Paper 12 – Company Accounts & Audit

Whenever necessary suitable assumptions may be made and disclosed by way of note.

Working Notes should form part of the answers

Section A

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

(i) What are the conditions to be satisfied to classify an asset as Current asset?

Answer:

"An asset shall be classified as current when it satisfies any of the following criteria:

(a) It is expected to be realized in, or is intended for sale or consumption in the company's normal operating cycle;
(b) It is held primarily for the purpose of being traded;
(c) It is expected to be realized within twelve months after the reporting date; or
(d) It is Cash or cash equivalent unless it is restricted from being exchanged or used to settle a liability for at least twelve months after the reporting date.

All other assets shall be classified as non- current."

(ii) What are the disclosure requirements pertaining to share application money?

Answer:

Various disclosure requirements pertaining to Share Application Money are as follows:

- terms and conditions;
- number of shares proposed to be issued;
- the amount of premium, if any;
- the period before which shares are to be allotted;
- whether the company has sufficient authorized share capital to cover the share capital amount on allotment of shares out of share application money;
- interest accrued on amount due for refund;
- the period for which the application money has been pending beyond the period for allotment as mentioned in the share application form along with the reasons for such share application money being pending.

The above disclosures should be made in respect of amounts classified under both Equity as well as Current Liabilities, wherever applicable.

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

(a) A Fixed asset purchased for ₹20 lakhs, Govt. grant is received ₹8 lakhs (useful life is 4 years, residual value ₹4 lakhs) grant becomes refundable in 3rd year to the extent of ₹6 lakhs. Show accounting under different alternatives assuming SLM method of depreciation. [8]

Solution:

(A) Non- Depreciable fixed Asset

(i) Fixed Asset/ Capital Reserve A/c	Dr.	₹6 lakhs	
To Bank A/c			₹6 lakhs
(ii) If grant was credited to deferred Govt. grant			
Deference Govt. grant	Dr.	₹4 lakhs	
Profit and Loss Account	Dr.	₹2 lakhs	
To Bank Account			₹6 lakhs
(Balance left in deferred Govt. grant a/c was ₹4 lakhs because 2 lakhs p.a. was recognised in profit & Loss A/c in last 2 years)			

(B) (i) Depreciable fixed assets – if grant is credited to fixed asset at the time of receipt

Fixed Asset A/c	Dr.	₹6 lakhs	
To Bank a/c			₹6 lakhs
(The balance of fixed asset A/c after 2 years depreciation was ₹8 lakhs and now it will become ₹14 lakhs assuming same residual value and remaining life of 2 years ₹5 lakhs depreciation will be charged in remaining 2 years)			

If grant is credited to deferred grant or income at the time of receipt

(ii) Deferred Govt. Grant A/c	Dr.	₹4 lakhs	
Profit and Loss A/c	Dr.	₹2 lakhs	
To bank A/c			₹6 lakhs
(Deferred grant account will become will become NIL. The fixed asset will continue to be depreciated at ₹4 lakhs per annum)			

(b) ACA Softex Ltd. has taken the assets on lease from ACS Impex Ltd. The following information is given below:

Lease term	**=**	**4 years**
Fair value at inception of lease	**=**	**₹ 16,00,000**
Lease Rent	**=**	**₹ 5,00,000 p.a. at the end of year**
Guaranteed Residual Value	**=**	**₹ 1,00,000**
Expected Residual Value	**=**	**₹ 3,00,000**
Implicit Interest Rate	**=**	**14.97%**

Do the accounting in the book of lessee (except Balance Bheet)? [8]

Solution:

Present value of minimum lease payment (MLP)

Year	MLP	Discount rate at 14.97%	PV
1	5,00,000	.8698	4,34,900
2	5,00,000	.7565	3,78,250
3	5,00,000	.6580	3,29,000
4	6,00,000 (including ₹1,00,000)	.5724	3,43,440
	21,00,000		14,85,590

Present value of minimum lease payment (₹14,85,590) is less than Fair value at the inception of lease (₹16,00,000) so the leased asset and liability should be recognized at ₹ 14,85,590.

Apportionment of Finance Lease: Rate of Interest 14.97%

Year	Liability	MLP	Finance Charge	Principle Amt. of reduction
0	14,85,590	-	-	-
1	12,07,983	5,00,000	2,22,393	2,77,607
2	8,88,818	5,00,000	1,80,835	3,19,165
3	5,21,874	5,00,000	1,33,056	3,66,944
4	-	6,00,000	78,125	5,21,875

Books of ACA Softex
Lease Rent Account

1st year To Bank	5,00,000	By Finance Charge By Lease liability A/c	2,22,393 2,77,607
	5,00,000		5,00,000
2nd year To Bank	5,00,000	By Finance Charge By Lease liability A/c	1,80,835 3,19,165
	5,00,000		5,00,000
3rd year To Bank	5,00,000	By Finance Charge By Lease liability A/c	1,33,056 3,66,944
	5,00,000		5,00,000
4th year To Bank	6,00,000	By Finance Charge By Lease liability A/c	78,126 5,21,874
	6,00,000		6,00,000

Lease Liability Account (Lessor)

1st year To Lease Rent To Balance c/d	 2,77,607 12,07,983	By Fixed Asset under Finance lease	14,85,590
	14,85,590		14,85,590
2nd year To Lease Rent To Balance c/d	 3,19,165 8,88,818	By Balance b/d	12,07,903
	12,07,903		12,07,903
3rd year To Lease Rent To Balance c/d	 3,66,944 5,21,874	By Balance b/d	8,88,818
	8,88,818		8,88,818
4th year To Lease Rent	 5,21,874	By Balance b/d	5,21,874
	5,21,874		5,21,874

Extract of Profit and Loss Account

1st year	To Finance Charge	2,22,393
	To Depreciation on leased Asset under SLM	3,71,397
2nd year	To Finance Charge	1,80,835
	To Depreciation on leased Asset under SLM	3,71,397
3rd year	To Finance Charge	1,33,056
	To Depreciation on leased Asset under SLM	3,71,397
4th year	To Finance Charge	78,125
	To Depreciation on leased Asset under SLM	3,71,397

(c)(i) S. Pharma Ltd. in the past three year spent ₹55,00,000 to develop a Drug to treat Cancer, which was charged to Profit and Loss Account since they did not meet AS-8 criteria for capitalization. In the current year approval of the concerned Govt. Authority has been received. The Company wishes to capitalize ₹55,00,000 and disclose it as a prior period item. Is it correct? Give reason for your views. [4]

Answer:

As per AS-26, expenditure on an intangible item that was initially recognised as an expense by a reporting enterprise in previous annual financial statements or interim financial reports should not be recognised as part of the cost of an intangible asset at a later date. Hence S.Pharma Ltd. cannot capitalize ₹55,00,000.

(ii) When to recognise the Provision? [4]

Answer:

Provision should be recognised in books when the following conditions are satisfied:

- Enterprise has a present obligation as a result of past events.

- Present obligation must exist on balance sheet date.
- Present obligation must be probable causing outflow of resources embodying economic benefits.
- No provision for cost that needs to be incurred to operate in the future or future operating losses.
- It is not necessary to identify the party to whom obligation is owed -it may be public at large.
- When obligation arises due to changes in the law, provision should be recognised only when the legislation is virtually certain to be enacted.
- When there are a number of similar obligations (example - product warranties) to consider the outflow of resources 'probable' the class of obligation as a whole should be taken and 'probable' outflow of resources should not be considered on case-to-case basis.
- It is necessary that reliable estimate of the obligation can be made. In other words if amount cannot be estimated reliably, provision cannot be recognized.

Section B

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

(i) Can Geographical Segments exist within the same country?

Answer:

Geographical segments can exist within the same country if-

a) the economic environment is different, and
b) the risks & returns are different from various components that operate in other economic environment.

(ii) What are the difference between Initial Public Offer and Follow on Public Offer?

Answer:

- IPO is made when company seeks to raise capital via public investment while FPO is subsequent public contribution.
- First issue of shares by the company is made through IPO when company first becoming a publicly traded company on a national exchange while Follow on Public Offering is the public issue of shares for an already listed company.

(iii) What are the sources of buy-back of shares?

Answer:

Section 77 A read with Section 77B(2) permits a company to buy its own shares or other specified securities out of:

(i) its free reserves: or

(ii) the securities premium account; or

(iii) the proceeds of any shares or other specified securities.

However, no buy-back shall be made out of the proceeds of an earlier issue of the same kind of shares or same kind of other specified securities.

(iv) Explain the disclosure requirement of debit balance in the Statement of Profit and Loss and in Reserve and Surplus under Revised Schedule VI.

Answer:

Debit balance in the Statement of Profit and Loss which would arise in case of accumulated losses, is to be shown as a negative figure under the head 'Surplus'. The aggregate amount of the balance of 'Reserve and Surplus', is to be shown after adjusting negative balance of surplus, if any. If the net result is negative, the negative figure is to be shown under the head "Reserves and Surplus'.

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

(a) The following is the extract of trial balance of Shiva Ltd as on 31st March 2013 is as under:

Liabilities	Debit(₹)	Credit(₹)
Authorized, Issued Equity Share Capital		
20,000 Shares of ₹ 100 each		20,00,000
10,000 Preference Shares (7%) of ₹ 100 each		10,00,000
Sundry Creditors		7,00,000
Bank Overdraft		3,00,000
Goodwill	2,00,000	
Plant and Machinery	18,00,000	
Stock	3,00,000	
Debtors	7,50,000	
Preliminary Expenses	1,00,000	
Cash	1,50,000	
Profit and Loss Account	7,00,000	
Total	40,00,000	40,00,000

Two years' Preference Dividends are in Arrears. The Company had bad time during the last two years and hopes for better business in future, earning profit and paying dividend, provided the capital base is reduced.

An Internal Reconstruction Scheme as follows was agreed to by all concerned:

1. **Creditors agreed to forego 50% of the claim.**
2. **Preference Shareholders withdrew Arrear Dividend claim. They also agreed to lower their Capital claim by 20% by reducing Nominal Value, in consideration of 9% Dividend effective after reorganization, in case Equity Shareholders' Loss exceed 50% on the application of the scheme.**
3. **Bank agreed to convert Overdraft into Term Loan to the extent required for making Current Ratio equal to 2:1.**
4. **Revalued figure for Plant and Machinery was accepted as ₹ 15,00,000.**
5. **Debtors to the extent of ₹ 4,00,000 were considered good.**
6. **Equity Shares shall be exchanged for same number of Equity Shares, at a revised denomination as required after reorganisation.**

Show:

1. **Total Loss to be borne by the Equity and Preference Shareholders for the Reorganisation,**
2. **Share of Loss to the Individual Classes of Shareholders,**
3. **New Structure of Share Capital after Reorganisation,**
4. **Working Capital of the Reorganized Company, and**
5. **A Proforma Balance Sheet after Reorganisation.** **[16]**

Solution:

1. Loss to be borne by Equity and Preference Shareholders and Sharing of Loss

Particulars		₹
Profit and Loss Account	(Debit Balance)	7,00,000
Preliminary Expenses		1,00,000
Goodwill		2,00,000
Plant and Machinery	(₹18,00,000 - ₹ 15,00,000)	3,00,000
Debtors	(₹ 7,50,000 - ₹ 4,00,000)	3,50,000
	Amount to be Written off	**16,50,000**
Less:	50% of Sundry Creditors = Claim foregone	3,50,000
	Total Loss to be Borne by the Equity and Preference Shareholders	**13,00,000**
Total Loss of ₹ 13,00,000 being more than 50% of Equity Share Capital, i.e. ₹ 10,00,000		
(a)	Pref. Shareholders' Share of Loss (20% of ₹ 10,00,000), contributed by Pref. Capital Reduction	2,00,000
(b)	Balance being Equity Shareholders' Share of Loss (₹ 13,00,000 - ₹ 2,00,000), contributed by Equity Capital Reduction	11,00,000

Note: Two years' Preference Dividend (Arrears) has been ignored in the computation of Loss to be borne by Equity and Preference Shareholders.

2. New Structure of Share Capital after Reorganisation

Particulars	₹
Equity Shares: 20,000 Equity Shares of ₹ 45 each fully paid up (₹ 20,00,000 - ₹ 11,00,000)	9,00,000
Preference Shares: 10,000, 9% Preference Shares of ₹ 80 each fully paid up (₹ 10,00,000 - ₹ 2,00,000)	8,00,000
Total	17,00,000

3. Working Capital of the Reorganized Company

Particulars	₹	₹
Current Assets:		
Stock	3,00,000	
Debtors	4,00,000	
Cash	1,50,000	8,50,000
Less: Current Liabilities:		
Creditors	3,50,000	
Bank Overdraft (See Note)	75,000	4,25,000
Working capital		4,25,000

Note: Required Current Ratio = 2:1. So, required Current Liabilities $\frac{CA}{2}=\frac{8,50,000}{2}$ ₹ 4,25,000, of which Revised Creditors = ₹ 3,50,000. Hence, balance Bank Overdraft = ₹ 4,25,000 - ₹ 3,50,000 = ₹ **75,000**

4. Balance Sheet of Shiva Ltd (and Reduced) as on 31st March 13 (after Reconstruction)

	Particulars as at 31st March	Note	This Year
I	EQUITY AND LIABILITIES:		
(1)	Shareholders' Funds:		
	Share Capital	1	17,00,000
(2)	Non-Current Liabilities:		
	Long Term Borrowings - Term Loan with Bank (Secured)		2,25,000
(3)	Current Liabilities:		
	(a) Short Term Borrowings - Bank Overdraft		75,000
	(b) Trade Payables - Sundry Creditors		3,50,000
	Total		23,50,000
II	ASSETS		
(1)	Non-Current Assets - Fixed Assets: Tangible Assets		
	- Plant & Machinery (Cost 18,00,000 – Decr. under Reconstruction 3,00,000)		15,00,000
(2)	Current Assets:		
	(a) Inventories - Stock-in-Trade		3,00,000
	(b) Trade Receivables - Sundry Debtors		4,00,000
	(c) Cash and Cash Equivalents - Cash in Hand		1,50,000
	Total		23,50,000

Note 1: Share Capital

Particulars		This Year
Authorised:	20,000 Equity Shares of ₹ 45 each	9,00,000
	10,000 9% Preference Shares of ₹ 80 each	8,00,000
Issued, Subscribed & Paid up:	20,000 Equity Shares of ₹ 45 each	9,00,000
	10,000 9% Preference Shares of ₹ 80 each	8,00,000
Total		17,00,000

(b) (i) Prepare Cash Flow Statement of Kapil Ltd for the year as per AS-3, from the following data. (Make necessary assumptions wherever required). [8]

Particulars	**(₹ in lakhs)**
Net Profit	**25,000**
Dividend (including Dividend Tax) paid	**8,535**
Provision for Income Tax	**5,000**
Income Tax paid during the year	**4,248**
Loss on Sale of Assets (Net)	**40**
Book Value of Assets sold	**185**
Depreciation charged to Profit & Loss Account	**20,000**
Amortisation of Capital Grant	**6**
Profit on Sale of Investments	**100**
Carrying Amount of Investments sold	**27,765**
Interest Income on Investments	**2,506**
Interest Expense	**10,000**
Interest paid during the year	**10,520**
Increase in Working Capital (excluding Cash & Bank Balance)	**56,075**
Purchase of Fixed Assets	**14,560**
Investments in Joint Venture	**3,850**
Expenditure on Construction Work-in-Progress	**34,740**
Proceeds from Calls-in-Arrears	**2**
Receipt of Grant for Capital Projects	**12**
Proceeds from Long-Term Borrowings	**25,980**
Proceeds from Short-Term Borrowings (assume as Financing Activities)	**20,575**
Opening Cash & Bank Balance	**5,003**
Closing Cash & Bank Balance	**6,988**

Solution:

Cash Flow Statement for the year

Particulars		₹Lakhs	₹Lakhs
A. Cash flow from operating activities			
Net Profit before Taxation	(25,000 + 5,000)	30,000	
Adjustments for: Depreciation		20,000	
Loss on Sale of Assets (Net)		40	
Amortisation of Capital Grant		(6)	
Profit on Sale of Investments		(100)	
Interest Income from Investments		(2,506)	
Interest Expense		10,000	
Operating Profit before Working Capital changes		57,428	
Add /(Less): Changes in Working Capital (Excluding Cash & Bank		(56,075)	
Cash Generated from Operations		1,353	
Less: Income Taxes paid		(4,248)	
Net Cash Flow from / (used in) Operating Activities [A]			(2,895)
B. Cash flow from investing activities			
Sale of Assets	Book Value 185 less Loss on Sale 40)	145	
Sale of Investments	(27,765 + 100)	27,865	
Interest Income on Investments (assumed as received fully during the year)		2,506	
Purchase of Fixed Assets		(14,560)	
Investment in Joint Venture		(3,850)	
Expenditure on Construction Work-in-Progress		(34,740)	
Net Cash Flow from / (used in) Investing Activities [B]			(22,634)
C. Cash flow from financing activities			
Proceeds from Calls-in-Arrears		2	
Receipt of Grant for Capital Projects		12	
Proceeds from Long-Term Borrowings		25,980	
Proceeds from Short-Term Borrowings		20,575	
Interest paid		(10,520)	
Dividend (including Dividend Tax) paid		(8,535)	
Net Cash Flow from / (used in) Financing Activities [C]			27,514
D. Net Increase / (Decrease) in Cash and Cash Equivalents	(A + B + C)		1,985
E. Cash and Cash Equivalents at the beginning of the period			5,003
F. Cash and Cash Equivalents at the end of the period	(D +		6,988

(ii) From the following particulars of Ajanta Ltd, you are required to calculate the managerial remuneration in the following situation:

(a) There is only one whole time director;

(b) There are two whole time directors;

(c) There are two whole time directors, a part time director and a manager;

Particulars	**Amount (₹)**
Net profit before provision for income tax and managerial remuneration, but after depreciation and provision for repairs	**8,70,410**
Depreciation provided in the books	**3,10,000**
Provision for repairs of office premises during the year	**50,000**
Depreciation allowable under section XIV	**2,60,000**
Actual expenditure incurred on repairs during the year	**35,000**

[8]

Solution:

Section 198 and 309 of the Companies Act,1956 prescribe the maximum percentage of profit that can be paid as managerial remuneration. For this purpose, profit is to be calculated in the manner a specified in section 349.

Calculation of net profit u/s 349 of the Companies Act,1956

Particulars	Amount (₹)	Amount (₹)
Net profit before provision for income tax and managerial remuneration, but after depreciation and for provision for repairs		8,70,410
Add back: Depreciation provided in the books	3,10,000	
Provision for repairs of office premises	50,000	3,60,000
		12,30,410
Less: Depreciation allowable under schedule XIV	2,60,000	
Actual expenditure incurred on repairs	35,000	2,95,000
Profit u/s 349		9,35,410

Calculation of Managerial Remuneration –

(a) There is only one whole time director:

Managerial Remuneration = 5% of ₹9,35,410 = ₹46,770.50

(b) There are two whole time directors:

Managerial Remuneration = 10% of ₹9,35,410 = ₹93,541

(c) There are two whole time directors, a part time director and a manager:

Managerial Remuneration = 11% of ₹9,35,410 = ₹1,02,895.10

(c)(i) Following is the extract of the Balance Sheet of S.R. Ltd. a Listed Company as at 31st March 2013

Particulars	₹	Particulars	₹
Authorised Capital:		**Reserves and Surplus:**	
40,000,12% Preference Shares of ₹ 10 each	4,00,000	Revaluation Reserves	80,000
4,00,000 Equity Shares of ₹ 10 each	40,00,000	General Reserves	5,00,000
		Capital Reserve	3,00,000
	44,00,000	Securities Premium	1,00,000
Issued and Subscribed Capital		Profit & Loss (Cr.)	7,00,000
3,60,000 Equity Shares of ₹ 10 each Fully Paid Up	36,00,000	Secured Loan - 12% Partly Convertible Debentures at ₹ 100 each	20,00,000
32,000,12% Preference Shares of₹ 10 each Fully Paid	3,20,000		

On 30th April, the Company decided to capitalize its Reserves by way of Bonus, at the rate 1:4. Securities Premium of ₹1,00,000 includes a Premium of ₹20,000 for Shares issued pursuant to a scheme of amalgamation. Capital Reserve includes ₹1,60,000, being Profit on sale of Plant and Machinery. 20% of 12% Debentures are convertible into Equity Shares of ₹ 10 each Fully Paid on 30th April.

State with reasons on the following:

1. **Whether Revaluation Reserve be capitalized?**
2. **How much amount of Capital Reserve can be capitalized?**
3. **How much amount of Securities Premium A/c can be capitalized?**
4. **Are the Convertible Debentureholders entitled to Bonus Shares?**
5. **What is minimum number of Equity Shares to be issued by way of Bonus on 30thApril?**
6. **What should be the minimum amount of Authorized Capital, if the decision to issue Bonus Shares gets implemented?** **[8]**

Solution:

Issue	Principle / Computation	Result
Use of Revaluation Reserve for Capitalization	Revaluation Reserve cannot be used for Bonus Issue. Only Free Reserves can be utilized.	Revaluation Reserve of ₹80,000 cannot be used for issue of Bonus Shares.
Amount of Capital Reserve that can be utilized for Issue of Bonus Shares	Capital Reserve realised in Cash can be used.	Profit derived from sale of Fixed Assets ₹1,60,000 included in Capital Reserve can be utilized.
Amount of Securities Premium that can be utilized for Issue of Bonus Shares	Bonus Issue shall be made out of Free Reserves built out of genuine profits or Securities Premium collected in Cash only.	₹80,000 (₹1,00,000 - Amount collected other than in cash ₹20,000) can be utilized for Bonus Issue.
Entitlement of Convertible Debentures	Both Fully / Partly Convertible Debentures are entitled for Bonus Shares.	20% of Nominal Value of Debentures = ₹20,00,000 x 20% = ₹4,00,000. They are eligible for 40,000 Equity Shares. (₹4,00,000 ÷ ₹10 per Share)

Minimum Number of Bonus Equity Shares	No. of Equity Shares Outstanding x Bonus Ratio	No. of Equity Shares Outstanding (Including Convertible Portion of Debentures) = 3,60,000 + 40,000 = 4,00,000 Bonus Ratio =1:4 No. of Shares Issuable = 4,00,000 x y4 = 1,00,000 Shares. Value of Bonus = 1,00,000 x ₹ 10 = ₹10,00,000
Minimum Authorized Capital	Present Paid up Equity Capital + Expected Conversion of Debentures + Proposed Bonus Shares	₹36,00,000 + ₹4,00,000 + ₹10,00,000 = ₹50,00,000

(ii) Sunny Ltd. is to be liquidated. Their summarized balance Sheet as at 30.9.12, appears as under:

Ref No.	Particulars		Note No.	30.9. 2012
	1	**EQUITY AND LIABILITIES**		
		(a) Share capital @₹10 each		**75,00,000**
		(b) Reserves and surplus		**(60,00,000)**
	3	**Non-current liabilities**		
		(a) Long-term borrowings	**1**	**90,00,000**
	4	**Current Liabilities**		
		(a) Trade payables		**1,05,00,000**
		Total (1+2+3+4)		**2,10,00,000**
	II	**ASSETS**		
	1	**Non-current assets**		
		(a) Fixed assets		
		(i) Tangible assets	**2**	**75,00,000**
	2	**Current assets**		**1,35,00,000**
		Total (1+2)		**2,10,00,000**

Notes on accounts

Note 1. Long Term borrowing	**30.9. 2012**

Debenture (Secured by Land & building) **Unsecured Loan**	**30,00,000** **60,00,000**
Total	**90,00,000**

Note 2. Tangible assets	**30.9. 2012**
Land & Building **Other Fixed Assets**	**15,00,000** **60,00,000**
Total	**75,00,000**

Contingent Liabilities are: (a) Bills Discounted ₹ 3,00,000; and (b) Excise Duty Demand ₹ 4,50,000

On investigation, it is found that the Contingent Liabilities are certain to devolve and that the Assets are likely to be realized as (a) Land & Building ₹ 33,00,000; (b) Other Fixed Assets ₹ 54,00,000; (c) Current Assets ₹1,05,00,000. Taking the above into account, prepare the Statement of Affairs. [8]

Solution:

In the matter of the Companies Act, 1956 &

In the matter of Sunny Ltd (in Liquidation)

Statement of Affairs as on 30.09.2012 (Amount in ₹)

Particulars	₹
Assets not specifically pledged as per List A: (ERV = Estimated Reasliable Value) Other Fixed Assets Current Assets	 54,00,000 1,05,00,000
Total	1,59,00,000

Assets specifically pledged as per List B

	ERV	Due to Secured Creditors	Deficiency ranking as unsecured	Surplus carried to last column	₹
Land & Building	33,00,000	30,00,000	—	3,00,000	
Estimated Surplus from Assets specifically pledged (as calculated above)					3,00,000
Estimated Total Assets available for Preferential Creditors, Debentureholders having a Floating Charge and Unsecured Creditors (1,59,00,000 + 3,00,000)					1,62,00,000

Summary of Gross Assets

Gross receivable value of assets specifically pledged Assets not specifically pledged	33,00,000 1,59,00,000
Total	1,92,00,000

Gross Liabilities (to be deducted from Surplus or added to Deficiency)

Gross Liab	Particulars	₹
30,00,000 4,50,000 Nil 60,00,000 1,05,00,000 3,00,000 2,02,50,000	Secured Creditors as per List B to the extent to which claims are estimated to be covered by assets specifically pledged Preferential Creditors as per List C – Excise Duty Demand **Estimated Balance of Assets available for Debentureholders** secured by a Floating Charges and Unsecured Creditors (1,62,00,000 – 4,50,000) Debentureholders secured by a Floating Charge as per List D **Estimated Surplus as regards Debentureholders** Unsecured Creditors as per List E Unsecured Loans 60,00,000 Trade Creditors 1,05,00,000 Contingent Liability on Bills Discounted 3,00,000	4,50,000 1,57,50,000 Nil 1,57,50,000 1,68,00,000
	Estimated Surplus as regards Creditors [being the difference between Gross Assets and Gross Liabilities] (1,57,50000 – 1,68,00,000) or (2,02,50,000 – 1,92,00,000)	- 10,50,000
	Issued & Called up Capital: Preference Share Capital as per List F 7,50,000 Equity Shares of ₹ 10 each, fully paid as per List G **Estimated Deficiency as regards Members**	Nil 75,00,000 - 85,50,000

Section C

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

(i) State the difference between Permanent audit file and Current Audit File.

Answer:

Permanent Audit File	Current Audit File
a. Legal and organizational structure of the entity, e.g. MOA and AOA in case of a company.	a. Correspondence relating to acceptance of annual reappointment.
b. Extracts or copies of legal documents, agreements and minutes relevant to the audit.	b. Extracts of important matters in the minutes of Board Meetings and General Meetings relevant to the audit.
c. A record if study and evaluation of internal controls.	c. Copies of management letters.
d. Analysis of significant ratios & trends.	d. Analysis of transactions and balances.

(ii) What is the difference between Management Fraud and Employee Fraud?

Answer:

Management Fraud	Employee Fraud
Fraud involving one or more members of Management or those charged with governance, is referred to as Management Fraud.	Fraud involving only employees of the entity is referred to as Employee Fraud.
Intentional misapplication of accounting policies, window – dressing, etc.	Mis-appropriation of assets. defalcation of cash, theft of stocks, etc.

Note: In either case, there may be collusion with third parties outside the entity.

(iii) Differentiate between Financial Audit and Cost Audit.

Solution:

Financial Audit	Cost Audit
Mandatory to all enterprises governed by the Statute.	Applicable only to those Companies specified under Law.
True and Fair view of Financial Statements.	Propriety and efficiency of transactions having an effect on cost of goods produced.
Covers all items forming part of the Financial Statements.	Primarily covers the cost aspects of the enterprise.

(iv) Differentiate between Financial Audit and Management Audit.

Answer:

Financial Audit	Management Audit
Examination of Financial Statements to express an opinion thereon.	Review of the decisions and actions of Management to analyse performance.
Generally propriety aspect is not considered in detail.	Propriety and efficiency of decisions and managerial actions are studied.
Restricted to items forming part of the Financial Statements.	Covers all aspects like organizational objectives, policies, procedures, structure, controls and systems.

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

(i) You are the Chief of the Internal Audit Department of a large manufacturing concern. As the head of the department your duty, inter alia, is to advise on and observe the maintenance of proper records of plants, machinery, and tools and dies as well as to keep a watch upon the changes of obsolescence of the plants and machineries. Draft a suitable programme by which you can discharge your duties properly. [8]

Answer:

The Internal Audit Programme in connection with Fixed Assets may be in the following lines.

a. Assets Register: To review the registers and records of Plant, Machinery, etc. showing clearly the date of purchase of assets, cost price, location, depreciation charges, etc.
b. Cost Report and Journal register: To review the reporting costs relating to each Plant and Machinery, to verify items, which have been capitalized.
c. Code Register: To see that each item of Plant and Machinery has been given a distinct code number to facilitate identification and verify the maintenance of Code Register.
d. Movement Register: To verify whether – (a) Movement Register for movable equipments, and (b) Log Books in case of Vehicles etc, are being recorded properly.
e. Physical Verification: To see that physical verification has been conducted at frequent intervals.
f. Asset Disposal Register: To review whether assets have been disposed of after proper technical and financial advice and sales / disposal / retirement, etc. of these assets are governed by authorization, sales memos or other appropriate documents.
g. Spare Parts Register: To examine the maintenance of a separate register of Tools, Spare Parts for each Plant and Machinery.
h. Review of Maintenance: To scrutinize the programme for an actual periodical servicing and overhauling of machines, to examine the extent of utilization of maintenance department services.
i. Review of Obsolescence: To scrutinize whether expert's opinion have been obtained from time-to-time to ensure purchase of technically most useful, efficient and advanced machines after a thorough study.
j. Review of R&D: To review R&D activity and ascertain the extent of its relevance to – (a) the operations of the organizations, (b) maintenance of machinery efficiency, and (c) prevention of early obsolescence.

(ii)(a) How will you verity preliminary expenses? [4]

Answer:

The expenditure incidental to the creation and floating of a company includes stamp duties, registration fees, legal costs, accountant's fees, cost of printing, etc.

(i) Check the contracts relating to preliminary expenses.
(ii) If preliminary expenses incurred by promoters have been reimbursed to them by the company, the resolution of the Board of Directors and the power in the Articles to make such reimbursement should be seen.
(iii) Examine the bills and statements supporting each item of preliminary expenses.
(iv) It should be seen that no expenses other than those which constitutes preliminary expenses are booked under this head. The auditor can cross check the amount of preliminary expenses with that disclosed in the prospectus, statutory report and the balance sheet.
(v) Check that any amount which is paid in excess of the amount disclosed in the prospectus should have been approved by the shareholders.
(vi) Expenditure in connection with the preliminary expenses so far it has not been written-off should be separately disclosed under the head miscellaneous expenditure.
(vii) Further, see that Underwriting Commission and brokerage paid for shares and debentures should not be included under the head preliminary expenses.

(b) How will you vouch interest and dividends received? [4]

Answer:

(i) Examine the separate ledger accounts kept for each investment or loan given.
(ii) The dates on which dividends or interest payments generally fall due should also be noted.
(iii) Check the counterfoil of dividends warrants. These should be tallied with the records of investment.
(iv) Where investments are sol ex-dividend, it should be seen that the dividends are subsequently received. Similarly when a purchase is on cum dividend basis, the receipt of dividend should be checked.
(v) It case of interest on deposit with banks, verification should be done by reference to the bank's statement and the agreed rate of interest.
(vi) Ensure that the interest and dividend received are credited to the respective account in full i.e., before deduction of tax at source and the tax deducted at source should be debited to an appropriate account. It should be further seen that the certificate for tax deducted at source exists in each case.

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

(a) Draft an Audit Programme to audit the receipts of a Cinema Theatre owned by a 'Partnership Firm. [12]

Answer:

The following matters deserve the Auditors' attention in the course of audit of a Cinema Hall:

A. Internal Control in Show Collections

- Verify that entry to the Cinema Hall during the show is only through printed tickets.
- See whether the printed tickets are serially numbered and bound into books.
- Verify whether the printed tickets are endorsed by the Commercial Tax Authorities.
- Verify that separate series of tickets is used for advance booking.
- See whether the stock of tickets is kept in the custody of a responsible official.
- Confirm that at the end of the show, a statement of tickets sold is prepared and cash collected is agreed with it and a record of the Free Passes issued is maintained.
- Vouch entries in the Cash Book in respect of cash collected on sale of tickets for different shows, based on the Daily Statements which have been test checked as aforementioned.
- Reconcile the amount of Entertainment Tax collected with the total number of tickets issued for each class.

B. Advertisement Receipts

- Verify the charges collected for advertisement slides and shots by reference to the agreements entered into with Advertisers.
- Cross verify Advertisement Income based on the "Register of Slides and Shots Exhibited" kept at the Cinema Hall.

C. Refreshments / Restaurant Income

- Enquire into the arrangement for collection of share in the restaurant income. It may either be a fixed sum or a fixed percentage of the takings.
- In case the stalls are run by the Cinema Hall, verify whether the restaurant/ refreshment stall incomes have been properly accounted. Ensure that closing stock of foodstuffs, cool drinks, etc. have been duly considered.

D. Cash Book Verification

- Examine whether the day's collection is deposited into Bank on the following day.
- Trace the deposits made in the Bank Account, along with Counterfoils of pay-in-slips.
- Conduct surprise verification of Cash Balances, and confirm whether the same agrees with the Cash Book.

E. Expenditure Verification

- Vouch the expenditure incurred on advertisement, repairs and maintenance.
- Verify whether any part of revenue expenditure has been wrongly capitalized. See whether expenditure on extensive re-decoration has been treated as Deferred Revenue Expenditure.
- Vouch payments towards film hire, with bills of distributors and underlying agreements.
- Verify whether depreciation on Furniture, etc. has been charged at the appropriate rates, which will be higher than those admissible for other businesses for similar assets.

F. Advances paid to Distributors

- Examine unadjusted balance out of advances paid to the distributors against film hire contracts, to see that they are good and recoverable.
- Verify whether all advances in respect of films already run, have been fully adjusted.
- See whether adequate provision has been made in respect of irrecoverable advances.

G. General

- Verify the physical existence of Fixed Assets.
- Scrutinise the accounts of Sundry Creditors for Goods, Creditors for Services and analyse whether there are any abnormal movements.
- Verify the Capital, Secured and Unsecured Loans, and other Liabilities.
- Compare the Financial Statements of the year under audit with that of previous years, compute significant accounting ratios and see whether there are any significant unexplained deviations.
- Verify whether the form and manner of presentation of financial information conforms to the applicable Accounting Standards and legal requirements.
- Obtain appropriate Management Representations and Certificates, in respect of the various aspects covered during the course of audit.

(b) Answer the following [2x6=12]

(i) Write short notes on Appointment of Auditors by Shareholders.

Answer:

1. Appointment: Under Sec.224 (1), every Company shall, at each Annual General Meeting, appoint an Auditor(s). Appointment in a General Meeting of the Company means appointment by the Shareholders of the Company.
2. Certificate from Auditor: Before appointment or re-appointment at the AGM, the Company shall obtain from the Auditor(s), a certificate to the effect that the appointment, if made, will be within the ceiling limits specified u/s 224(1B).
3. Tenure of Office: The Auditor shall hold appointment from the conclusion of that AGM (in which he is appointed) till the conclusion of the next AGM.
4. Intimation: The Company shall give intimation of appointment to the concerned Auditor within 7 days of the appointment.
5. Intimation to Previous Auditor: The appointed Auditor shall communicate to the previous Auditor about the appointment and enquire whether there is any professional reason why the appointment should not be accepted. This forms part of the Chartered Accountant's Code of Conduct.
6. Acceptance: The Auditor, on receipt of the intimation from the Company about his appointment, is required to send a written communication to the ROC in Form 23B within 30 days of the receipt of intimation stating whether he has accepted or refused to accept the appointment.

(ii) Outline the matters to be included in the Company Auditors' Report u/s 227.

Answer:

The matters to be included in the Report of the Company Auditor u/s 227 are -

1. Inquiry u/s 227 (1A): If the Auditor has any special comments to make on any of the items of inquiry u/s 227 (1A), he shall report on the same. If he is satisfied as a result of his inquiries, no report is required.
2. Financial Statements [Sec. 227(2)]: The Auditor shall report to the members of the Company on the accounts examined by him and on every Balance Sheet and Profit & Loss Account and every other document declared by the Act to be part of, or annexed to, the Balance Sheet and the Profit & Loss Account, laid before the Company in General Meeting during the tenure of his office.
3. True and Fair View: His report shall state whether in his opinion and to the best of his information and according to the explanations given to him, the said accounts give the information required by the Companies Act, 1956, in the manner so required and give a true and fair view -

(a) In the case of Balance Sheet, of the State of Affairs of the Company as at the end of the Financial Year, &

(b) In the case of Profit and Loss Account, of the Profit or Loss for the Financial Year.

4. Information and Explanations [Sec.227 (3)(a)]: The Auditors' Report shall state whether he has obtained all the information and explanations, which to the best of his knowledge and belief were necessary for the audit.

5. Proper Books of Account [Sec. 227(3) (b)]: The Auditor's Report shall state whether in his opinion, (a) proper books of account as required by law have been kept by the Company, so far as appears from his examination of those books, and (b) proper returns adequate for the purpose of his audit have been received from branches not visited by him.

6. Branch Auditors Report [Sec.227(3)(bb)]: The Auditors' Report shall state whether the Report on the accounts of any Branch Office audited u/s 228 by a person other than the Company's Auditor has been forwarded to him as required by Sec. 228(3)(c) and how he has dealt with the same in preparing his report.

7. Books and Financial Statements [Sec.227(3)(c)]: The Auditors' Report shall state whether the Company's Balance Sheet and Profit & Loss Account dealt with by the Report are in agreement with the books of account and returns.

8. Accounting Standards [Sec.227(3)(d)]: The Auditors' Report shall state whether in his opinion, the Balance Sheet and Profit & Loss A/c comply with the Accounting Standards referred to u/s Sec.211(3C).

9. Adverse Comments [Sec.227(3)(e)]: The Auditors' Report shall state in thick type or in italics the observations or comments of the Auditors, which have any adverse effect on the Company's functioning.

10. Directors Disqualification [Sec.227(3)(f)]: The Auditors' Report shall state whether any Director is disqualified from being appointed as Director u/s 274 (1)(g).

11. Cess u/s 441A [Sec.227(3)(g)]: The Auditors' Report shall state whether the cess payable u/s 441A has been paid and if not, the details of amount of cess not so paid. [Section 441A provides for levy and collection of cess on Turnover or Gross Receipts of Companies]

12. CARO Matters [Sec. 227 (4A)]: The Auditors' Report shall include a statement on the matters prescribed under the Companies Auditors' Report Order (CARO) 2003.

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

(i) Discuss the basic principles governing an Audit.

Answer:

SA 200 issued by ICAI gives the following basic principles that govern the auditor's responsibilities whenever an audit is carried out:

(a) Integrity, objectivity and independence — The auditor should be straightforward, honest, sincere and free form any influence on his audit work.

(b) Confidentiality — He should not disclose the client's information to anybody without the client's permission or under any regulatory requirement.

(c) Skills and competence — The audit should be performed and audit report be prepared by adequately trained, experienced and competent person.

(d) Work performed by others — The auditor should carefully supervise the work performed by others (such as his subordinates, other auditors, experts etc.) as remains responsible for the work delegated by him to his assistants, other auditors or experts.

(e) Documentation — Proper working papers should be maintained by the auditor to evidence the audit work.

(f) Planning — The auditor should obtain the knowledge about client's business to determine the nature, timing and the extent of the audit procedures.

(g) Audit evidence — The auditor should obtain sufficient appropriate audit evidence through performing the compliance and substantive procedures.

(h) Accounting system and internal controls — An understanding of the accounting system and the related internal controls help in determining the nature, timing and extent of other audit procedures.

(i) Audit conclusions and reporting — On the basis of conclusions drawn from the audit evidence obtained the auditor should give unqualified report or qualified report or adverse report or the disclaimer report.

(ii) Distinguish between Explanatory Notes and Qualificatory Notes.

Answer:

Explanatory Notes	Qualificatory Notes
An Explanatory Note is meant to explain or supplement a matter contained in, or related to Financial Statements.	A Qualificatory Note is intended to communicate the Auditor's reservation on the accounts.
The matter on which an Explanatory Note is given is one on which the Auditor has not taken an adverse view.	Qualificatory Notes are notes on which the Auditor has taken an adverse view e.g. tax provision not made in the accounts.
Explanatory Notes are given by the Directors of the Company.	Qualifications are made by the Auditor in his Report to the Company's Shareholders.

These are usually shown under "Notes to Accounts". All Notes, wherever shown, including those required by the Schedule VI constitute an integral part of the Financial Statements.	These notes are included in the Auditors' Report before the Opinion Paragraph. The reader's attention is drawn to the Qualification paragraph by use of the word "Subject to".
There is no specific reporting requirement for the Directors for Explanatory Notes.	Sec.211 requires the Directors to furnish full information on every qualification or adverse remark contained in the Auditors' Report.

(iii) Distinguish between Principles & Techniques of Auditing.

Answer:

Principles of Auditing	Techniques of Auditing
It refers to the fundamental considerations that sustain the function of auditing and direct its activities.	It refers to the methods and means adopted by the Auditor for collection and evaluation of audit evidence in different auditing situations.
As listed in SA - 200, these are - (a) Integrity, Objectivity & Independence, (b) Confidentiality, (c) Skills and Competence, (d) Work performed by others, (e) Documentation, (f) Planning, (g) Audit Evidence, (h) Accounting System & Internal Control, (i) Audit Conclusions and Reporting.	These are not listed exhaustively. Some examples are - (a) Physical Inspection (of Fixed Assets), (b) Confirmation (of Debtors Balances), (c) Inquiry (on Accounting Systems), (d) Calculation of Ratios (GP Ratio, NP Ratio).
The principles are not liable to change frequently.	Audit techniques may vary according to the nature of propositions to be tested.
They do not vary with time.	The techniques to be adopted vary with the time / period of auditing.
Principles of auditing remain the same irrespective of the nature of the Firm.	They may vary from Firm to Firm depending upon the nature of business, number of transactions, etc.