment [(₹22,00,000-10,00,000) x 5.66%]	= ₹67,920
(equivalent to 11.65% annually, compounded every 6 months)	
Total Expected Return	₹9,99,920

Actual Return

Fair Value of Plan assets at year – end	₹1,05,00,000
Less: Fair Value of Plan assets at year – beginning	(₹80,00,000)
Less: Contributions Received	(₹22,00,000)
Add: Benefits paid during the year	₹10,00,000
Actual Return on Plan Assets	₹13,00,000

(ii) PQR. Ltd. supplied the following information:

You are required to compute the basic earnings per share – Accounting year 1.1.2012 – 31.12.2012.

(a) Net Profit for the year 2012 = ₹ 80,00,000; 2013 = ₹ 90,00,000

(b) No. of shares outstanding prior to right issue = 13,50,000 shares

(c) Right Issue

- **One new share for each four outstanding i.e., 3,37,500 shares**
- **Right Issue Price ₹ 40**
- **Last date of exercising right – 31.03.2013**

(d) Fair rate of one equity share prior to exercise of rights on 31.3.2013 – ₹ 75. [4]

Solution:

1. Determination of Theoretical Ex-Rights Fair Value/ Price:

$$\frac{(\text{Base Shares Quantity x Fair Value per share before rights}) + (\text{Rights Issue x Rights Issue Price})}{\text{Base shares Quantity} + \text{Rights Shares Quantity}}$$

$$\frac{(13,50,000 \text{ x } 75) + (3,37,500 \text{ x } 40)}{13,50,000 + 3,37,500} = \frac{10,12,50,000 + 1,35,00,000}{16,87,500} = 68$$

2. Adjusted Factors (AF) = $\frac{\text{Fair Value before Rights Issue}}{\text{Theoretical Ex - Right price (as above)}} = \frac{75}{68} = 1.1029$

3. Computation of Earnings per share

$$\text{EPS for 2012} = \frac{\text{Net Profit attributable to equity shareholders}}{\text{No. of equity shares}} = \frac{80,00,000}{13,50,000} = 5.93$$

$$\text{EPS restated for 2012 for right issue} = \frac{80,00,000}{13,50,000 \text{x} 1.1029} = \frac{80,00,000}{14,88,915} = 5.37$$

$$\text{EPS for 2013 including Right issue} = \frac{90,00,000}{(13,50,000 \times 1.1029 \times \frac{3}{12}) + (16,87,500 \times \frac{9}{12})} = 5.49$$

Section B

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

(i) Bright Engineering Ltd. granted 50,000 options on 1st August 2012 at ₹75 when the market price was ₹250. The vesting period is two years.
You are required to:
Calculate the amount to be amortized every year.

Solution:
The Vesting period is two years. This value of option shall be amortised on a straight line basis over the vesting period. Therefore, the amount to be amortised every year = [50,000 x (₹250-₹75)]/ 2 = ₹43,75,000.

(ii) Explain the disclosure requirement under revised schedule VI of the following items:-
(a) Fixed Assets (Land & Building) held for sale
(b) Term Loan (secured) repayment within 12 months.

Solution:
(a) Fixed Assets (Land & Building) held for sale should be disclosed under sub-heading Tangible assets of Fixed Assets.
(b) Term Loan (secure) repayable within 12 months should be disclosed under sub-heading Other Current Liabilities of Current Liabilities.

(iii) Who are the important users of the financial statements of an Enterprise?

Solution:
Important users of the Financial Statements are
- Investors
- Employees
- Lenders
- Supplier and other trade creditors
- Customers
- Government and their agencies
- Public

(iv) Explain the disclosure requirement under revised schedule VI of the following items:-
(a) Equity Share Capital
(b) Preference Share Capital

Solution:

Disclosure requirement under Revised Schedule VI of Equity Share Capital and Preference Share Capital are

For each class of share capital (different classes of preference shares to be treated separately):

(a) the number and amount of shares authorized;
(b) the number of shares issued, subscribed and fully paid, and subscribed but not fully paid;
(c) par value per share;
(d) a reconciliation of the number of shares outstanding at the beginning and at the end of the reporting period;
(e) the rights, preferences and restrictions attaching to each class of shares including restrictions on the distribution of dividends and the repayment of capital;
(f) shares in respect of each class in the company held by its holding company or its ultimate holding company including shares held by or by subsidiaries or associates of the holding company or the ultimate holding company in aggregate;
(g) shares in the company held by each shareholder holding more than 5 percent shares specifying the number of shares held;
(h) shares reserved for issue under options and contracts/commitments for the sale of shares/disinvestment, including the terms and amounts;
(i) For the period of five years immediately preceding the date as at which the Balance Sheet is prepared:
   - Aggregate number and class of shares allotted as fully paid up pursuant to contract(s) without payment being received in cash.
   - Aggregate number and class of shares allotted as fully paid up by way of bonus shares.
   - Aggregate number and class of shares bought back.
(j) Terms of any securities convertible into equity/ preference shares issued along with the earliest date of conversion in descending order starting from the farthest such date.
(k) Calls unpaid (showing aggregate value of calls unpaid by directors and officers)
(l) Forfeited shares (amount originally paid up).

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

(a) The Balance Sheets of Sankar Ltd. and Ganesh Ltd. as on 31.03.13 were as follows:

Balance Sheet as on 31.03.13 **(Amount in ₹)**

Liabilities	Sankar Ltd.	Ganesh Ltd.	Assets	Sankar Ltd.	Ganesh Ltd.
Equity Share	**16,00,000**	**6,00,000**	**Building**	**4,00,000**	**2,00,000**

capital (₹100)			**Machinery**	**10,00,000**	**6,00,000**
10% Preference Share capital (₹100)	**-**	**4,00,000**	**Furniture**	**2,00,000**	**1,20,000**
			Investment: 600 shares of Ganesh Ltd.	**1,20,000**	**—**
General Reserve	**6,00,000**	**2,00,000**	**Stock**	**3,00,000**	**3,80,000**
Profit and Loss A/c	**4,00,000**	**2,00,000**	**Debtors**	**7,00,000**	**5,00,000**
Creditors	**4,00,000**	**6,00,000**	**Cash and Bank**	**1,80,000**	**1,40,000**
			Preliminary Expenses	**1,00,000**	**60,000**
	30,00,000	**20,00,000**		**30,00,000**	**20,00,000**

Sankar Ltd. has taken over the entire undertaking of Ganesh Ltd. on 30.09.13, on which date, the position of Current assets except cash and bank balances and Current liabilities were as follows:

	Sankar Ltd (₹)	Ganesh Ltd (₹)
Stock	**2,40,000**	**3,00,000**
Debtors	**7,60,000**	**5,00,000**
Creditors	**3,60,000**	**4,20,000**

Profits earned for the half year ended on 30.09.13 after charging depreciation as 5% on building, 15% on machinery and 10% on furniture, are:

Sankar Ltd. ₹ 2,05,000

Ganesh Ltd. ₹ 1,08,000

On 30.08.13 both companies have declared 15% dividend for 2012-13.

Goodwill of Ganesh Ltd. has been valued at ₹1,00,000 and other Fixed assets at 10% above their book values on 31.03.13. Preference shares of Ganesh Ltd. are to be allotted 10% Preference Share of Sankar Ltd. and Equity shareholders of Ganesh Ltd. are to receive requisite number of equity shares of Sankar Ltd. valued at ₹150 per share on satisfaction of their claims.

Show the Balance Sheet as on 30.09.13 assuming absorption is through by that date. [16]

Solution:

Name of the Company: Sankar Ltd. and Ganesh Ltd.							
Balance Sheet as on September 30, 2013							
				Sankar Ltd.		Ganesh Ltd.	
Ref No.	Particulars		Note No.	As at 30th Sept,2013	As at 31st March,2013	As at 30th Sept,2013	As at 31st March,2013
				₹	₹	₹	₹
	I.	Equity and Liabilities					
	1	Shareholders' funds					
		(a) Share capital	1	16,00,000	16,00,000	10,00,000	10,00,000
		(b) Reserves and surplus	2	9,74,000	10,00,000	4,18,000	4,00,000

		(c) Money received against share warrants					
	2	Share application money pending allotment					
	3	Non-current liabilities					
		(a) Long-term borrowings					
		(b) Deferred tax liabilities (Net)					
		(c) Other Long term liabilities					
		(d) Long-term provisions					
	4	Current Liabilities					
		(a) Short-term borrowings					
		(b) Trade payables	3	3,60,000	4,00,000	4,20,000	6,00,000
		(c) Other current liabilities					
		(d) Short-term provisions					
		Total (1+2+3+4)		29,34,000	30,00,000	18,38,000	20,00,000
	II.	Assets					
	1	Non-current assets					
		(a) Fixed assets					
		(i) Tangible assets	4	15,05,000	16,00,000	8,64,,000	9,20,000
		(ii) Intangible assets					
		(iii) Capital work-in-progress					
		(iv) Intangible assets under development					
		(b) Non-current investments	5	1,20,000	1,20,000	-	
		(c) Deferred tax assets (Net)					
		(d) Long-term loans and advances					
		(e) Other non-current assets					
	2	Current assets					
		(a) Current investments					
		(b) inventories	6	2,40,000	3,00,000	3,00,000	3,80,000
		(c) trade receivables	7	7,60,000	7,00,000	5,00,000	5,00,000

		(d) Cash and cash equivalents	8	2,09,000	1,80,000	1,14,000	1,40,000
		(e) Short-term loans and advances					
		(f) Other current assets	9	1,00,000	1,00,000	60,000	60,000
		Total (1+2)		29,34,000	30,00,000	18,38,000	20,00,000

(Amount in ₹)

	Sankar Ltd.		Ganesh Ltd.	
Note 1. Share Capital	As at 30th Sept,2013	As at 31st March, 2013	As at 30 th Sept, 2013	As at 31st March, 2013
Authorised, Issued, Subscribed and fully paid up				
16,000, Equity Shares of ₹ 100 each 4,000, 10% Preference Share Capital of ₹ 100 each	16,00,000	16,00,000	6,00,000 4,00,000	6,00,000 4,00,000
Total	16,00,000	16,00,000	10,00,000	10,00,000

RECONCILATION OF SHARE CAPITAL								
FOR EQUITY SHARE:-	Sankar Ltd.				Ganesh Ltd.			
	As at 30th Sept, 2013		As at 31st March, 2013		As at 30th Sept, 2013		As at 31st March, 2013	
	Nos	Amount (₹)	Nos	Amount (₹)	Nos	Amount (₹)	Nos	Amount (₹)
Opening Balance	16,000	16,00,000	16,000	16,00,000	6,000	6,00,000	6,000	6,00,000
Add: Fresh Issue (incl. Bonus shares, Right shares, split shares, shares issued other than cash)		-		-		-		-
Less: Buy Back of shares		-		-		-		-
	16,000	16,00,000	16,000	16,00,000	6,000	6,00,000	6,000	6,00,000

FOR 10% PREFERENCE SHARE:-	Sankar Ltd.				Ganesh Ltd.			
	As at 30th Sept, 2013		As at 31st March, 2013		As at 30th Sept, 2013		As at 31st March, 2013	
	Nos	Amount (₹)	Nos	Amount (₹)	Nos	Amount (₹)	Nos	Amount (₹)

Opening Balance	-	-	-	-	4,000	4,00,000	4,000	4,00,000
Add: Fresh Issue (Incld Bonus shares, Right shares, split shares, shares issued other than cash)	-	-	-	-	-	-	-	-
Less: Buy Back of shares	-	-	-	-	-	-	-	-
	-	-	-	-	4,000	4,00,000	4,000	4,00,000

Note 2. Reserves and Surplus	Sankar Ltd.		Ganesh Ltd.	
	As at 30th Sept, 2013	As at 31st March, 2013	As at 30th Sept, 2013	As at 31st March, 2013
General Reserve	6,00,000	6,00,000	2,00,000	2,00,000
Profit and Loss A/c*	3,74,000	4,00,000	2,18,000	2,00,000
Total	9,74,000	10,00,000	4,18,000	4,00,000
Note 3. Trade Payables	As at 30th Sept, 2013	As at 31st March, 2013	As at 30th Sept, 2013	As at 31st March, 2013
Creditors	3,60,000	4,00,000	4,20,000	6,00,000
Total	3,60,000	4,00,000	4,20,000	6,00,000
Note 4. Tangible Assets	As at 30th Sept, 2013	As at 31st March, 2013	As at 30th Sept, 2013	As at 31st March, 2013
Building (less Depreciation@5%)	3,90,000	4,00,000	1,95,000	2,00,000
Machinery (less Depreciation@15%)	9,25,000	10,00,000	5,55,000	6,00,000
Furniture (less Depreciation@10%)	1,90,000	2,00,000	1,14,000	1,20,000
Total	15,05,000	16,00,000	8,64,000	9,20,000
Note 5. Non Current Investment	As at 30th Sept, 2013	As at 31st March, 2013	As at 30th Sept, 2013	As at 31st March, 2013
Investment	1,20,000	1,20,000	-	-
Total	1,20,000	1,20,000	-	-
Note 6. Inventories	As at 30th Sept, 2013	As at 31st March, 2013	As at 30th Sept, 2013	As at 31st March, 2013
Stock	2,40,000	3,00,000	3,00,000	3,80,000

Total	2,40,000	3,00,000	3,00,000	3,80,000
Note 7. Trade Receivables	As at 30th Sept, 2013	As at 31st March, 2013	As at 30th Sept, 2013	As at 31st March, 2013
Debtors	7,60,000	7,00,000	5,00,000	5,00,000
Total	7,60,000	7,00,000	5,00,000	5,00,000
Note 8. Cash and Cash Equivalents	As at 30th Sept, 2013	As at 31st March, 2013	As at 30th Sept, 2013	As at 31st March, 2013
Bank Balance (Bal. Fig)	2,09,000	1,80,000	1,14,000	1,40,000
Total	2,09,000	1,80,000	1,14,000	1,40,000
Note 9. Other Current assets	As at 30th Sept, 2013	As at 31st March, 2013	As at 30th Sept, 2013	As at 31st March, 2013
Preliminary Expenses	1,00,000	1,00,000	60,000	60,000
Total	1,00,000	1,00,000	60,000	60,000

* Calculation of Profit & Loss Account Balances

Particulars	Sankar Ltd.	Ganesh Ltd.
Opening balance	4,00,000	2,00,000
Add: Profit for half year	2,05,000	1,08,000
Less: Equity dividend	(2,40,000)	(90,000)
Add: Dividend income on 600 Equity Shares	9,000	–
Total	3,74,000	2,18,000

Assumptions:

a) Preference dividend has already been paid

b) Half year profit given is "Trading Profit" and does not include dividend income.

c) The entire dividend income is post-acquisition (ie. investment has been acquired prior to 1.4.13)

Part II

Purchase Consideration - Net Assets Method

Particulars	Amount	Amount
	₹	₹
Goodwill	1,00,000	
Building	2,20,000	
Machinery	6,60,000	

Furniture	1,32,000	
Stock	3,00,000	
Debtors	5,00,000	
Cash	1,14,000	20,26,000
Less: Creditors		(4,20,000)
Purchase Consideration		16,06,000

Analysis of

Total consideration summary:-

	Particulars	Amount
		₹
i)	Preference Share capital at par	4,00,000
ii)	7,236 Equity shares @ ₹ 150 per share [(₹16,06,000 – ₹4,00,000) x 90%]/₹150	10,85,400
	Total	14,85,400

Part - III: In the books of Sankar Ltd.

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

Journal entries

	Particulars		Debit	Credit
a.	For Purchase Consideration Due :			
	Business Purchase A/c	Dr.	14,85,400	
	To Liquidator of Salt Ltd			14,85,400
2.	For Assets & Libilties taken over:			
	Building A/c	Dr.	2,20,000	
	Machinery A/c	Dr.	6,60,000	
	Furniture A/c	Dr.	1,32,000	
	Stock A/c	Dr.	3,00,000	
	Debtors A/c	Dr.	5,00,000	
	Cash A/c	Dr.	1,14,000	
	Goodwill (Bal. Fig)	Dr.	99,400	
	To Creditors A/c			4,20,000
	To Business Purchase A/c			14,85,400
	To Investment in Ganesh Ltd A/c			1,20,000
3.	Discharge of Purchase Consideration			
	Liquidator of Salt Ltd A/c	Dr.	14,85,400	
	To 10% Preference Share Capital A/c			4,00,000

To Equity Share Capital A/c (7,236 x 100)	7,23,600
To Securities Premium A/c (7,236 x 50)	3,61,800

Name of the Company: Sankar Ltd.					
Balance Sheet as at 30.09.2012 (After absorption)					
Ref No.	Particulars		Note No.	After absorption	Before absorption
				₹	₹
	I.	Equity and Liabilities			
	1	Shareholders' funds			
		(a) Share capital	1	27,23,600	16,00,000
		(b) Reserves and surplus	2	13,35,800	9,74,000
		(c) Money received against share warrants			
	2	Share application money pending allotment			
	3	Non-current liabilities			
		(a) Long-term borrowings			
		(b) Deferred tax liabilities (Net)			
		(c) Other Long term liabilities			
		(d) Long-term provisions			
	4	Current Liabilities			
Ref No.	Particulars		Note No.	After absorption	Before absorption
				₹	₹
		(a) Short-term borrowings			
		(b) Trade payables	3	7,80,000	3,60,000
		(c) Other current liabilities			
		(d) Short-term provisions			
		Total (1+2+3+4)		48,39,400	29,34,000
	II.	Assets			
	1	Non-current assets			
		(a) Fixed assets			

		(i) Tangible assets	4	25,17,000	15,05,000
		(ii) Intangible assets	5	99,400	-
		(iii) Capital work-in-progress			
		(iv) Intangible assets under development			
		(b) Non-current investments			1,20,000
		(c) Deferred tax assets (Net)			
		(d) Long-term loans and advances			
		(e) Other non-current assets			
	2	Current assets			
		(a) Current investments			
		(b) Inventories	6	5,40,000	2,40,000
		(c) Trade receivables	7	12,60,000	7,60,000
		(d) Cash and cash equivalents	8	3,23,000	2,09,000
		(e) Short-term loans and advances			
		(f) Other current assets	9	1,00,000	1,00,000
		Total (1+2)		48,39,400	29,34,000

Note 1. Share Capital	After absorption	Before absorption
Authorised, Issued, Subscribed & Paid up:-		
23,236 Equity shares of ₹100 each [Out of which 7,236 shares are allotted for consideration other than cash]	23,23,600	16,00,000
10% Preference Share Capital of ₹100 each (The above shares are alloted for consideration other than cash)	4,00,000	
Total	27,23,600	16,00,000

RECONCILATION OF SHARE CAPITAL				
FOR EQUITY SHARE:-	After absorption		Before absorption	
	Nos	Amount (₹)	Nos	Amount (₹)
Opening Balance as on 01.04.12	16,000	16,00,000	16,000	16,00,000

Add: Fresh Issue (Incld Bonus shares, Right shares, split shares, shares issued other than cash)	7,236	7,23,600	-	-
	23,236	23,23,600	16,000	16,00,000
Less: Buy Back of shares	-	-	-	-
	23,236	23,23,600	16,000	16,00,000

FOR 10% PREFERENCE SHARE:-	After absorption		Before absorption	
	Nos	Amount (₹)	Nos	Amount (₹)
Opening Balance as on 01.04.13	-	-	-	-
Add: Fresh Issue (Incld Bonus shares, Right shares, split shares, shares issued other than cash)	4,000	4,00,000	-	-
			-	-
Less: Buy Back of shares			-	-
	4,000	4,00,000	-	-

Note 2. Reserve and Surplus	After absorption	Before absorption
Securities Premium	3,61,800	-
General Reserve	6,00,000	6,00,000
Profit and Loss A/c	3,74,000	3,74,000
Total	13,35,800	9,74,000

Note 3. Trade Payables	After absorption	Before absorption
Creditors (3,60,000+4,20,000)	7,80,000	3,60,000
Total	7,80,000	3,60,000

Note 4. Tangible Assets	After absorption	Before absorption
Building (4,00,000-10,000+2,20,000)	6,10,000	3,90,000
Machinery (10,00,000-75,000+6,60,000)	15,85,000	9,25,000
Furniture (2,00,000-10,000+1,32,000)	3,22,000	1,90,000
Total	25,17,000	15,05,000

Note 5. Intangible Assets	After absorption	Before absorption
Goodwill	99,400	-
Total	99,400	-

Note 6. Inventories	After absorption	Before absorption
Stock (2,40,000+3,00,000)	5,40,000	2,40,000
Total	5,40,000	2,40,000

Note 7. Trade Receivables	After absorption	Before absorption
Debtors (7,60,000+5,00,000)	12,60,000	7,60,000
Total	12,60,000	7,60,000

Note 8. Cash & Cash Equivalant	After absorption	Before absorption
Cash & Bank (2,09,000+1,14,000)	3,23,000	2,09,000
Total	3,23,000	2,09,000

Note 9. Other Current Assets	After absorption	Before absorption
Preliminary Expenses	1,00,000	1,00,000
Total	1,00,000	1,00,000

(b) (i) Cool & Care Ltd. planned to set up a unit for manufacture of bulk drugs. For the purpose of financing the unit, the Board of Directors have issued 20,00,000 Equity Shares of ₹10 each. 25% of the issue was reserved for Promoters and the balance was offered to the public. P Ltd., Q Ltd. and R Ltd. have come forward to underwrite the public issue in the ratio of 3:2:1 and also agreed for Firm Underwriting of 50,000, 35,000, 15,000 Shares respectively. The Underwriting Commission was fixed at 5%. The amount payable on application was ₹ 2.50 per share. The details of subscriptions are:

Particulars	**Marked Forms of P**	**Marked Forms of Q**	**Marked Forms of R**
No. of Shares	**6,50,000**	**3,00,000**	**2,00,000**

Unmarked Forms were received for 1,20,000 Shares. From the above, you are required to show the allocation of liability among underwriters with workings. Also, pass Journal Entries in the books of the Company for

a. Underwriters' net liability and the receipt or payment of cash to or from underwriters

b. Determining the liability towards the payment of commission to the Underwriters. [8]

Solution:

(a) Computation of liability of underwriters (No. of shares):

Particulars	P	Q	R	Total
Gross Liability (3:2:1)	7,50,000	5,00,000	2,50,000	15,00,000
Less: Firm underwriting	50,000	35,000	15,000	1,00,000
	7,00,000	4,65,000	2,35,000	14,00,000

Less: Marked application	6,50,000	3,00,000	2,00,000	11,50,000
	50,000	1,65,000	35,000	2,50,000
Less: Unmarked applications distributed to P, Q and R in 3:2:1 ratio	60,000	40,000	20,000	1,20,000
	(10,000)	1,25,000	15,000	1,30,000
Less: Surplus of P distributed to Q & R in 2:1 ratio	10,000	6,667	3,333	
Net Liability (excluding firm underwriting)	Nil	1,18,333	11,667	1,30,000
Add: Firm underwriting	50,000	35,000	15,000	1,00,000
Total Liability (No. of Shares)	50,000	1,53,333	26,667	2,30,000

(b) Computation of amounts receivable from / payable to underwriters:

Particulars	P	Q	R	Total
a. Total Liability (incl. Firm underwriting) (share)	50,000	1,53,333	26,667	2,30,000
b. Amount due at 2.50 per share (a x 2.50)	1,25,000	3,83,333	66,667	5,75,000
c. Amount paid for firm Underwriting at 2.50 per share	1,25,000	87,500	37,500	2,50,000
d. Balance due from Underwriters (b-c)	Nil	2,95,833	29,167	3,25,000
e. Underwriting commission payable by company	7,50,000 x 10 x 5% =3,75,000	5,00,000 x 10 x 5% =2,50,000	2,50,000 x 10 x 5% =1,25,000	7,50,000
f. Amount due to / (payable by) co. (d-e)	(3,75,000)	45,833	(95,833)	(4,25,000)

(c) In the Books of Cool & Care Ltd.

Journal Entries

Particulars	Dr.	Cr.
Bank A/c To Equity Share Capital A/c P Ltd -50,000 x 2.5 Q Ltd – 35,000 x 2.5 R Ltd – 15,000 x 2.5 (Being allotment of shares against amounts received towards subscription for Firm Underwriting at 50,000 ;35,000 and 15,000 shares respectively from P, Q, R at ₹2.50)	2,50,000	 1,25,000 87,500 37,500
Q A/c (1,18,333 x 2.50) R A/c (11,667 X 2.50) To Equity Share Capital A/c (Being allotment of share to underwriters. Application and allotment money credited to Equity Share Capital A/c)	2,95,833 29,167	 3,25,000

Underwriting Commission A/c To P A/c To Q A/c To R A/c (Being the underwriting Commission payable to P,Q and R at 5% of the normal value of the share underwritten)	7,50,000	 3,75,000 2,50,000 1,25,000
P A/c R A/c To Bank A/c (Being the amount paid to P and R in final settlement of underwriting commission due less amount receivable from them on share allotted)	3,75,000 95,833	 4,70,833
Bank A/c To Q A/c (Being the amount received from Q on shares allotted less underwriting Commission payable to him)	45,833	 45,833

(ii) X Ltd. has the following balances as on 1st April, 2012

	₹
Fixed Assets	**16,40,000**
Less: Depreciation	**4,36,000**
	12,04,000
Stocks and Debtors	**7,25,000**
Bank Balance	**1,22,500**
Creditors	**2,24,000**
Bills payable	**1,76,000**
Capital (Shares of ₹100 each)	**7,50,000**

The Company made the following estimates for financial year 2012-13:

(i) The company will pay a free of tax dividend of 20% the rate of tax being 30%.

(ii) The company will acquire fixed assets costing ₹3,20,000 after selling one machine for ₹45,000 costing ₹1,95,000 and on which depreciation provided amounted to ₹1,66,500.

(iii) Stocks and Debtors, Creditors and Bills payables at the end of financial year are expected to be ₹6,70,000, ₹1,88,000 and ₹1,52,800 respectively.

(iv) The profit would be ₹2,04,500 after depreciation of ₹2,14,000.

Prepare the projected cash flow statement and ascertain the bank balance of X Ltd. at the end of Financial year 2012-13.

[8]

Solution:

Working:

(i) Cash Flow from Operation	₹
Profit for the year	2,04,500

Add: Depreciation (Non-cash Item)	2,14,000
	4,18,500
Less: Profit on sale of Machine	16,500
	4,02,000
Add: Increase in stocks & Debtors (₹7,25,000 – ₹6,70,000)	55,000
	4,57,000
Less: Decrease in	
Creditors (₹2,24,000 - ₹1,88,000)	36,000
Bills Payable (₹1,76,000 – ₹152,800)	23,200
Cash from Operations	3,97,800
(ii) Payment of Dividend	
20% on Capital ₹7,50,000	1,50,000
Tax 30%	45,000
Total Dividend	1,95,000

It is assumed that income tax on company's profit ignore.

Projected cash flow statement for the year ended on 31st March, 2013

	₹	₹
Bank Balance as on 1st April, 2012		1,22,500
Add: Inflow of cash		
Sale of Machine	45,000	
Cash from operation	3,97,800	4,42,800
		5,65,300
Less: Outflow of Cash		
Purchase of Fixed Asssets	3,20,000	
Payament of Dividends	1,50,000	
Tax Paid	45,000	5,15,000
Bank Balance on 31st March, 2013		50,300

(c) (i) The following is the Balance Sheet of "Smart" Ltd as on 31.12.2012.

Liabilities	**₹**	**Assets**	**₹**
Issued and Subscribed Capital:		**Land and Buildings**	**8,50,000**
25,000 15% Cum. Pref. Shares of ₹100 each fully paid	**25,00,000**	**Machinery and Plant**	**23,75,000**

12,500 Equity Shares of ₹100 each, ₹75 paid	**9,37,500**	**Patents**	**3,00,000**
32,500 Equity Shares of ₹100 each, ₹60 paid	**19,50,000**	**Stock**	**9,02,500**
18% Debentures secured by Floating Charge	**15,00,000**	**Sundry Debtors**	**16,25,000**
Interest outstanding on Debentures	**1,80,000**	**Cash and Bank A/c**	**2,25,000**
Creditors	**9,00,250**	**Profit and Loss A/c**	**16,90,250**
Total	**79,67,750**	**Total**	**79,67,750**

Preference Dividends were in arrears for 2 years and the Creditors included Preferential Creditors of ₹ 38,000.

The assets realized as follows:

(a) Land and Building ₹ 16,00,000;

(b) Machinery and Plant ₹ 18,00,000;

(c) Patents ₹ 2,25,000;

(d) Stock ₹ 7,50,000 and

(e) Sundry Debtors ₹ 12,50,000.

Expense of Liquidation amounted to ₹ 62,500. The Liquidator is entitled to a Commission of 2.5% on assets realized except Cash.

Assuming that the final payments including those on debentures were made on 30.06.2013, show the Liquidator's Final Statement of Account. [8]

Solution:

Liquidator's Final Statement of Account

Receipts	Amount	Amount	Payment	Amount	Amount
Assets realized:			By Liquidator's Remuneration		1,40,625
To Bank		2,25,000	(56,25,000 x 2.5%)		
To Other Assets:			By Liquidator's Expenses		62,500
- Land & Buildings	16,00,000		By Debentures		
- Machinery & Plant	18,00,000		- Face Value of Debtentures	15,00,000	
- Patents	2,25,000		- Interest accrued	1,80,000	
- Stock	7,50,000		-Interest up to 30.06.13 (WN 1)	1,35,000	18,15,000
- Sundry Debtors	12,50,000	56,25,000			
To Call on Equity Shareholders			By Preferential Creditors		38,000
(32,500 x 11.24) (approx)		3,65,375	By Unsecured Creditors (bal. Crs)		8,62,250
(WN 2)			By Preference Share Holders:	25,00,000	

			(a) Preference Share Capital (b) Arrears of Dividend (25,00,000 x 15% x 2 years)	7,50,000	32,50,000
			By Equity Shareholders at ₹ 3.76 (approx) on 12,500 Shares		47,000
Total		62,15,375	Total		62,15,375

WN 1: As the Company is solvent, Interest on Debentures will have to be paid upto the date of final settlement i.e., for the period 01.01.2013 to 30.06.2013 i.e., ₹ 15,00,000 x 18% x 6/12 = 1,35,000

WN 2: Calls from Holders of Partly Paid Shares

Particulars		₹
a.	Total of Receipts before considering Call Money (from the above account)	58,50,000
b.	Total Payments before final payment to Equity Shares (from the above account)	61,68,375
c.	Deficits from above before Calls made on Equity Shares (a-b)	(3,18,375)
d.	Notional Call @ ₹40 on 32,500 shares and ₹25 on 12,500 shares	16,12,500
e.	Surplus Cash balance after Notional Call (comparing c and d)	12,94,125
f.	Number of Shares deemed paid at ₹ 100 per share (12,500 + 32,500)	45,000
g.	Notional Refund on Fully Paid Shares (e ÷ f) (approximately)	₹ 28.76
h.	Actual Call on 32,500 partly paid shares (₹40 – ₹28.76)	₹ 11.24
I.	Actual Refund on 12,500 shares (₹28.76 – ₹25.00)	₹3.76

(ii) Green India Ltd. has five segments namely T, P, R, S & U. The total assets of the company are ₹22 crores, segment T has ₹ 4 crores., segment P has ₹6 crores., segment R has ₹3 crore, S has ₹5.5 crores, and U has ₹3.5 crores, deferred tax assets included in the assets of each segments are T - ₹1.50 crores; P - ₹1.29 crores; R - ₹1.10 crores; S - ₹2.25 crores & U - ₹1.35 crores. The accountant contended that all the five segments are reportable segments. Comments. [4]

Solution:

Segment Assets do not include income tax assets. Therefore, the revised total assets is [22 Crores – (1.50+1.29+1.10+2.25+1.35)] = 14.51 Crores, which is analysed as under –

Assets excluding DTA		Percentage of Total
T	4.00 – 1.50 = 2.50	17.23%
P	6.00 – 1.29 = 4.71	32.46%
R	3.00 – 1.10 = 1.90	13.09%
S	5.50 – 2.25 = 3.25	22.40%
U	3.50 – 1.35 = 2.15	14.82%
Total	14.51	

Thus all the five segments hold more than 10% of the Total Assets, all segments are Reportable Segments.

(iii) A Company is planning to raise funds by making rights issue of equity shares to finance its expansion. The existing equity share capital of the company is ₹1,00,00,000. The market value of its share is ₹65. The company offers to its shareholders the right to buy 2 shares at ₹18 each for every 5 shares held. You are required to calculate:

(a) Theoretical market price after rights issue;

(b) The value of rights; and

(c) Percentage increase in share capital. [4]

Solution:

	₹
Market value of 5 shares already held by a shareholder @₹ 65(65 x 5)	325
Add: Price to be paid by him for acquiring 2 more shares@₹18 per shares	36
Total price of 7 shares after rights issue	361

(a) Therefore, theoretical market price of one share (361/7) = ₹51.57

(b) Value of Rights = Market Price – Theoretical Market Price
= ₹65 – ₹51.57
= ₹13.43

(c) Percentage increased in Share Capital

Present Capital	₹1,00,00,000
Right Issue (₹1,00,00,000 x 2/5)	₹40,00,000

% Increase in share Capital (40,00,000/1,00,00,000) X 100 = 40%

Section C

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

(i) What are the Methods of selection of audit sample?

Solution:
Auditor should select items in such a way that the sample can be expected to be representative of the population. This requires that all items in the population have an opportunity of being selected. The three common methods of selection are (1) Random Selection, (2) Systematic Selection & (3) Haphazard Selection.

(ii) What are the limitations of an Internal Control Systems of an Organisation?

Solution:

The inherent limitations of Internal Control system are as under –

(a) Organizational Structure: Deficiencies in organizational structure make internal control ineffective.

(b) Size of the Organization: Small organizations have very low levels of internal control, which are almost negligible due to more interference by owners and management.

(c) Unusual Transactions: The internal control procedures normally fail to keep a check on unusual transactions.

(d) Costly: The implementation of internal control procedures and processes involves incurring costs in terms of time, effort and resources.

(e) Abuse of Power: Members at the top-level management may override/interfere with control.

(f) Collusion of two or more People: It may lead to internal controls being over- ridden.

(g) Obsolescence: Control system may become redundant with passage of time if not updated with change in the size and nature of business.

(h) Potential for human error.

(i) Frequent follow-up measures: Follow-up procedures need to be frequent to ensure its effectiveness, which is extremely time-consuming.

(iii) Discuss the disadvantages of surprise checks in an Audit.

Solution:

Disadvantages of surprise checks in an Audit are -

(a) It allows little time for preparation and development of a site visit protocol. More time will be expanded on-site in understanding the program elements.

(b) It typically requires a longer site visit to cover the same issues as an announced visit.

(c) It has a greater potential to create conflicts.

(d) Personnel required for evaluation and interview may not be available.

(iv) Discuss the advantages of Internal Control system in an Organisation.

Solution:

Advantages of Internal Control System

(i) Efficiency, effectiveness and economy: A good internal control system ensures that the resources are utilized only for their intended purposes and helps to overcome the risk associated with the misuse of organization's funds and other resources.

(ii) Prevention of errors and irregularities: It prevents errors and irregularities by detecting them in a timely manner, thereby promoting reliable and accurate accounting records.

(iii) Safeguard from irregularities or misappropriations.

(iv) Employees' satisfaction: It protects the interests of employees by segregation of duties and delegation of responsibilities.

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

(a) As an Internal Auditor of a Cement Manufacturing Company, draft an audit program for verification of purchase of raw materials.

Solution:

Internal Audit Program for Purchase of Raw Materials

(i) Check whether there is any system of centralized Purchase.
(ii) Check whether purchases are made only from approved supplier. If not, list down the transaction for the same.
(iii) Check whether master list contain more than one source of supply for all important materials.
(iv) List down the cases where purchase orders made without valid purchase requisitions duly signed by persons authorized in this behalf.
(v) Cross check the quantity of Purchase Order from Goods Received Note (GRN) and obtain the reason for variation in the quantity of goods received.
(vi) Obtain the copy of all bulk order or annual purchase order copy and cross check the rate clause and quantum of quantity order from annual budget of the company.
(vii) Cross check the rate of goods on the invoice from Purchase Orders and note down the instances in case of variation if any.
(viii) Check whether purchases are based on competitive quotations from two or more suppliers. If not, list down the instances of the case.
(ix) Check whether comparative quotation analysis sheet is drawn before purchases are authorized.
(x) In case, the lowest quotation is not accepted, obtained the reason for the same and check whether the purchase was approved by a senior official or not.
(xi) In case the price variation clause is included, check whether it is approved by a Senior official or not.
(xii) List out the instances of cases where major variation in the quality of the goods from standard norms is received from supplier.
(xiii) Check whether reference no. of purchase order is given in the GRN.
(xiv) Check whether purchase orders are pre-numbered and strict control exercised over unused forms.
(xv) Check whether purchase orders signed only by employees authorized in this behalf.
(xvi) Check whether copies of purchases orders and revisions forwarded to Accounts and Receiving Department.
(xvii) Check a List of pending purchase orders complied by purchase department at least office every quarter?
(xviii) Check whether all materials, supplies, etc. received only in the Receiving Department. If not, obtain the reason.
(xix) If the goods are received directly by User Department/Processors/ Customers, check whether there a procedure of obtaining acknowledgements for quantity received and the conditions of the goods.
(xx) Check whether there is proper system towards material receiving, supplies etc. inspected and counted, weighted or measured in the Receiving Department before preparing GRN.
(xxi) Check whether copies of Goods Received Notes forwarded to Accounts Department and a list of goods received to Purchase Department regularly.
(xxii) Check whether in all cases of materials returned, shortages and rejections advised to the Accounts Department, for raising Debit Memos on suppliers or claim bill on carriers/ insurance companies as the case may be.

(b) Discuss how Cost Audit is useful to Management, society, Shareholders and Government?

Solution:

The major advantage of Cost Audit, to various categories of persons, is as under –

1. To Management:
   - (a) Reliability of date for day-to-day operations like determination of price, cost control, decision making etc.
   - (b) Continuous check on all wastages through a proper system of reporting.
   - (c) Highlighting of inefficiencies in operations, in order to take corrective action.
   - (d) Adoption of management by Exception through allocation of responsibilities to individual managers.
   - (e) Introduction of a system of Budgetary Control and Standard Costing.
   - (f) Establishment of reliable check on the valuation of Closing Stock and Work-in-Progress.
   - (g) Detection and prevention of errors and fraud.
2. To the Society:
   - (a) Proper pricing on the basis of correct costing data saves consumer from exploitation.
   - (b) Consumers can maintain their standard of living, since price increase by the industry is not allowed without proper justification like, increase in cost of materials, labour, etc.
3. To Shareholders: Cost Audit benefits the shareholders by ensuring that –
   - (a) Proper records are kept for purchases, utilization of materials, expenses incurred on wages, OH, etc.
   - (b) The enterprise has been run economically and efficiently.
   - (c) A fair return on investment is determined by proper determination of costs.
4. To The Government:
   - (a) To fix the price of cost-plus contracts, wherever applicable.
   - (b) To fix selling price of essential commodities and therefore check undue profiteering.
   - (c) To focus its attention on inefficient units.
   - (d) To decide on granting of protection to certain industries based on their needs.
   - (e) To settle trade disputes brought to the Government.
   - (f) To impose automatic check on inflation by promoting healthy competition among industries.

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

(a) (i) The rate of Equity Dividend declared and paid by a Company are as follows:
Year: 2010 – 16%, Year: 2009 – 12%, and Year: 2008 – 12%
The Company has earned sufficient Profit after tax in 2011 and wishes to propose a dividend on Equity Share at 11% of the current profits. It also wishes to transfer more than 10% of Current Profits to its Reserves. The Company did not issue bonus shares during last few years.
The Company's PAT for the past year are: Year 2010- ₹25,00,000, Year 2009 - ₹22,00,000, Year 2008 - ₹21,00,000, and year 2007 – ₹30,00,000.
Can the company transfer a higher rate of profit to Reserves? Explain. [8]

Solution:

A Company can transfer at a rate higher than 10% of Current Profits to Reserve, only as per Companies (Transfer of Profit to Reserve) Rules. Conditions for voluntary transfer of higher percentage are –

Condition	Applicability
Rate Condition: Rate of Dividend for the year	Proposed Dividend Rate 11% is less than

≥ Average Rate of Dividend declared in immediately preceding 3 years.	Average Past Rate of Dividend of previous 3 years = $\frac{16+12+12}{3}$ = 13.33% . Hence, this condition is not satisfied.
Bonus Issue: Minimum Dividend to be distributed ≥ Average amount of dividend declared during immediately preceding 3 years.	No Bonus Issue, hence this condition is not applicable.
Inadequate Profits: Net Profit after tax for the year ≤ 80% of the Average Net Profit after Tax of immediately 2 years.	It is given that the Post-Tax Profit in 2011 is higher than the corresponding profit of each of the previous 3 years. Hence, the exception is not applicable.

The Company cannot transfer a rate higher than 10% to its Reserves.

(ii) Distinguish between Qualified Report and Adverse Report. [4]

Solution:

Distinguish Between Qualified Report and Adverse Report

Qualified Report	Adverse Report
i. A Qualified Audit Report is one an Auditor gives an opinion subject to certain reservations.	An Adverse Report is given when the Auditor conclude that based on his examination, he does not agree with the affirmations made in the Financial Statements/ Financial Report.
ii. The Auditor's reservation is generally Stated as: "Subject to the above, we report that the Balance Sheet shows a true and fair view."	The Auditor states that the Financial Statements do not present a true and fair view of the state of affairs and working results of the organisation.
iii. The accounts present a true and fair view subject to certain reservations.	The accounts do not present a true and fair view on the whole.
iv. A Qualification is made in the Audit Report when the Auditor has reservation on specific item(s) of material nature.	An Adverse Report is given when the Auditor has his reservations on the true and fair view presented by the Financial Statements.

(b) Answer the following [3x4=12]

(i) What types of Companies are specially exempted from application of CARO?

Solution:

CARO does not apply to the following classes of Companies –
(g) Banking Company as defined u/s 5(c) of the Banking Regulation Act, 1949,
(h) Insurance Company as defined u/s 2(21) of the Companies Act, 1956,
(i) Company licensed to operate u/s 25 of the Companies Act, 1956 and
(j) Private Limited Companies subjected to the following conditions-
- Aggregate of Paid up Capital and Reserves should not exceed ₹50 Lakhs
- Loan outstanding from any Bank or Financial Institution should not exceed ₹25 Lakhs.

- Turnover should not exceed ₹5 Crores.

(ii) Mayank, a practicing Cost Accountant, is attending to the matters of Q Ltd., and for that purpose has to regularly attend to the Company from 10.00 A.M to 4.00 P.M. on all working days. He is paid ₹25,000 p.m. for the same. Q Ltd. intends to appoint Mayank as its Cost Auditor. Advice whether Mayank can accept the appointment.

Solution:

Disqualifications of Cost Auditor

The following persons shall not be appointed or re-appointed as Cost Auditor –

(a) A person covered by section 226(3) or 226(4) (i.e., Disqualification for Company Auditors).
(b) Auditor of the Company appointed u/s 224 (i.e., Company Auditor shall not be the Cost Auditor).
(c) A person who acquires any of the above disqualifications, subsequent to his appointment.

(iii) State the advantages of Continuous Audit.

Solution:

Advantages of Continuous Audit

(a) Early location of errors and frauds: It helps in detecting errors and frauds immediately on their occurrence, and not at the year end when it would become difficult to install corrective control mechanisms.
(b) Quick rectification: rectification of errors at an early stage is possible.
(c) Continuous guidance to client.
(d) Finalizations of accounts completion in time: Just at the end of the accounting period.
(e) Moral check: Make employees of the client alert and more efficient in conducting their work.
(f) Improves statutory auditor's focus: It relieves statutory auditors of routine testing and allows them to focus efforts on more valuable activities.

(c) Write short notes on the following: [3 x4=12]

(i) Environment Audit
(ii) Proprietary Audit
(iii) Energy Audit

Solution:
(i) Environment Audit:

According to the United States Environmental Protection Agency (USEPA), environmental audit may be defined as a systematic, documented, periodic and objective review by a regulated entity of facility operations and practices related to meeting environmental requirements,"

The Confederation of British Industry has defined environmental auditing as "the systematic examination of the interactions between any business operation and its surroundings."

Scope and Object

i. All emissions to air, land and water

ii. Legal constraints

iii. The effects on the neighboring community, landscape and ecology

iv. The public's perception of the operating company in the local area

v. It provides expert opinion on hazards in the environment

vi. Associated risks

vii. 'The measures that may need to be taken for the management and control of risks.

The International Chamber of Commerce presents the different steps of an environmental audit as follows:

1. Pre-audit activities:
   i. Selection and scheduling of facility to audit.
   ii. Selection of audit team.
   iii. Contact with facility.
   iv. Planning of the audit.
2. Site activities:
   i. Understanding of internal controls.
   ii. Assessment of internal controls.
   iii. Gathering of audit evidence.
   iv. Evaluation of audit findings.
   v. Report of findings to facility.
3. Post audit activities:
   i. Production of a draft report.
   ii. Production of a final report.
   iv. Preparation and implementation of an action plan.
   iv. Monitoring of action plan.

ISO I4001 is a voluntary international standard for Environmental Management Systems (EMS). It provides the requirements for an EMS and gives general guidelines for its maintenance. An EMS meeting the requirements of ISO 14001:2004 is a management tool enabling an organization of any size or type to:

Identify and control the environmental impact of its activities, products or services.

Improve its environmental performance continually.

Implement a systematic approach to setting environmental objectives and targets, to achieving these and to demonstrating that they have been achieved.

(b) Proprietary Audit:
A propriety audit is not just concerned with the truthfulness and fairness of the Financial Statements and books of accounts of the client, but also ensures that the transactions entered into by the client, business practices and activities undertaken are not against public interest. Its

objective is to see that the business lives upto standards of proper conduct. Legal, economic and financial are all equally important aspects that require to be looked into during the course of the audit.
It is an essential element of a Government Audit. The Comptroller and Auditor General examines the propriety of all government expenditures to ensure that they have been incurred in the interest of the general public, and are not influenced by personal interests of the government authorities sanctioning it.
Under the provisions of the Companies (Auditors' Report) Order, 2003, a company auditor is required to examine the propriety of some financial transactions and comment on the same through his audit report.
Section 227(IA) of the Companies Act, 1956 requires the auditor to look into some specified matters to ensure that the Directors of the company do not engage in misappropriation and siphoning of funds.

(c) Energy Audit:

An energy audit is a preliminary activity towards instituting energy efficiency programs in an establishment. It consists of activities that seek to identify conservation opportunities preliminary to the development of an energy savings program.

The Role of an Energy Audit

To institute the correct energy efficiency programs, you have to know first which areas in your establishment unnecessarily consume too much energy, e.g. which is the most cost-effective to improve. An energy audit identifies where energy is being consumed and assesses energy saving opportunities - so you get to save money where it counts the most.

In the factory, doing an energy audit increases awareness of energy issues among plant personnel, making them more knowledgeable about proper practices that will make them more productive. An energy audit in effect gauges the energy efficiency of your plant against "best practices". When used as a "baseline" for tracking yearly progress against targets, an energy audit becomes the best first step towards saving money in the production plant.

An energy audit seeks to document things that are sometimes ignored in the plant, such as the energy being used on site per year, which processes use the energy, and the opportunities for savings. In so doing, it assesses the effectiveness of management structure for controlling energy use and implementing changes. The energy audit report establishes the needs for plant metering and monitoring, enabling the plant manager to institutionalize the practice and hence, save money for the years to come. The energy audit action plan lists the steps and sets the preliminary budget for the energy management program.