Paper 12 - Company Accounts & Audit

Full Marks: 100

Section A

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

(i) The carrying amount of an asset given on sale and leaseback that results in an operating lease is ₹10,000. The fair value and the selling price of the asset at inception of the lease is ₹9,000. Give the accounting treatment in the books.

Answer:

Loss of ₹1,000 (₹10,000 - ₹9,000) to be immediately recognized in the profit and Loss account.

(ii) An asset does not meet the requirement of environment laws which have been recently enacted. The asset has to be destroyed by the law. The asset is carried in the Balance Sheet at the year end at ₹12,00,000. The estimated cost of destroying the asset is ₹1,50,000. How is the asset to be accounted for?

Answer:

Fixed assets should be eliminated from the Financial Statements on disposal, or when no further benefit is expected from its use or disposal. So, the fixed asset should be eliminated from the Financial Statements, as it is proposed to be destroyed as per law.

Cost of destroying the asset of ₹150,000 should be accounted for as and when incurred. A provision for the same should not be created since it is an obligation from a future event i.e. destruction of the asset.

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

(a) In the context of relevant accounting Standard, give your comments on the following matters for the financial year ended on 31.3.2013.

(i) A company with a turnover of ₹350 crores and an annual advertising budget of ₹2 crores had taken up the marketing of a new product. It was estimated that the company would have a turnover of ₹25 crores from the new product. The company had debited to its Profit & Loss account, the total expenditure of ₹2 crore incurred on extensive special initial advertisement campaign for the new product.

Is the procedure adopted by the company correct? [4]

Answer:

Expenditure on Advertisement constitutes one of the items to which AS – 26 is applicable. Since the Turnover attributable to the new product ₹25 Crores constitutes 7.14% of the Total Turnover of the Company (i.e. ₹350 Crores), the new products revenue and costs, shall be considered material from the overall Financial Statements' viewpoint.

An Intangible Assets is an Identifiable non-monetary Asset without physical substance held for use in the production or supplying of goods or services for rentals to others or for administrative purpose.

An Intangible Asset should be recognized only if –

(a) It is probable that the future economic benefits that are attributable to the asset will flow to the Enterprise, and

(b) The cost of the asset can be measured reliably.

Since the recognision criteria are met in the above case, the Company should treat the Advertising Expenditure as an "Intangible Asset". Hence, writing off the entire Advertisement Expense in the year of incurrence to the P&L A/c is not considered proper.

(ii) Modern Ltd. took a factory premises on lease on 01.04.2010 for ₹2,00,000 per month. The lease is operating lease. During March, 2011, Modern Ltd. relocates its operation to a new factory building. The lease on the old factory premises continues to be live upto 31.12.13. The lease cannot be cancelled and cannot be sub-let to another user. The auditor insists that lease rent of balance 33 months upto 31.12.2013 should be provided in the accounts for the year ending 31.3.2011. Modern Ltd. seeks your advice. [4]

Answer:

"Onerous Contract" is a contract in which the unavoidable costs of meeting the obligation under the contract exceeds the economic benefits expected to be received under it.

In the given case, the Operating Lease Contract has become onerous, as the economic benefit of lease contract for next 33 months up to 31.12.2013 will be nil. However, the Lessee, Modern Ltd. Has to pay lease rent of ₹66,00,000 (i.e. ₹2,00,000 p.m. for next 33 months). Therefore, provision on account of ₹66,00,000 is to be made in the accounts for the year ending 31.03.2011, in accordance with AS-29 requirements.

(b) (i) An enterprise operates a pension plan that provides a pension of 2% on final salary for each year of service. The benefit will be vested after 5 years of service. On 1.1.2009, the enterprise improves the pension to 2.5% of the final salary for each year of service starting from 2005. At the date of improvement the Present Value of additional benefits for service from 1.1.2005 to 1.1.2009 is as follows:

Employees with more than 5 years of service at 1.1.2009	**₹200**
Employees with less than 5 years of service	**₹120**

(Average period until vested = 3 years)

Suggest the accounting treatment. [4]

Answer:

As per Accounting Standard 15 "Employee Benefits" the enterprise recognises ₹200 immediately because those benefits are already vested. The enterprise recognizes ₹120 on a straight – line basis over three years from January, 2007.

(ii) Himalayas Ltd. is showing an intangible Asset at ₹72 lakhs as on 01.04.13 and that item was required for ₹96 lakhs on 01.04.2009 and that item was available for use from that date. Himalayas Ltd. has been following the policy of amortization of the intangible asset over a period of 12 years on straight line basis. Comments on the accounting treatment of the above with reference to relevant accounting standard. [4]

Answer:

There may be persuasive evidence in some cases that the useful life will be a specific period longer than ten years. In such case the Enterprise should –

(a) Amortise the Intangible Asset over the best estimate of its useful life,

(b) Estimate the recoverable amount of the Intangible Asset at least annually in order to identify any Impairment Loss, and

(c) Disclose the reasons for overriding the presumptive period of 10 years, and the factors that played a significant role in determining the useful life of the asset.

Rebuttable Presumption: AS- 26 assumes that the useful life of an Intangible Asset will not exceed a period of 10 years, but this presumption is rebuttable.

Amortisation amount as per Company policy:

(a) Amortisation Amount (₹96 lakhs ÷ 12 years)	= ₹8 laks p.a
(b) Accumulated amortization upto 31st March 2013 (for four years) (₹8 lakh x 4)	= ₹32 lakhs
(c) Carrying Amount (₹96 lakhs – ₹32 lakhs)	= ₹64 lakhs
(d) However, Carrying amount as per books	= ₹72 lakhs

Therefore, the difference of ₹8 lakhs should be written off to the P&L A/c in the current year.

Future Amortisation: The balance Carrying Amount of ₹64 lakhs should be amortised over the balance useful life (8 years) at ₹ 8 lakhs per annum.

(c) (i) How should a lessee account for installation, erection and commissioning costs incurred in connection with an asset taken of finance lease? [4]

Answer:

Accounting for Finance Lease – In the books of Lessee

- Leased asset as well as liability for lease should be recognized at the lower of –
- Fair value of the leased asset at the inception of lease or
- Present value of minimum lease payment from the lessee point of view.
- Apportionment of lease payment-Each lease payment is apportioned between finance charge and principal amount.
- The lessee in its books should charge depreciation on finance lease asset as per AS-6(in this case, straight line method will be followed)
- Initial direct cost for financial lease is included is asset under lease.

Therefore, in finance lease installation, erection and commissioning incurred by lessee also to be capitalized.

(ii) Y Ltd. issued 6,00,000 shares of ₹10 each on April 1, 2012. ₹5 per share were called up on that day, which was paid by all shareholders. On October 1, 2012, the remaining ₹5 per share were called up, which was paid by all but one shareholder, who held 50,000 shares. His amount was unpaid even at March 31, 2013, the date of the financial statement. As per the Articles of the company, the shareholders have a right to dividend to the extent of their share in the paid-up capital. Calculate Basic EPS for the year ended March 31, 2013, if the net profit attributable to shareholders for the year was ₹12,00,000. [4]

Answer:

Computation of weighted Average number of equity shares outstanding at the end of the period

Date	No. of Equity Shares	Proportion of paid-up Value to FV	Period Outstanding	Time Weighting factor	Weighted Average No. of Shares
(1)	(2)	(3)	(4)	(5)	(6)
1st Apr	6,00,000	₹5 ÷ ₹10 = 50%	6 months (upto 30th Sep)	6/12	1,50,000
1st Oct	5,50,000	₹10 ÷ ₹10 = 100%	6 months (upto 31th Mar)	6/12	2,75,000
	50,000	₹5 ÷ ₹10 = 50%	6 months (upto 31th Mar)	6/12	12,500
Weighted Average number of equity shares outstanding at the end of the period					4,37,500

$$\text{Basic EPS} = \frac{\text{Net Profit or Loss attributable to Equity Shareholders}}{\text{Weighted Average Number of Equity Shares outstanding}} = \frac{12,00,000}{4,37,500} = 2.74 \text{ per share.}$$

Section B

(3) Answer the following (Compulsory) [4x2]

(i) Goodwill arising on acquisition as per AS-14 is to be treated as per AS-26. Comments.

Answer:
An Intangible Asset acquired in the course of an amalgamation in the nature of purchase, is accounted for in accordance with AS -14. The Transferee Company should recognize an Intangible Asset meeting the recognition criteria under AS – 26, even if such asset had not been recognized in the Financial Statement of the Transferor Company.

(ii) Calculate from the following information- Theoretical ex-right fair value

Right factor:
- **Number of equity shares outstanding 2 lakhs**
- **Right issue 2 shares for each 5 shares**
- **Fair value per share before right ₹34.00**
- **Right issue price ₹20.00**

Answer:
Determination of Theoretical Ex-Rights Fair Value / Price:

$$= \frac{\text{(Base Shares Quantity x Fair Value per Share Before Rights)+(Rights Issue +Rights Issue Price)}}{\text{Base Shares Quantity + Rights Shares Quantity}}$$

$$\text{Theoretical ex-right fair} = \frac{(2,00,000 \times 34) + (80,000 \times 20)}{2,00,000 + 80,000} = ₹30$$

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

Answer:

(a) To be shown as a negative figure under "Surplus".

(b) If it is repayment after 12 months – Sub-classified under "Long-term Borrowing" to be presented as a separate line item. Also state the term of repayment.
If it is repayment within twelve months – Sub – classified under "other current liabilities. To be shown as a separate line item.

(iv) Write short notes on Creditors' Voluntary Wind-up.

Answer:

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

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

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

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

(a) Balance Sheet of Dixit Ltd. as on 31.3.2013

Liabilities	**₹**	**Assets**	**₹**
Equity Share Capital (60,000 equity shares of 10 each)	6,00,000	Goodwill	80,000
		Land & Building	8,80,000
15% Pref. Share Capital	2,00,000	Patents	60,000
Capital Redemption Reserve	1,20,000	Motor car	1,00,000
Dividend Equalization fund	40,000	Investments	1,20,000
Insurance fund	1,60,000	Stock	3,00,000
Workmen compensation fund	1,20,000	Insurance policy	2,00,000
10% debenture	4,00,000	Debtors	1,80,000
Creditors	2,40,000	Cash	1,40,000
Outstanding wages	40,000	Discount on shares	20,000
Proposed dividend	60,000		
Provision for tax	1,00,000		
	20,80,000		**20,80,000**

Contingent liability ₹40,000. It was agreed by Shivam Ltd. to take over Dixit Ltd. as on 31.3.13.

(i) Shivam Ltd. took over Dixit Ltd. and it was agreed to pay ₹2 in cash per share and issue 4 shares for every 6 held valued at ₹12 each.

(ii) Preference Shareholders are issued 10% new preference shares in such quantity- so as to maintain their dividend.

(iii) Patents are valued 25% lesser while investments are valued at 80%.

(iv) Insurance policy was taken over by Shivam Ltd. at its surrender value of ₹1,20,000.

(v) Contingent liabilities was agreed to be taken over by Shivam Ltd. which is estimated to ₹28,000.
(vi) Liability against workman compensation fund is ₹40,000
(vii) Shareholders holding 2,400 shares dissented and it was agreed to pay them ₹13 in cash while 120 shares are fund fractional which was discharged @ ₹10.
(viii) Liquidation expenses amounting to ₹20,000.

Close the books of Dixit Ltd. Journalise in Shivam Ltd. and show new balance sheet of Shivam Ltd. [16]

Answer:

Working Note – 1

Calculation of Purchase Consideration

To	In	Working	Amount
Equity Share Holder	ES	[{4/6 x (60,000 – 2400 -120)} x 12]	4,59,840
Equity Share Holder	Cash	2 x (60,000)	1,20,000
Equity Share Holder (dissent)	Cash	2400 x 13	31,200
Equity Share Holder (fresher)	Cash	120 x 10	1,200
Preference Share Holder	PS	(2,00,000 x 15) / 10	3,00,000
			9,12,480

Books of Dixit Ltd.
Realisation A/c

Particulars	Amount	Particulars	Amount
To Goodwill	80,000	By Creditor	2,40,000
To land & Building	8,80,000	By Outstanding Wages	40,000
To Patent	60,000	By 10% debenture	4,00,000
To Machine	1,00,000	By Working Capital Fund	
To Investment	1,20,000	Liability	40,000
To Stock	3,00,000	By Provision for tax	1,00,000
To Insurance policy	2,00,000	By Shivam Co. – PC	9,12,240
To Debtor	1,80,000	By Cash Exp	20,000
To Cash	1,40,000	By R/Loss	4,27,760
To Cash	20,000		
To PSH a/c	1,00,000		
	21,80,000		21,80,000

Equity Share Holder A/c

Particulars	Amount	Particulars	Amount
To Discount on Shares	20,000	By Equity Share Capital	6,00,000
To Equity Share of PCO	4,59,840	By CRR	1,20,000
To Cash of SH	1,52,400	By D.E. Res.	40,000
To R/Loss	4,27,760	By W. Fund	80,000
		By Proposed dividend	60,000
		By Insurance Fund	1,60,000
	10,60,000		10,60,000

Preference Share Holder A/c

Particulars	Amount	Particulars	Amount
To PS of Shivam Ltd.	3,00,000	By PSC By Realisation A/c	2,00,000 1,00,000
	3,00,000		3,00,000

Shivam Ltd.

Particulars	Amount	Particulars	Amount
To Real A/c	9,12,240	By Es of Shivam Co. By Cash for Shivam Co. By PS of Shivam Co. By Cash	4,59,840 1,20,000 3,00,000 32,400
	9,12,240		9,12,240

Cash A/c

Particulars	Amount	Particulars	Amount
To Realisation	20,000	By Realisation	20,000
	20,000		20,000

Books of Shivam Ltd.

1. Business purchased To Liquidator of Dixit Ltd. (Being business purchased)	Dr.	9,12,240	 9,12,240
2. Land & Building Motor Car Patents Investments Stock Ins. Policy Debtors Cash To Capital Reserve (b/f) To Deb. Holders To Creditor To O/s Wages To Provision for tax To WCF – Liability To (Contingent) Liability taken ones To Business Purchased	Dr. Dr. Dr. Dr. Dr. Dr. Dr. Dr.	8,80,000 1,00,000 45,000 96,000 3,00,000 1,20,000 1,80,000 1,40,000	 1,00,760 4,00,000 2,40,000 40,000 1,00,000 40,000 28,000 9,12,240
3. Liquidator of Dixit Ltd. To Equity Share Capital To Cash To 10% PSC To Security Premium (Being PC discharged)	Dr.	9,12,240	 3,83,200 1,52,400 3,00,000 76,640
4. Goodwill A/c To Cash (Being liquidator expense)	Dr.	20,000	 20,000
5. Debenture Holder A/c To 10% Debenture	Dr.	4,00,000	 4,00,000

(Being debenture issued)		

Name of the Company: Shivam Ltd.
Balance Sheet as at 31st March, 2013

(₹)

Ref No.	Particulars		Note No.	As at 31st March, 2013	As at 31st March, 2012
	1	EQUITY AND LIABILITIES			
		(a) Share capital	1	6,83,200	
		(b) Reserves and surplus	2	1,57,400	
		(c) Money received against share warrants			
	2	Share application money pending allotment			
	3	Non-current liabilities			
		(a) Long-term borrowings	3	4,00,000	
		(b)Deferred tax liabilities (Net)			
		(c) Other Long term liabilities			
		(d) Long-term provisions			
	4	Current Liabilities			
		(a) Short-term borrowings			
		(b) Trade payables	4	2,40,000	
		(c)Other current liabilities	5	1,40,400	
		(d) Short-term provisions	6	1,00,000	
		Total (1+2+3+4)		17,21,000	
	II	ASSETS			
	1	Non-current assets			
		(a) Fixed assets			
		(i) Tangible assets	7	10,25,000	
		(ii) Intangible assets			
		(iii) Capital work-in-progress			

		(iv) Intangible assets under development			
		(b) Non-current investments	8	96,000	
		(c)Deferred tax assets (Net)			
		(d) Long-term loans and advances			
		(e) Other non-current assets			
	2	Current assets			
		(a)Current investments			
		(b) inventories	9	3,00,000	
		(c) trade receivables	10	1,80,000	
		(d) Cash and cash equivalents			
		(e)Short-term loans and advances			
		(f) Other current assets	11	1,20,000	
		Total (1+2)		17,21,000	

Notes on Accounts (₹)

Note 1. Share Capital	As at 31st March, 2013	As at 31st March, 2012
Authorized share capital		
……… Equity shares of ₹ 10 each	…….	
…….. ,10 % Pref. shares	…….	
	…….	
Issued, Subscribed and paid-up share capital		
38,320 Equity share of ₹ 10 each fully paid	3,83,200	
10% Pref. shares	3,00,000	
Total	6,83,200	

RECONCILIATION OF SHARE CAPITAL

FOR EQUITY SHARE	As at 31st March, 2013		As at 31st March, 2012	
	Nos.	Amount (₹)	Nos.	Amount (₹)
Opening Balance as on 01.04.11	-	-		
Add: Fresh Issue (Including Bonus shares, right shares, split shares, share issued other than cash)	38,320	3,83,200		

	38,320	3,83,200		
Less: Buy Back of share				
Total	38,320	3,83,200		

FOR Pref. SHARE	As at 31st March, 2013		As at 31st March, 2012	
	Nos.	Amount (₹)	Nos.	Amount (₹)
Opening Balance as on 01.04.11	-	-		
Add: Fresh Issue		3,00,000		
Total		3,00,000		

Note 2. Reserve & Surplus	As at 31st March, 2013	As at 31st March, 2012
Capital Reserve (1,00,760 – 20,000)	80,760	
Securities premium	76,640	
Total	1,57,400	

Note 3. Long-term borrowings	As at 31st March, 2013	As at 31st March, 2012
10 % Debenture	4,00,000	
Total	4,00,000	

Note 4. Trade Payables	As at 31st March, 2013	As at 31st March, 2012
Sundry Creditors	2,40,000	
Total	2,40,000	

Note 5. Other Current Liabilities	As at 31st March, 2013	As at 31st March, 2012
Bank Overdraft (1,52,400 + 20,000 – 1,40,000)	32,400	
Outstanding wages	40,000	
Workmen compensation fund	40,000	
Contingent liability	28,000	
Total	1,40,400	

Note 6. Short term provisions	As at 31st March, 2013	As at 31st March, 2012

Provision for tax	1,00,000	
Total	1,00,000	

Note 7. Tangible Assets	As at 31st March, 2013	As at 31st March, 2012
Land and buildings	8,80,000	
Motor Car	1,00,000	
Patents	45,000	
Total	10,25,000	

Note 8. Non-current Investment	As at 31st March, 2013	As at 31st March, 2012
Investments	96,000	
Total	96,000	

Note 9. Inventories	As at 31st March, 2013	As at 31st March, 2012
Stock	3,00,000	
Total	3,00,000	

Note 10. Trade receivables	As at 31st March, 2013	As at 31st March, 2012
Sundry Debtors	1,80,000	
Total	1,80,000	

Note 11. Other current assets	As at 31st March, 2013	As at 31st March, 2012
Insurance policy	1,20,000	
Total	1,20,000	

(b) (i) TQM Ltd. group has three divisions T, Q, M. details of their turnover, results and net assets are given below:

	(₹ in lakhs)
Division T	
Sale to Q	**3,050**
Other sales (Home)	**60**
Export sales	**4,090**
	7,200

Division Q	
Sale to M	**30**
Export sales to Europe	**200**
	230
Division M	
Export sales to America	**180**

		Division		
	Head Office	**T**	**Q**	**M**
	(₹ in lakhs)	**(₹ in lakhs)**	**(₹ in lakhs)**	**(₹ in lakhs)**
Operating Profit or loss before tax		**160**	**20**	**(8)**
Re-allocated cost from Head Office		**48**	**24**	**24**
Interest cost		**4**	**5**	**1**
Fixed assets	**50**	**200**	**40**	**120**
Net current assets	**48**	**120**	**40**	**90**
Long-term liabilities	**38**	**20**	**10**	**120**

Prepare a segmental Report for publication in TQM Ltd. Group. [8]

Answer:

TQM Ltd.

Segment Report (₹ in Lakhs)

	Divisions				
	T	Q	M	Inter segment Elimination	Consolidated Total
Segment Revenue Sales:					
Domestic	60	-	-	-	60
Export	4,090	200	180	-	4,470
External Sales	4,150	200	180	-	4,530
Inter-segment sales	3,050	30	-	3,080	-
Total Revenue	7,200	230	180	3,080	4,530
Segment result (given)	160	20	(8)	-	172
Head office expenses					(96)
Operating profit					76
Interest expense					10
Profit before tax					66
Other information					
Fixed Assets	200	40	120	-	360
Net current assets	120	40	90	-	250
Segment Assets	320	80	210	-	610
Unallocated corporate assets					98
Segment Liabilities	20	10	120		150
Unallocated corporate liabilities					38

Sales Revenue by Geographical Market

	Home Sales	Export Sales (by division T)	Export to Europe	Export to America	Consolidated Total
External Sales	60	4,090	200	180	4,530

(ii) From the following information prepare Cash flow statement:

Balance Sheet **(₹ in Amount)**

Liabilities	31.3.12	31.3.13	Assets	31.3.12	31.3.13
Share Capital	10,00,000	12,00,000	Goodwill	2,00,000	1,60,000
Debentures	6,00,000	4,00,000	Land	5,40,000	7,90,000
General Reserve	3,00,000	3,00,000	Machinery	7,20,000	9,00,000
Profit and loss A/c	2,40,000	3,20,000	Stock	3,20,000	2,50,000
Provision for Income tax	70,000	1,20,000	Debtors (Good)	3,00,000	2,40,000
Creditors	1,63,000	65,000	Preliminary Expenses	24,000	12,000
Bills payable	30,000	45,000	Cash	3,35,000	1,22,000
Provision for Doubtful debts	36,000	24,000			
	24,39,000	24,74,000		24,39,000	24,74,000

Additional Information:

a. **During the year, a part of machine costing ₹17,500 (accumulated depreciation thereon being ₹2,500) was sold for ₹3,000.**

b. **Income tax of 2011-2012 paid in 2012-13 was ₹70,000.**

c. **Depreciation on machinery provided for 2012-13 was ₹56,000.** **[8]**

Answer:

Cash Flow Statement

Cash from Operating Activities	2,85,000
Cash from Investing Activities	(4,98,000)
Cash from Financing Activities	0
Total	(2,13,000)
(+) Opening Cash and Cash Equivalents	3,35,000
Closing Cash and Cash Equivalents	1,22,000
Operating Activities	
Change in Profit and Loss Account	80,000
+ Provision for tax	1,20,000
- Tax Paid	(70,000)
- Change in Creditors	(98,000)
+ Change in Bills Payable	15,000
+ Goodwill Written Off	40,000
+ Loss on Sales on Machine	12,000
+ Depreciation	56,000
+ Change in Stock	70,000
+ Change in Debtors	60,000
+ Preliminary Expenses Written Off	12,000
- Change in Provision for Doubtful Debts	(12,000)
	2,85,000
Cash from Investing Activities	
Purchase of Land	(2,50,000)
Purchase of Machinery	(2,51,000)
Sale of Machinery	3,000
	(4,98,000)
Cash from Financing Activities	
Issue of Share Capital	2,00,000
Payment to Debenture holders	(2,00,000)

	0

(c) (i) In a winding up which commenced on 12th May of a certain calendar year, certain Creditors could not receive payments out of the realization of assets and out of contribution from 'A' List of Contributories. Following are the details of certain share transfers that took place prior to liquidation and the amount of creditors remaining unpaid.

Shareholders	No. of shares transferred	Date when ceased to be a member	Creditors remaining unpaid and outstanding on the date of ceasing to be a member (₹)
Abhay	**2400**	**5th February**	**11,000**
Bimal	**1800**	**18th June**	**13,500**
Chetan	**1600**	**25th September**	**22,400**
Damodar	**1200**	**8th October**	**23,600**
Ravi	**700**	**7th December**	**26,000**

All the shares were of ₹10 each on which ₹5 per share had been called and paid up. Ignoring Expenses of Liquidation, Remuneration to Liquidator etc., work out the amount to be realized from the above contributories. [8]

Answer:

The winding up commenced on 12th May. Hence, only those persons who had transferred their shares within a period of 12 months preceding the date of winding up is liable for Contribution under List B. In this, Abhay is not a B list Contributory since his shares have been transferred much earlier than the 12 month period.

The other Transferors are liable subject to the restriction that an individual should not be made liable for more than unpaid value on the shares.

Statement of Liability of B List Contributories (Amount in ₹)

Name of Shareholder			Bimal	Chetan	Damodar	Ravi	Amount payable to Creditors
Number of Shares held			1,800	1,600	1,200	700	
Creditors payable on the date of ceasing to be member							
Date ,Amount Payable to Creditors		Ratio					
18/06 Given	13,500	18:16:12:7	4,585	4,075	3,057	1,783	13,500
25/09 (22,400 – 13,500)	8,900	16:12:7		4,069	3,051	1,780	8,900
08/10 (23,600 – 22,400)	1,200	12:7			758	442	1,200
07/12 (26,000 – 23,600)	2,400	Only by Ravi				2,400	2,400
(a) Total of above			4,585	8,144	6,866	6,405	26,000
(b) Maximum Liability on Shares held (₹5 per share)			9,000	8,000	6,000	3,500	
(c) Amount paid (a) or (b) whichever is Lower			4,585	8,000	6,000	3,500	22,085

Chetan, Damodar and Ravi can be called upon to pay only ₹8,000, ₹6,000 and ₹ 3,500 respectively. The Creditors totaling ₹ 3,915 (₹ 2,400 on 7th December, ₹1,200 on 8th October and ₹ 315 on 25th September) will not be receiving any payment.

(ii) A company announced a share-based payment plan for its employees on 1.4.10, subject to a vesting period of 3 years. By the plan, the employees can (i) either claim difference between exercise price ₹150 per share and market price of those shares on vesting date in respect of 10,000 shares or (ii) can subscribe to 12,000 shares at exercise price ₹ 150 per share, subject to lock in period of 5 years. On 01.04.10, fair value of the option, without considering restrictions on transfers was ₹30 and that after considering restrictions on transfer was ₹27. The fair value estimates, without considering transfer restriction were ₹31.50, ₹32.70 and ₹34.00 respectively, at the end of 2010-11, 2011-12 & 2012-13.

Show important accounts in books of the company if employees opt for (i) cash settlement (ii) equity settlement. [8]

Answer:

1. Computation of Equity Component and Debt component in option

Particulars	₹
Fair value under equity settlement = 12,000 Shares x Fair value ₹27 Less: Fair Value under Cash Settlement = 10,000 Shares x Fair Value ₹30 (Liability Component)	3,24,000 (3,00,000)
Equity Component to be recognized as Expense over the vesting period	24,000
Vesting Period	3 Years
Expense to be recognized each year (24,000 ÷ 3 years)	₹8,000

2. Computation of Expense to be recognized for liability component

(a) Year 2010 – 11

Number of Shares expected to vest Fair value per share as at year end Fair value of Liability component (10,000 x ₹31.50) Vesting Period Expense recognized for 2010 –11 = ₹3,15,000 ÷ 3 Years	10,000 ₹31.50 ₹3,15,000 3 Years ₹1,05,000

(b) Year 2011 – 12

Number of Shares expected to vest Fair value per share as at year end Fair value of Liability component (10,000 x ₹32.70) Vesting Period	10,000 ₹32.70 ₹3,27,000 3 Years
Cumulative expense to be recognized upto 2011–12 = 3,27,000 ÷ 3 years x 2 Years Less: Expense recognized in 2010 –11	2,18,000 1,05,000
Expense recognized in 2011 - 12	₹1,13,000

(c) Year 2012 – 13

Number of Shares vesting at year End Fair value per share as at year end Fair value of Liability component (10,000 x ₹34) Less: Expense recognized in 2010 –11 and 2011 - 12	10,000 ₹34 ₹3,40,000 2,18,000
Expense recognized in 2011 - 12	₹1,22,000

3. Ledger Accounts

(a) Employees' compensation A/c

Year	Particulars	₹	particulars	₹

2010 – 11	To Provision for Liability A/c To ESOP Outstanding A/c	1,05,000 8,000	By Profit & Loss A/c	1,13,000
		1,13,000		1,13,000
2011– 12	To Provision for Liability A/c To ESOP Outstanding A/c	1,13,000 8,000	By Profit & Loss A/c	1,21,000
		1,21,000		1,21,000
2012 - 13	To Provision for Liability A/c To ESOP Outstanding A/c	1,22,000 8,000	By Profit & Loss A/c	1,30,000
		1,30,000		1,30,000

(b) Provision for Liability component A/c

Year	Particulars	₹	particulars	₹
2010 – 11	To Balance c/d	1,05,000	By employees' Compensation A/c	1,05,000
		1,05,000		1,05,000
2011 – 12	To Balance c/d	2,18,000	By balance b/d By employees' Compensation A/c	1,05,000 1,13,000
		2,18,000		2,18,000
2012 - 13	To Balance c/d	3,40,000	By balance b/d By employees' Compensation A/c	2,18,000 1,22,000
		3,40,000		3,40,000
CASH SETTLEMENT				
2013- 14	To Bank (cash Settlement	3,40,000	By Balance b/d	3,40,000
		3,40,000		3,40,000
EQUITY SETTLEMENT				
2013 - 14	To ESOP Outstanding	3,40,000	By Balance b/d	3,40,000
		3,40,000		3,40,000

(c) ESOP Outstanding Account

Year	Particulars	₹	particulars	₹
2010 – 11	To Balance c/d	8,000	By employees' Compensation A/c	8,000
		8,000		8,000
2011– 12	To Balance c/d	16,000	By balance b/d By employees' Compensation A/c	8,000 8,000
		16,000		16,000
2012-13	To Balance c/d	24,000	By balance b/d By employees' Compensation A/c	16,000 8,000
		24,000		24,000
CASH SETTLEMENT				
2013 - 14	To General Reserve	24,000	By Balance b/d	24,000
		24,000		24,000
EQUITY SETTLEMENT				
2013 - 14	To Share Capital	12,00,000	By Balance b/d	24,000

	To Securities Premium A/c	9,64,000	By Provision for Liability component By bank	3,40,000 18,00,000
		21,64,000		21,64,000

Section c

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

(i) Difference between Statutory Audit and Government Audit.

Answer:

The following are the differences between Statutory Audit and Government Audit:

SL. No.	Statutory Audit	Government Audit
i.	Applicable to (a) All private companies (b) All co-operative societies (c) Proprietorship and partnership concerns in some cases. E.g. Tax audit under section 44AB of the Income Tax Act.	Applicable to (a) Government departments (b) Statutory corporations (c) Government companies
ii.	(a) In case of private companies: shareholders. (b) In case of sole proprietor and partnership: proprietor or partners. (c) In case of trust: trustee or Managing Committee. (d) In case of co-operative societies: Managing Committee with prior approval of the Registrar.	(a) In case of government departments: Comptroller and Auditor General (b) In case of statutory corporation: as per the provisions of the special statute for that corporation. (c) In case of government company: Company Law Board, on the advice of the Comptroller and Auditor General.
iii.	Report is submitted to the owners/ shareholders in a format prescribed by the Companies Act, 1956, in the case of Companies.	Report is submitted to the shareholders and a copy is given to the Comptroller and Auditor General in a format prescribed by the CAG.

(ii) Write short notes on signing of the Audit Report.

Answer:

Signing of Audit Report:

Place of Signature: The Report should name the specific location, which is ordinarily the city where the Audit Report is signed.

Auditor's Signature: The Report should be signed by the Auditor in his personal name. Where a Firm is appointed as the Auditor, the Report should be signed in the personal name of the Auditor and in the name of the Audit Firm. The Partner / Proprietor signing the Report should mention his ICAI Membership Number.

(iii) Difference between Operational Audit and Management Audit.

Answer:

The differences between Operational Audit and Management Audit are as follows:

Particulars	Operational Audit	Management Audit
1. Meaning	Examination of all operations and activities of the entity.	Review of the decisions and actions of Management to analyze performance.
2. Propriety	It is concerned with (i) formulation of plans, (ii) their implementation, and (iii) control in respect of production and marketing activities.	Propriety and efficiency of decisions and managerial actions are studied.
3. Coverage	Covers operations such as marketing, manufacturing, etc.	Covers all aspects like organizational objectives, policies, procedures, structure, controls and systems.
4. Advantage	Operational audit is one of the management tools to get first hand information. It is more useful in an entity where the management is at a distance from actual operations.	Management audit attests the quality of the management in the similar fashion as financial audit attests the accuracy of the records and financial statements. It permits more objective and complete evaluation of the total management and operating structure.

(iv) Write short notes on Qualification of Company Auditor under section 226(1) &(2).

Answer:

Qualification of Company Auditor [Section 226(1) & (2)]

(a) A person shall not be qualified for appointment as auditor of a company unless he is a Chartered Accountant within the meaning of the Chartered Accountants Act,1949:
Provided that a firm whereof all partners practicing in India are qualified for appointment as aforesaid may be appointed by its firm name to be auditor of a company, in which case any partner so practicing may act in the name of the firm [Sec.226(1)].

(b) A person holding a certificate in an erstwhile part B State Act 1951 which entitled him to act as an auditor of companies in the territories of that state, is also entitled to be appointed as an auditor of companies registered anywhere in India [Sec. 226(2)].

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

(i) What are the essential features of a good Internal Audit Report?

Answer:

The contents of an Internal Audit Report are based on - (a) nature of internal audit function in the Company, (b) level of reporting, (c) degree of management support, and (d) capabilities of internal audit staff.

A good Internal Audit Report should have the following features -

1. Objectivity: In order to maintain the credibility of internal audit function, the comments and opinions expressed in the Report should be as objective and unbiased as possible.
2. Clarity: The language used should be simple and straightforward. Use of technical jargon(s) should be avoided. Each draft of the report should be read from the user's viewpoint to confirm clarity.
3. Accuracy: The information contained in the report, whether quantified or otherwise, should be accurate. Approximation or assumptions made should be clearly stated along with reasons, if material.
4. Conciseness: Brevity is a vital aspect. However, important information should not be omitted.
5. Constructiveness: Destructive criticism should be avoided. The report should clearly demonstrate that the Internal Auditor is trying to assist the management in effective discharge of its responsibilities.
6. Readability: The reader's interest should be captured and retained throughout. Appropriate paragraph heading may be used.
7. Timeliness: The report should be submitted promptly because if the time lag between the occurrence of an event and its reporting is considerable, the opportunity for taking action may be lost or a wrong decision may be taken in the absence of the information.
8. Findings and conclusions: These may be given either department-wise or in the order of importance. All the facts and data pertaining to the situation should be assembled, classified and analysed. Each conclusion and opinion should normally follow the findings. Tables or graphs may be used for the presentation of statistical data in appendices.
9. Recommendations: The Internal Audit Report should include recommendations for potential improvements. In order to enable the management to accept and implement the recommendations, the Internal Auditor should be able to convince the management that the conclusions are logical and valid and the recommendations represent effective and feasible ways of taking action.
10. Auditee's views: The Auditee's views about audit conclusions or recommendations may also be included in the audit report in appropriate circumstances.
11. Summary: A summary of conclusions and recommendations may be given at the end. This is useful in case of lengthy reports.
12. Supporting information: The Internal Auditor should supplement his report by such documents and data, which adequately and convincingly support the conclusions. Supporting information may include the relevant standards or regulations.
13. Draft Report: Before writing the Final Report, the Internal Auditor should prepare a draft report. This would help him in finding out the most effective manner of presenting his reports. It would also indicate whether there is any superfluous information or a gap in reasoning.

(ii) Bring out the reporting responsibilities of an Auditor under CARO,
(a) in relation to maintenance of Cost Records,
(b) In relation to Internal Audit.

Answer:

(a) Reporting responsibilities relating to "Cost Accounting Records" [4(viii)]: The Auditor is required to check whether the accounts and records have been prepared and maintained properly or not, if the Central Govt. prescribes maintenance of Cost Records u/s 209(1)(d).

(b) Reporting responsibilities relating to "Internal Audit" [4(vii)]: Having regard to their size and nature of business, the Auditor should Report whether or not the following Companies have an Internal Audit System –
   (i) Listed Companies,
   (ii) Companies having Paid-up Capital and Reserves exceeding ₹50 lakhs as at the commencement of the Financial Year concerned,
   (iii) Companies having an Average Annual Turnover exceeding ₹5 Crores for a period of 3 consecutive Financial Years immediately preceding the Financial Year concerned.

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

(a) (i) Outline the areas of review under the Internal Audit function. [8]

Answer:

Internal Audit Covers the following areas for review -

As per SA-610, the scope and objectives of internal audit vary widely and are dependent upon the size and structure of the entity and the requirements of its management.

Normally, however, internal audit operates in one or more of the following areas:

1. Review of accounting system and related internal control: The establishment of an adequate accounting system and related controls is the responsibility of the management, which demands proper attention on a continuous basis. The internal audit function is often assigned specific responsibility by the management for reviewing the accounting system and related accounting controls, monitoring their operation and suggesting improvements thereto.
2. Examination for management of financial and operating information: This may include review of the means used to identify, measure, classify and report such information and specific inquiry into individual items including detailed testing of transactions, balances and procedures.

3. Examination of the effectiveness of operations: Generally, the external auditor is interested in the results of such audit work only when it has an important bearing on the reliability of the financial records.

4. Physical verification: The internal audit generally includes examination and verification of physical existence and condition of the tangible assets of the entity.

(ii) Write short notes on the Appointment of Auditors of Government Company. [4]

Answer:

Appointment of Auditor of Government Company -

- Section 619 of the companies Act, 1956 provides that the Auditors of Government Companies shall be appointed or reappointed by the Central Government on the advice of the Comptroller & Auditor General of India (C & AG). However, the appointment of such auditor shall be subject to the limits laid down in Section 224(1B). The provisions of section 619 override the provisions of section 224 & 233.

- The first auditor of the Government Company should be appointed by the Comptroller and Auditor General of India within one month of the date of registration of the company.
- For subsequent auditors, the Government Company shall write to the C & AG with a copy to the Central Government immediately after the Annual general Meeting is held for recommending the appointment of their auditor to the Central Government.
- The remuneration of the Government Auditor is fixed by the company in general meeting or in such manner as the company in general meeting may determine.
- The provision of sec. 619 shall apply to a company in which not less than 51% of the paid up share capital is held by one or more of the following or any combination thereof as if it were a Government Company, namely:
  (i) the Central Government and one or more Government Companies;
  (ii) any State Government or Governments and one or more Government Companies;
  (iii) the Central Government, one or more State Government, and one or more Government Companies;
  (iv) the Central Government and one or more corporations owned or controlled by the Central Government;
  (v) the Central Government, one or more State Governments and one or more corporations owned or controlled by the Central Government;
  (vi) one or more corporations owned or controlled by the Central Government or the State Government;
  (vii) more than one Government company.

(b) (i) How to vouch the following items in case of audit of a Manufacturing Company-
(A) Petty cash
(B) Salaries and wages **[8]**

Answer:

(A) Petty Cash -

1. Trace the amounts advanced to the petty cashier for meeting petty office expenses from the Cash Book in the Petty Book.
2. Vouch payments with docket vouchers which must be supported, wherever possible, by external evidence e.g., payee’s receipted bill or invoices, cash memo, etc.
3. Trace payments made for the purchase of postage stamps recorded in the Postage Book. The totals of the Postage Book should be test checked.
4. Confirm that the postage expenses for the year are reasonable as compared with that in the postage expenses from month to month.
5. Where a columnar Petty Cash Book is maintained, check that the extension have been carried forward into appropriate amount columns.
6. Check the column totals and cross totals. Trace posting of the various columns in which payments are classified to the respective ledger accounts.
7. Verify the cash balance in hand.

(B) Salaries and Wages - The auditor should take into consideration the following points:

(a) Internal Control: See that an adequate system of internal control exist as to the appointment, promotion, transfer and discharge of’ employees, recording attendance of workers engaged on the time basis, as well as particulars of’ jobs performed by piece workers, arrangement for the preparation of wages and salaries bills and their analysis, and sanctioning the disbursement of wages and salaries. The system of internal check should be operational one and that too in an effective manner.

(b) Other matters:

- Salary and Wage Bill: Check the salary and wage bill in detail by reference to the record of attendance, schedule of rates, sanctioned by the management for different classes of workers and employees and the sanction for their payment.
- Dummy Workers: Examine that the salary and wage sheet contains no names of dummy workers. Also see that the employee or worker who has received the salary or wage has put his initials for the amount received against his name in the sheet.
- Statutory Deductions: Check the computation of wages and salaries payable to different workers and employees on taking into account the deduction and other factors such as leave pay, PF, ESI, TDS etc. into consideration.
- Mode of Payment: Check whether the amount has been paid in cash or through cheque or through bank arrangements. Nowadays, the companies are also giving the salary in the form of ESOPs etc.
- Undisbursed Payments: Ensure that all payments to workers and other employees have been acknowledged and amounts which have remained undisbursed have been deposited back in the bank and credited to the Unpaid Wages and Salaries Accounts.
- Computation: Test the correctness of the amount paid by reference to the Annual Return of Salaries, etc., submitted to the Income-tax Authorities and that of wages with Employee's State Insurance Cards.
- Loans and Advances to employees or workers: Where loans have been granted to employees or workers, the auditor should trace recoveries out of loans and advances, outstanding against employees into the Employees Loans and Advances Register.
- Arrangement with Banks: Where the enterprise has made arrangements with bank as to the deposit of salary and wages in say, `Salary and Wage Account - XYZ Limited' with the bank, the auditor should prepare a reconciliation statement as to the amount withdrawn and not withdrawn by the employees or workers.

(ii) Describe the Auditor's responsibilities regarding Disqualification of Directors. [4]

Answer:

Disqualification: A person shall not be capable of being appointed Director of a Company, if such person is already a Director of a Public Company and that Company has -

(A) Not filed its Annual Accounts and Annual Returns for continuous 3 financial years, or

(B) Failed to -

• repay deposit or any interest thereon on due date, or • redeem its debentures on due date, or • pay dividend.	and such failure continues for a period of 1 year or more.

Note: For Sec. 274(1)(g), the person concerned is disqualified from being appointed as Director of any other Public Company, for a period of 5 years from the date of failure to file returns / accounts, or has failed to repay Deposits or Interest or redeem Debentures, or pay dividend.

Private Company Directors: Where none of the Directors of a Private Company have been Directors in a Public Company, the disqualification u/s 274(1)(g) would not get attracted since the disqualification therein is defined in respect of a person who is Director of a Public Company.

Date: Whether any of the Directors of the Company has attracted disqualification should be considered as on the Balance Sheet date.

Rules: The Companies (Disqualification of Directors u/s 274(1)(g)) Rules, 2003 applies to - (a) all Public Limited Companies, (b) a Public Company, which is granted a license u/s 25, and (c) a Private Company, which is a Subsidiary of a Body Corporate incorporated outside India [as per Sec.4(7)].

Exemptions: Disqualification u/s 274(1)(g) shall not apply to -

1. Default in repayment of privately placed Bonds/ Debentures/ Debt Instruments by Public Financial Institutions. (F No. 2/5/2001-CLV dated 14.1.2003)
2. A Government Company. (Notification No.GSR 829(E))
3. Nominee Directors appointed by Public Financial Institutions and Companies established under the Act of Parliament having non obstante provisions over the Companies Act, like IDBI, LIC, UTI, IIBI, etc, in their respective statutes. (C.No.8/2002 dated 22.3.2002)
4. Nominee Directors appointed on the Boards of assisted concerns or other Public Companies by - (i) Public Financial Institutions, (ii) Central or State Government, and (iii) Banking Companies.
5. Person appointed as a Small Shareholders' Director pursuant to Companies (Appointment of the Small Shareholders' Director) Rules, 2001.
6. Defaulting Company is a Private Company, and the Proposed Directorship is in a Public or Private Company.

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

(i) Social Audit

(ii) Government Audit

(iii) Management Audit

Answer:

(i) Social Audit:

Organizations, these days, focus on attaining economic growth through performing processes that ensure social and environmental development simultaneously. A social audit is a way of measuring, understanding, reporting and improving an organization's performance towards meeting its social and ethical objectives.

Objectives of Social Audit

- Assessing the needs of the society and resources available for fulfilling them.
- Spreading awareness among beneficiaries about the business' efforts towards attaining social objectives.
- Increasing efficacy and effectiveness of the organization's corporate social responsibility (CSR) programmes.
- Scrutiny of policy decisions, keeping in view the interests of stakeholders.

Advantages of Social Audit

- Encourages community participation among different business entities.
- Ensures continuous efforts towards environmental protection and use of environment friendly production processes.
- Builds customer satisfaction and trust through ethical business practices.

- Promotes collective decision making and sharing responsibilities.
- Develops human resources by working towards improvement of workers' and the underprivileged persons' working/ living conditions.

(ii) Government Audit:
Meaning: UN Handbook on Government Auditing in Developing Countries states that "Government auditing is the objective, systematic, professional and independent examination of financial, administrative and other operations of a public entity for the purpose of evaluating and verifying them, presenting a report containing comments, conclusions and recommendations and expressing the appropriate professional opinion in respect of financial statements."
Authorization: The Comptroller & Auditor General of India (CAG) is the Supreme Audit Institution.
Types of Government Audit:
(a) Transaction audit
  - Expenditure Audit
  - Receipts Audit
(b) Efficiency cum Performance Audit

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:
(a) 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.
(b) 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.
(c) 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.
(d) 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) Management Audit:
Management audit is a comprehensive and thorough examination of an organization or one of its components. The audit is implemented to identify problems or significant weaknesses in the organization or corporation, thus providing management with a tool to address and repair the problem area.
The management audit is now widely accepted in the business field. For more than 40 years, corporations and non-profit organizations have utilized the management audit as a comprehensive tool.
The management audit is defined by its scope and objectives. The scope is broad and generally includes all functions of the organization, including objectives and strategy, corporate structure, organizational planning, the budgeting process, human and financial resources management, decision making, research and development, marketing, equipment and operations, and management information systems. This breadth extends to recent, present, and future operations and covers external issues as well as internal concerns. Objectives of the

management audit include the development of recommendations and improvements, as well as increased awareness of the credibility and acceptance of the audit's results. The process is more an audit of management, in order to enhance corporate profits and financial stability.

The audit follows a logical, step-by-step format, including initial interviews with key managers. A study team uses the interview process to define the scope of the audit, including the areas or functions to be studied. Next, the team requests various forms of documentation, including budgets, planning documents, corporate reports, financial statements, policy and procedure manuals, biographical material, and various other documents. Following this stage, the study team then prepares a schedule and detailed plan of study, all aimed at proceeding to the internal fact finding step. Fact-finding relies once again on interviews, documentation, and personal observation of facilities and organizational work patterns. By the time these steps are completed, the study team develops a thorough understanding of organizational structure and operations.

The team generally turns next to an external review, using interviews to determine the opinions and attitudes key people outside the organization have about its operations. Examples of those interviewed are customers, representatives of financial institutions, and employees of federal agencies having contact with the audited organization. These interviews provide the team with more objective evaluations, and lead to an analysis of all the information and data now gathered. Organizational performance is profiled, then efficiency and effectiveness are evaluated and compared against industry norms. While many criteria can be measured quantitatively, team members have to use sound judgment and objectivity when evaluating issues that cannot be measured. In turn, the organization's management has to be receptive to the audit process and demonstrate clear acceptance of audit findings.

The study team then develops conclusions and recommendations which are communicated to the organization's management. These final two stages—conclusions/recommendations and communication—are essential to the management audit process. The audit is expected to identify corporate strengths and weaknesses, sources of problems, and potential problem areas. Recommendations for correction are presented to top management. The final report comes in the form of an overall plan of action, which includes prioritized recommendations, the specific units and individuals expected to carry out the recommendations, a schedule for action, and expected results. When conducted with thoroughness, objectivity, and timeliness, the management audit becomes a powerful tool for corporate and organizational executives who seek to improve effectiveness and efficiency.

An important aspect of the management audit is the composition of the study team. Both internal and external analysts are frequently used on audit teams; the composition depends on several factors, including the need for independent appraisal, the lack of human or financial resources to conduct the audit, and the need to provide an external audit to contrast against internal findings. In some instances, associations such as the American Institute of Management (AIM) provide audit teams. The AIM has developed ten categories of the management audit, and many audits apply these same categories. They include:

(i) economic function
(ii) corporate structure
(iii) health of earnings
(iv) service to stockholders
(v) research and development
(vi) directorate analysis
(vii) fiscal policies
(viii) production efficiency
(ix) sales vigor
(x) executive evaluation

Management audits are not limited to business corporations. Nonprofit organizations—including educational institutions, hospitals, and churches—often use the management audit to attempt to improve operations. When conducted effectively, and when recommendations are applied properly, the management audit has proved its usefulness as a management technique.