Intermediate
Group II
Paper 12 : COMPANY ACCOUNTS & AUDIT
(SYLLABUS – 2016)

Section A – Accounts of Joint Stock Companies

Objectives

1. **(a) Choose the correct answer from the given four alternatives:**

(i) Which of the following is not a statutory book?
(A) Register of charges
(B) Register of Members
(C) Register of debenture holders
(D) **None of the above**

(ii) Which of the following is / are source/s of Bonus Issue of Shares?
(A) Free Reserves
(B) Securities Premium Account
(C) Capital Redemption Reserve Account
(D) **All of the above**

(iii) The Electricity Act,2003 replaced which of the following legislations?
(A) The Indian Electricity Act, 1910
(B) The Electricity (Supply) Act, 1948
(C) The Electricity Regulatory Commissions Act, 1998
(D) **All of the above**

(iv) Cash receipts from sale of fixed assets as a trade item is a cash flow from _________ activity
(A) **Operating**
(B) Investing
(C) Financing
(D) None of the above

(v) Which of the following is not a component of Cash Flow Statement
(A) Cash payments to suppliers for goods and services
(B) Cash advances and loans made to third parties
(C) Cash repayments of amounts borrowed
(D) **None of the above**

(vi) "Employee Benefits Expenses" will come in
(A) Profit and Loss Account
(B) Balance Sheet
(C) Bothe (A) & (B)
(D) None of the above

(vii) Sundry Creditors will come under _____________ of Balance Sheet (Shedule III)
(A) Long term Borrowing

(B) **Current Liabilities**
(C) Non Current Assets
(D) Reserves & Surplus

(viii) RBI's Prudential Accounting Norms to control the lending activities (after accepting the recommendation of Narasimhan Committee)are:
(A) Recognition of Income;
(B) Classification of Assets;
(C) Provision for Loans and Advances;
(D) **All of the above**

(ix) The register of claims of an Insurance Company should contain which of the following particulars in respect of each claim?
(A) The date of claim;
(B) The name and address of the claimant;
(C) The date on which the claim was discharged;
(D) **All of the above**

(x) Which of the following is not a test to determine quantum for buy-back:
(A) Share outstanding test
(B) Resource test
(C) Debt-Equity Ratio test
(D) **Reserves and Surplus Test**

(b) Match the following:

	Column 'A'		**Column 'B'**
1.	**AS 18**	**A.**	**Export Credit Guarantee Corporation**
2.	**Underwriting**	**B.**	**At the beginning of term, present value of minimum lease rental covers substantially the initial fair value**
3.	**Schedule III Part I**	**C.**	**amount of capital with which the company intends to be registered with**
4.	**Section 53**	**D.**	**Related Party**
5.	**Finance Lease**	**E.**	**Firm**
6.	**Authorized Capital**	**F.**	**Balance Sheet**
7.	**Borrowing Cost**	**G.**	**Prohibition on Issue of Shares at a Discount**
8.	**ECGC**	**H.**	**Investing Activity**
9.	**Dividend and interest**	**I.**	**Issue and Redemption of Preference Shares**
10.	**Section 55**	**J.**	**Qualifying Assets**

Answer:

	Column 'A'		**Column 'B'**
1.	AS 18	**D.**	Related Party
2.	Underwritting	**E.**	Firm
3.	Schedule III Part I	**F.**	Balance Sheet

4.	Section 53	**G.**	Prohibition on Issue of Shares at a Discount
5.	Finance Lease	**B.**	At the beginning of term, present value of minimum lease rental covers substantially the initial fair value
6.	Authorized Capital	**C.**	amount of capital with which the company intends to be registered with
7.	Borrowing Cost	**J.**	Qualifying Assets
8.	ECGC	**A.**	Export Credit Guarantee Corporation
9.	Dividend and interest	**H.**	Investing Activity
10.	Section 55	**I.**	Issue and Redemption of Preference Shares

(c) State whether the following statements are True (or) False:

(i) Rollover must be with the written consent of the debenture holders.
(ii) An issuance of stock following a company's Initial Public Offer is called a Follow on Public Offer.
(iii) Transfer to capital redemption reserve account is not allowed from Dividend equalisation fund.
(iv) A Shareholder has a right to interest even if the company does not make profit.
(v) If the maturity of debentures is more than 9 months, the company has to appoint debenture trustees to safeguard the interests of the debenture holders.
(vi) Underwriting is the agreement to subscribe the securities of a body corporate when existing shareholders or the public do not subscribe to the securities offered to them.
(vii) A company is not a distinct legal person, it depends on its members.
(viii) Interest income in case of a Finance Company is treated as a part of revenue from Operation.
(ix) Cash comprises cash in hand and demand deposits.
(x) Providing custodianship for securities and other valuables is a function of banking companies.

Answer:

(i) True
(ii) True
(iii) False
(iv) False
(v) False
(vi) True
(vii) False
(viii) True
(ix) True
(x) True

Study Note 1 – Accounting of Shares and Debentures

2. (a) 1,900, 14% Debentures of ₹100 each issued at 5% premium and redeemable at 10% premium converted into Equity Shares of ₹10 each issued at par. Give Journal entries on issue and redemption of debentures only.

Answer:

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	On Issue of Debentures: Bank A/c Dr. To Debentures Application & Allotment A/c (Being the receipt of application money)		1,99,500	 1,99,500
	Debentures Application & Allotment A/c Dr. Loss on Issue of Debentures A/c Dr. To 14% Debentures A/c To Securities Premium A/c To Premium on Redemption of Debentures A/c (Being the issue of Debentures)		1,99,500 19,000	 1,90,000 9,500 19,000
	On Redemption of Debentures 14% Debentures A/c Dr. Premium on Redemption of Debentures A/c Dr. To Debenture-holders' A/c (Being the amount due on redemption)		 1,90,000 19,000	 2,09,000
	Debenture-holders' A/c Dr. To Equity Share Capital A/c (Being the issue of 20,900 equity shares of ₹10 each at par on conversion of 1900 Debentures)		2,09,000	 2,09,000

Note: No. of Shares to be issued = ₹2,09,000/₹10 = 10,450.

(b) Given below are the extract from the Balance Sheet of MSM Ltd. as at 31st March 2017:

Particulars	₹ in lacs
Equity Shares Capital (Fully paid up shares of ₹10 each)	**4,800**
Securities Premium	**700**
General Reserve	**1,860**
Profit and Loss Account	**680**
Sundry Creditors	**4,500**
Sundry Provisions	**980**
Machinery	**7,200**
Furniture	**904**
Investments (Face Value ₹200 lacs)	**296**
Stock	**2,400**
Debtors	**1,040**
Cash at Bank	**1,480**

On 1 April 2017 the company announced the buy-back of 25% of its equity shares @ ₹15 per share. For this purpose it sold all of its investment @ 75% and issued 4,00,000 14% preference shares of ₹100 each at par, the entire amount being payable with application.

The issue was fully subscribed. The company achieved the target of Buy-back. Later the company issued one fully paid up equity shares of ₹10 by way of bonus shares for every four equity shares held by the equity shareholders.

Pass journal entries for all transactions including cash transactions.

Answer:

Journal

(₹ in lakhs)

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
1	Bank A/c Dr. To, Investments A/c (Being the investment sold)		300	 300
2	Investments A/c Dr. To Profit and Loss A/c (Being the transfer of Profit on sale of Investments)		4	 4
3	Bank A/c Dr. To, 14% Preference Share Application & Allotment A/c (Being the Application money received)		400	 400
4	14% Preference Share Application & Allotment A/c Dr. To 14% Preference Share Capital A/c (Being the Allotment of Shares)		400	 400
5	Equity Shares Buy-back A/c Dr. To Bank A/c (Being the payment made to equity shareholders on buy-back)		1,800	 1,800
6	Equity Share Capital A/c Dr. Securities Premium A/c Dr. To Equity Shares Buy-back A/c (Being the cancellation of share bought back)		1,200 600	 1,800
7	General Reserve A/c Dr. To Capital Redemption Reserve A/c (Being the Buy-back out of general reserves to the extent not covered by fresh issue of share capital)		800	 800
8	Capital Redemption Reserve A/c Dr. Securities Premium A/c Dr. To Bonus Issue A/c (Being the utilities of capital redemption reserve and securities premium to issue on bonus share for every four shares held)		800 100	 900
9	Bonus Issue A/c Dr. To Equity Share Capital A/c (Being the issue of one bonus share for every four equity shares)		900	 900

3. A company issued 1,50,000 shares of ₹10 each at a premium of ₹10. The entire issue was underwritten as follows:

A — 90,000 shares (Firm underwriting 12,000 shares)
B — 37,500 shares (Firm underwriting 4,500 shares)
C — 22,500 shares (Firm underwriting 15,000 shares)

Total application received by the company (excluding firm underwriting and marked applications) were 22,500 shares.

The marked applications (excluding firm underwriting) were as follows:

A — 15,000 shares; B — 30,000 shares; C — 7,500 shares.

Commission payable to underwriters is as 5% of the issue price. The underwriting contract provides that credit for unmarked applications be given to the underwriters in proportion to the shares underwritten and benefit of firm underwriting is to be given to individual underwriters.

(i) Determine the liability of each underwriter (number of shares)
(ii) Compute the amount payable or due to underwriters; and
(iii) Pass necessary journal entries in the books of company relating to underwriting.

Answer:

B. Computation of Underwriters' Liability (Number of Shares)

	Particulars	**A**	**B**	**C**
I.	Gross Liability	90,000	37,500	22,500
II.	Less Marked applications	(15,000)	(30,000)	(7,500)
III.	Less Unmarked applications in ratio 12:5:3	(13,500)	(5,625)	3,375
IV.	Less: Firm Underwriting	(12,000)	(4,500)	(15,000)
V.	Balance	49,500	(2,625)	(3,375)
VI.	Less: Surplus of B & C distributed to A	(6,000)	2,625	3,375
VII.	Net Liability (excluding firm underwriting)	43,500	Nil	Nil
VIII.	Add: Firm Underwriting	12,000	4,500	15,000
IX.	Total Liability (number of shares)	55,500	4,500	15,000

B. Computation of Amounts Payable by Underwriters

Particulars	**₹**	**₹**	**₹**
Liability towards shares to be subscribed @ 20 per shares	11,10,000	90,000	3,00,000
Less: Commission @ 5% on 1,50,000 shares @ ₹20	(90,000)	(37,500)	(22,500)
Net Amount to be paid by Underwriters	10,20,000	52,500	2,77,500

C. Journal of The Company

Date	**Particulars**	**L.F.**	**Dr.(₹)**	**Cr.(₹)**
	A Dr.		11,10,000	
	B Dr.		90,000	
	C Dr.		3,00,000	
	To Share Capital A/c			7,50,000
	To Securities Premium A/c			7,50,000
	(Being shares including firm underwritten shares allotted to underwriters)			
	Underwriting Commission A/c Dr.		1,50,000	
	To A			90,000
	To B			37,500
	To C			22,500
	(Being underwriting commission on the shares underwritten)			
	Bank A/c Dr.		13,50,000	
	To A			10,20,000

	To B To C (Being the amount received from underwriters)			52,500 2,77,500

4. (a) Good Morning Ltd. invited applications for 1,00,000 equity shares at ₹100 each, which are payable on application ₹40, on allotment ₹20 and on first and final call ₹40. The company received application for 1,10,000 shares. The directors accepted application for 1,00,000 and rejected the rest. Show journal entries if the company refunded the application money to rejected applicants and allotment money was received for 90,000 shares.

Give the journal entries in the books of Good Morning Ltd.

Answer:

In the books of Good Morning Ltd.

Particulars	Dr. (₹)	Cr. (₹)
Bank A/c Dr. To, Equity Share Application A/c (Being application money received for 1,10,000 shares)	44,00,000	 44,00,000
Equity Share Application A/c Dr. To Equity Share Application A/c To Bank A/c (Being allotment made for 1,00,000 share and the balance refunded)	44,00,000	 40,00,000 4,00,000
Equity Share Allotment A/c Dr. To Equity Share Capital A/c (Being allotment amount due for 1,00,000 equity shares at ₹20 shares as per directors' resolution no…. dated….)	20,00,000	 20,00,000
Bank A/c Dr. Calls in arrear A/c To Equity Share Allotment A/c (Being allotment money received for 90,000 shares @ ₹20 per share)	18,00,000 2,00,000	 20,00,000

(b) PQR Ltd. has an authorised capital of ₹300 crores divided into equity shares of ₹10 each and its Balance Sheet as at March 31, 2016 was as follows:

Particulars	Amount In ₹ crores
Share Capital Issued and fully paid-up	**200**
General Reserve	**20**
8% Debentures	**40**
Sundry Creditors	**20**
Fixed Assets	**120**
Current Assets	**30**
Own Debentures (nominal value ₹10 lakhs)	**9**
Cash at Bank	**21**

The Company decided:

1. **To redeem the 8% debentures due for redemption on September 30, 2016 and also to cancel its Own Debentures. [Due Date of Interest: 30th Sept. & 31st Mar.]**
2. **To pay interest to debenture holders being due on the date of redemption.**

Required: Record necessary entries to give effect to the above transactions.

Answer:

Date	Particulars	L.F.	Dr. in ₹ crores	Cr. in ₹ crores
30.09.2016	Interest on Debentures A/c Dr. To Debentureholders A/c [30×8%×6/12] To Interest on Own Debentures A/c [10×8%×6/12] (Being the interest due on debenture outstanding including own debentureholders as investments)		1.60	 1.20 0.40
	Debentureholders' A/c Dr. To Bank A/c (Being the payment of interest to debentureholders)		1.20	 1.20
	General Reserve A/c Dr. To Debenture Redemption Reserve A/c (Being the transfer of General Reserve to DRR to have 50% of the debenture issue)		20	20
30.09.2016	8% Debentures A/c [40 – 10] Dr. To Debentureholders' A/c (Being the amount due on redemption)		30	 30
	Debentureholders' A/c Dr. To Bank A/c (being the payment made to debentureholders)		30	 30
	8% Debentures A/c Dr. To Own Debentures A/c To Gain on cancellation of Debentures A/c (Being the cancellation of own debentures)		10	 9 1
	Gain on Cancellation of Debentures A/c [10-9] Dr. To Capital Reserve A/c (being the Gain on cancellation of debentures transferred to capital reserve)		1	 1
31.03.2017	Interest on Own Debentures A/c Dr. To Profit and Loss A/c (Being the transfer of interest on own debentures to Profit and Loss A/c)		0.40	 0.40
31.03.2017	Profit and Loss A/c Dr. To Interest on Debentures A/c (Being the transfer of debenture interest to Profit and Loss A/c)		1.60	 1.60

Study Note 2 – Presentation of Financial Statements (As per Schedule III)

5. (a) From the following information, prepare the relevant Notes to Accounts:

Particulars	₹
Opening Balance of Profit and Loss Statement	**452**
Profit for the period	**560**
Transfer to Reserve @ 5%	
Interim Dividend	**100**
Debenture Redemption Reserve	**100**

Answer:

Particulars	₹
Opening Balance	452
Add: Profit for the period	560
Less: Transfer to reserve @ 5%	(28)
Less: Interim Dividend	(100)
Less: Debenture Redemption Reserve	(100)
Closing Balance	784

(b) Mitra Ltd. was formed with a capital of ₹1,00,000 divided into 10,000 Equity Shares of ₹10 each. Out of these 2,000 Equity Shares were issued to the vendors as fully paid as purchase consideration for a fixed asset acquired. 6,000 Equity Shares were offered to the public nad the issue was fully subscribed. The directors called ₹6 per share and received the entire amount except a call of ₹ 2 per share on 500 shares out of which 200 shares were forfeited.

How would you show the relevant items in the Balance Sheet of Mitra Ltd., as per Shedule III to The Companies Act, 2013.

Answer:

An Extract of Balance Sheet of Mitra Ltd. as at….

Particulars	Note No	Current Year ₹	Previous Year ₹
Equity & Liabilities			
I. Shareholders' Funds			
Share Capital	1	55,000	

Notes to Accounts:

Particulars	₹	₹
Authorised Capital:		
10,000 Equity Shares of ₹10 each		1,00,000
Issued Capital:		
8,000 Equity Shares of ₹10 each		80,000
Subscribed Capital and fully paid		
2,000 Equity Shares of ₹10 each		20,000
(allotted as fully paid up pursuant to a contract without payments being received in cash)		

Subscribed Capital but not fully paid		
5,800 Equity Shares of ₹10 each ₹6 paid up		34,800
Less: Calls unpaid (300 × ₹2)		(600)
Add: Forfeited Shares (200 × ₹4)		800
		55,000

6. From the following information extracted from the books of AB Ltd., prepare a Balance Sheet of the company as at 31st March, 2017 as per Schedule III of the Companies Act, 2013:

Particulars	₹
Long term borrowing	**525**
Share Capital	**390**
Fixed Assets (Tangible)	**625**
Trade Receivables	**80**
Share Application Money pending Allotment	**10**
Trade Payables	**30**
Reserve and Surplus	**90**
Inventories	**20**
Cash and Cash Equivalents	**120**
Non-Current Investments	**200**

Answer:

AB Ltd.
Balance Sheet as at 31st March, 2017

Particulars	Note No	2016-17 ₹	2015-16 ₹
I. Equity and liabilities			
(1) Shareholders' Funds			
(a) Share Capital		390	
(b) Reserves and Surplus		90	
(2) Share Application Money pending Allotment		10	
(3) Non-Current Liabilities			
(a) Long term Borrowings		525	
(4) Current Liabilities			
(a) Trade payables		30	
Total		1,045	
II. Assets			
(1) Non-current Assets			
(a) Fixed Assets			
(i) Tangible Assets		625	
(b) Non-Current Investments		200	
(2) Current Assets			
(a) Inventories		20	
(b) Trade Receivables		80	
(c) Cash and Cash Equivalents		120	

Total		1,045	

7. ABC Ltd. provides the following Trial Balance as on 31st March 2017:

Particulars	Dr. Balances (₹)	Cr. Balances (₹)
Equity Share Capital: 350000 shares of ₹ 10 each fully paid		35,00,000
10% Debentures		3,00,000
Motor Van	4,00,000	
Machinery	20,00,000	
Building	12,00,000	
12% Long Term Govt. Securities	2,00,000	
Sales		60,00,000
Sales Return	3,00,000	
Interest on Debenture	22,500	
Purchase	36,00,000	
Purchase Returns		4,00,000
Opening Stock	3,00,000	
Discount	7,500	
Carriage Outward	1,50,000	
Rent and Rates	50,000	
Income from Govt. Securities		24,000
Trade Receivables	10,00,000	
Trade Payables		2,00,000
Advertisement	1,50,000	
Bad Debt	20,000	
Salaries	6,72,000	
Misc. Expenditure	30,000	
Contribution to P.F. and Gratuity Funds	1,00,000	
Cash at Bank and in hand	2,22,000	
Total	1,04,24,000	1,04,24,000

Additional Information:

(i) Closing Stock as on 31st March 2017 was ₹ 3,50,000.
(ii) Depreciation Rates: Motor Vehicle 10%, Machinery 20% and Land & Building 5%.
(iii) Misc. expenditure includes ₹ 20,000 as audit fees.
(iv) Interest on debenture is payable quarterly and the last quarter's interest is yet to be paid.
(v) Trade receivables include a sum of ₹ 25,000 due from Mr. X who has become insolvent and only 25 paisa in a rupee is expected to be recoverable from him.
(vi) Create a provision for doubtful debt @ 2% on trade receivables.
(vii) Provide for income tax ₹ 1,20,000.

Prepare a Statement of Profit and Loss for the year ended on 31st March 2017 and a Balance Sheet as on that date.

Answer:

Notes to Accounts:

1. Employee Benefit Expenditure	₹
Salaries	6,72,000
Contribution to P.F.	1,00,000

	7,72,000

2. Finance Cost	₹
Interest on Debentures	22,500
Outstanding Interest	7,500
	30,000

3. Other Expenditure	₹
Discount	7,500
Carriage	1,50,000
Rent	50,000
Advertisement	1,50,000
Bad Debt	20,000
Audit fees	20,000
Misc. Exp.	10,000
Provision for B/D	38,250
	4,45,750

4. Trade Receivable	₹
Total Receivable	10,00,000
(-) Provision @ 2%	38,250
	9,61,750
Provision = 25000 × 0.75 + (1000000 – 25000) × 0.02	38,250

5. Fixed Assets	Motor Van	Machine	Building
Balance	4,00,000	20,00,000	12,00,000
(-) Depreciation	40,000	4,00,000	60,000
	3,60,000	16,00,000	11,40,000
Total Fixed Assets			31,00,000
Depreciation			5,00,000

Statement of Profit and Loss for the year ended on 31.03.2017

Particulars	Note	₹
I. Revenue from operation (sales less returns)		57,00,000
II. Other Income (Income from investment)		24,000
III. Total revenue		57,24,000
IV. Expenses:		
Purchase		32,00,000
Changes in inventory i.e. opening less. Closing		(50,000)
Employee Benefit expenses	1	7,72,000
Finance cost	2	30,000
Depreciation	5	5,00,000
Other expenses	3	4,45,750
		48,97,750
V. Profit before exceptional and extraordinary items and tax		8,26,250
VI. Exceptional items		Nil
VI Profit before extraordinary items and tax		8,26,250
VII. Extraordinary items		Nil
VIII. Profit before tax		8,26,250

IX. Tax (provision for tax)		1,20,000
X. Profit after tax		7,06,250

Balance Sheet as on 31.03.2017

I. Equity and Liabilities	**Note**	**₹**
1. Shareholders' Funds		
(a) Share Capital		35,00,000
(b) Reserve and Surplus (Balance of Profit)		7,06,250
2. Share Application money pending allotment		Nil
3. Non-current liabilities (10% Debentures)		3,00,000
4. Current Liabilities		
Trade Payable		2,00,000
Outstanding interest		7,500
Provision for Tax		1,20,000
Total		48,33,750
II. Assets		
1. Non-current Assets		
(a) Fixed Assets (Tangible)	5	31,00,000
(b)Non-current Investment (12% L.T. Govt. Securities)		2,00,000
2. Current Assets		
Inventories		3,50,000
Trade Receivable	4	9,61,750
Cash and cash equivalent		2,22,000
Total		48,33,750

Study Note 3 – Cash Flow Statement

8. Mr. Joythi of Star Oils Limited has collected the following information for the preparation of cash flow statement for the year ended 30.06.2017 :

	(₹ 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 the assets sold	**185**
Depreciation charged to Profit & Loss Account	**20,000**
Amortisation of Capital grant	**6**
Profit on sale of Investments	**100**
	(₹ in lakhs)
Carrying amount of Investment sold	**27,765**
Interest income on investments(received during the year)	**2,506**
Interest expenses	**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**
Investment in joint venture	**3,850**
Expenditure on construction work in progress	**34,740**
Proceeds from calls in arrear	**2**

Receipt of grant for capital projects	**12**
Proceeds from long-term borrowings	**25,980**
Proceeds from short-term borrowings	**20,575**
Opening cash and Bank balance	**5,003**
Closing cash and Bank balance	**6,988**

***Required* :**
Prepare the Cash Flow statements for the year in accordance with AS-3 on Cash Flow statements issued by the Institute of Chartered Accountants of India (Make necessary assumptions).

Answer :

Cash Flow Statement for the year ended 30-06-20107

(₹ in Lakhs)

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 on investments	(2,506)	
Interest expenses	10,000	
Operating profit before working capital changes	57,428	
Changes in working capital (excluding cash and bank balance)	(56,075)	
Cash generated from operations	1,353	
Income taxes paid	(4,248)	
Net cash used in operating activities		(2,895)
Cash flows from investing activities		
Sale of assets (185-40)	145	
Sale of investments (27,765 + 100)	27,865	
Interest income on investments	2,506	
Purcahse of fixed assets	(14,560)	
Investment in joint venture	(3,850)	
Expenditure on construction work-in-progress	(34,740)	
Net cash used in investing activities		(22,634)
Cash flows from financing Activities		

Proceeds from calls in arrear	2	
Receipts 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 dividedn tax) paid	(8,535)	
Net cash provided by financing activities		27,514
Net increase in cash and cash equivalents		1,985
Add : Cash and cash equivalents at the beginning of the period		5,003
Cash and cash equivalents at the end of the period		6,988

9.

X Ltd. has the following balances as on 1st April, 2017

	₹
Fixed Assets	**11,40,000**
Less; Depreciation	**3,99,000**
	7,41,000
Stocks and Debtors	**4,75,000**
Bank Balance	**66,500**
Creditors	**1,14,000**
Bills payable	**76,000**
Capital (Shares of ₹ 100 each)	**5,70,000**

The Company made the following estimates for financial year 2017-18:

(i) The company will pay (tax free) dividend of 10% the rate of tax being 25%.

(ii) The company will acquire fixed assets costing ₹1,90,000 after selling one machine for ₹ 38,000 costing ₹ 95,000 and on which depreciation provided amounted to ₹ 66,500.

(iii) Stocks and Debtors, Creditors and Bills payables at the end of financial year are expected to be ₹ 5,60,500, ₹ 1,48,200 and ₹ 98,800 respectively.

(iv) The profit would be ₹ 1,04,500 after depreciation of ₹ 1,14,000.

Compute the Cash flow from Operating Activities.

Answer:

	Computation of Cash Flow from Operating Activities	
	Cash Flow from operations	₹
	Profit for the year	1,04,500

	Add: Depreciation (non cash item)	1,14,000
		2,18,500
	Less: Profit on sale of machine	9,500
		2,09,000
	Add increase in:	
	Creditors (₹ 1,48,200 – ₹ 1,14,000) = ₹ 34,200	
	Bills payable (₹ 98,800 – ₹ 76,000) = ₹ 22,800	57,000
		2,66,000
	Less : Increase in stocks & debtors (₹ 5,60,500 – ₹ 4,75,000)	85,500
	Cash from operations	1,80,500

Study Note 4 – Accounts of Banking, Electricity and Insurance Companies

10. (a)From the following information of Paisa Hi Paisa Bank Ltd. calculate the amount of interest earned (as per Schedule 13), Other Income (as per Schedule 14), Other Liabilities as Provisions (as per Schedule 5) and provisions and Contingencies:

Particulars	₹'000
Interest and Discount	**2045**
Income from Investments	**112**
Interest on balance with RBI	**177**
Commission, Exchange & Brokerage	**712**
Profit on Sale of Investments	**127**
Interest on Deposits	**822**
Interest to RBI	**147**
The following items are already adjusted with interest and discount (Cr)	**₹'000**
Tax Provision	**148**
Provision for Doubtful Debts	**92**
Loss on Sale of Investments	**12**
Rebate on Bills Discounted	**55**

Answer:

Schedule 13 — Interest Earned

Particulars	(₹,000)
Interest/Discount [2045+148+92+12]	2,297
Income on Investment	112
Interest on Balance with RBI	177
	2,586

Schedule 14 — Interest Earned

Particulars	(₹,000)	(₹,000)
Commission, Exchange and Brokerage		712
Profit on Sale of Investments	127	

Less: Loss on Sale of Investments	12	115

Provisions and Contingencies

	Particulars	(₹,000)
I.	Provision for Tax	1,48
II.	Provision for Doubtful Debts	92
		240

Schedule 5 — Other Liabilities & Provisions

	Particulars	(₹,000)
I.	Provision for Tax	1,48
II.	Provision for Doubtful debts	92
III.	Rebate on Bills Discounted	55
		295

(b) From the following information for a Bank calculate the amount of discount to be transferred to the Statement of Profit and Loss.

(i) Rebate on Bills Discounted (as on 01.04.2016) ₹ 28,000. Discount Received ₹ 1,05,000.

(ii) The following bills have been discounted during the year:

Amount of Bill (₹)	Rate of Discount	Due Date (including grace days)
65,000	13%p.a.	June 14,2017
1,50,000	15% p.a.	July 19,2017
4,30,000	12% p.a.	August 30,2017

Also pass the necessary journal entry for the unexpired discount as on 31.03.2017.

Answer:

Calculation for rebate on bill discounted

Bill Due Date	Days after due date	Amount (₹)	Rate	Discount
14.06.17	75	65,000	13%	1,736
19.07.17	110	1,50,000	15%	6,781
10.08.17	132	4,30,000	12%	18,661
			Total	27,178

Amount to be credited to P/L = 28,000 + 1,05,000 – 27,178 = ₹ 1,05,822.

Journal Entry:

Interest and Discount A/C ....Dr	₹ 27,178	
To Rebate on Bill Discounted A/C		₹ 27,178

11. From the following information Calculate Depreciation and Advance against Depreciation as per Regulation 21 of the Central Electricity Regulatory Commission (Terms and Conditions of Tariff) Regulations, 2004.

- **Date of Commercial Operation of COD = 1st April 2010**
- **Approved opening Capital cost as on 1st April 2010 = 1,50,000**
- **Weighted Average Rate of Depreciation: 3.5%**
- **Details of allowed Additional Capital Expenditure. Repayment of Loan and Weighted Average Rate of Interest on Loan is as follows:**

	1st year	2nd year	3rd year	4th year
Additional Capital Expenditure (Allowed}	**10,000**	**3,000**	**2,000**	**2,000**
Repayment of Loan	**8,000**	**10,000**	**10,000**	**11,000**
Weighted Average Rate of Interest on Loan	**7.4**	**7.5**	**7.6**	**7.5**

Answer:

1. COMPUTATION OF DEPRECIATION

Particulars	1st year	2nd year	3rd year	4th year
A. Opening Capital Cost	1,50,000	1,60,000	1,63,000	1,65,000
B. Additional Capital Cost	10,000	3,000	2,000	2,000
C. Closing Capital Cost (A + B)	1,60,000	1,63,000	1,65,000	1,67,000
D. Average Capital Cost [(A + C)/2]	1,55,000	1,61,500	1,64,000	1,66,000
E. Weighted Average Rate of Dep.	3.5%	3.5%	3.5%	3.5%
F. Annualized Depreciation (D × E)	5,425	5,652.50	5,740	5,810
G. Advance Against Depreciation (AAD)	2,575	4,347.50	4,260	5,190
H. Total Depreciation (including AAD) for Tariff (F +G)	8,000	10,000	10,000	11,000

2. COMPUTATION OF ADVANCE AGAINST DEPRECIATION (AAD)

Particulars	1st year	2nd year	3rd year	4th year
A. Repayment of Loan (10% of Loan Amount	8,000	10,000	10,000	11,000
B. Depreciation (Excluding AAD)	5,425	5,652.5	5,740	5,810
C. Difference between A & B (A - B)	2,575	4,347.50	4,260	5,190
D. Cumulative Repayment of Loan	8,000	18,000	28,000	39,000
E. Cumulative Depreciation (Excluding AAD) at the beg.	5,425	11,077.5	16,817.50	22,627.5
F. Difference between D & E (D - E)	2,575	6,922.50	11,182.50	16,372.5
G. Advance Against Depreciation (AAD) (Minimum of C & F)	2,575	4,347.50	4,260	5,190

12. (a) From the following information Calculate Return on Equity as per Regulation 21 of the Central Electricity Regulatory Commission (Terms and Conditions of Tariff) Regulations, 2004:

1. **Date of Commercial Operation of COD = 1st April 2010**
2. **Approved Opening Capital Cost as on 1st April 2010 = ₹1,50,000**
3. **Details of allowed Additional Capital Expenditure. Repayment of Loan and Weighted Average Rate of Interest on Loan is as Follows:**

Particulars	1st Year	2nd Year	3rd Year	4th Year

Additional Capital Expenditure (Allowed)	**10,000**	**3,000**	**2,000**	**1,000**

Answer:

Computation of Return on Equity

Particulars	1st Year	2nd Year	3rd Year	4th Year
i. Opening Equity (30%)	45,000	48,000	48,,900	49,500
ii. Additional Equity (30%)	3,000	900	600	300
iii. Closing Equity (A+B)	48,000	48,900	49,500	49,800
iv. Average Equity [(A+C)/2]	46,500	48,450	49,200	49,650
v. Return on Equity (D×14%)	6,510	6,783	6,888	6,951

(b) On 31 st March, 2014, Uncertain Bank Ltd. has a balance of ₹9 crores in "rebate on bills discounted" account. During the year ended 31 st March, 2015. Uncertain Bank Ltd. discounted bills of exchange of ₹4,000 crores charging interest at 18% per annum, the average period of discount being for 73 days. Of these, bills of exchange of ₹600 crores were due for realisation from the acceptors/customers after 31st March, 2015, the average period outstanding after 31st March, 2015 being 36.5 days.

Pass journal entries and show the ledger accounts pertaining to:

(i) discounting of bills of exchage and
(ii) rebate on bills discounted.

Answer:

JOURNAL **(₹ in Crores)**

Date	Particulars	LF.	Dr.(₹)	Cr.(₹)
	Rebate on bills discounted A/c Dr. To Discount on bills A/c (Being the transfer of opening balance in rebate on bills discounted account to discount on bills account)		9.00	 9.00
	Bills purchased and discounted A/c Dr. To Discount on bills A/c [4,000 x 18/100 x 73/365] To Customers' A/c (Being the discounting of bills of exchange during the year)		144.00	 144.00 3,856.00
	Cash A/c [4,000 - 600] Dr. To Bills Purchased & Discounted A/c (Being the discounted Bills collected)		3,400.00	 3,400.00
	Discount on bills A/c [600 x 18/100 x 36.5/365] Dr. To Rebate on bills discounted A/c (Being the unexpired portion of discount in respect of the discounted bills of exchange carried forward)		10.80	 10.80

	Discount on bills A/c Dr. To Profit and Loss A/c (Being the amount of income for the year from discounting of bills of exchange transferred to Profit and Loss A/c)		142.20	142.20

Ledger Accounts:

Dr. DISCOUNT ON BILLS ACCOUNT Cr.

Date	Particulars	₹	Date	Particulars	₹
2015 Mar.31	To Rebate on bills discounted A/c To Profit and Loss A/c	10.80 142.20	2014 April 1 2014-2015	By Rebate on bills discounted A/c By Bills purchased and discounted A/c	9.00 144.00
		153.00			153.00

Dr. REBATE ON BILLS DISCOUNTED ACCOUNT Cr.

Date	Particulars	₹	Date	Particulars	₹
2014 April 1 2015 March 31	To Discount on bills A/c To Balance c/d	9.00 10.80	2014 April 1 2015 March 31	By Balance b/d By Discount on bills A/c	9.00 10.80
		19.80			19.80

13. The Revenue Account of a Life Insurance Company showed the life fund at ₹73,17,000 on 31.03.2015 before taking considering the following items. Pass the journal entries for the following and prepare the corrected Life fund:

Particulars	Amount (₹)
Claims intimated but not admitted	**98,250**
Bonus utilized is reduction of Premium	**13,500**
Interest accrued on Investments	**29,750**
Outstanding Premiums	**27,000**
Claims covered under Reinsurance	**40,500**
Provision for Taxation	**31,500**

Answer:

A. Journal Entries

Date	Particulars	Dr. (₹)	Cr. (₹)
1.	Claims A/c Dr. To, Outstanding Claims A/c (Claims intimated but not admitted taken, omitted to be accounted earlier, now brought into account)	98,250	 98,250
1.	Bonus used in reduction of Premium A/c Dr. To, Premium A/c	13,500	 13,500

	(Bonus in reduction of Premium account, omitted to be accounted earlier, now accounted for)		
2.	Accrued Interest A/c Dr. To, Interest A/c (Interest accrued on Investments as on 31.03.2015 accounted for)	29,750	29,750
3.	Outstanding Premium A/c Dr. To, Premium A/c (Outstanding Premiums brought into account)	27,000	27,000
4.	Reinsurance Claims A/c Dr. To, Claim A/c (Adjustments for claims covered under reinsurance)	40,500	40,500
5.	Revenue A/c Dr. To, Provision for taxes A/c (Adjustments for Provisions for taxation)	31,500	31,500

B. Corrected Life Assurance Fund

Particulars	Dr. (₹)	Cr. (₹)
Life Assurance Fund as on 31.03.2015		73,17,000
Add:		
Bonus in Reduction of Premium	13,500	
Accrued Interest	29,750	
Outstanding Premium	27,000	
Reinsurance claims	40,500	1,10,750
Less:		
Claims Outstanding	98,250	
Bonus in Reduction of Premium	13,500	
Provision for taxation	31,500	1,43,250
Correct Life Fund as on 31.03.2015		**72,84,500**

Study Note 5 – Accounting Standards

14. (a) A company reports the following information regarding pension plan assets. Calculate the fair value of plan assets.

Particulars	₹
Fair market value of plan assets (beginning of year)	**7,00,000**
Employer Contribution	**1,00,000**
Actual return on plan assets	**50,000**
Benefit payments to retirees	**40,000**

Answer:

The actual return on pension plan assets follows:

Particulars	₹
Fair market value of plan assets (beginning of year)	7,00,000

Employer Contribution	1,00,000
Actual return	50,000
Benefit payments	(40,000)
Fair market value of plan assets (end of year)	8,10,000

(b) Amit purchased a computer for ₹44,000 and leased out it to Sumit for four years on leases basis, after the lease period , value of the computer was estimated to be ₹ 3,000; which he realized after selling it in the second hand market. Lease amount payable at the beginning of each year is ₹ 22,000; ₹13,640;₹6,820 & ₹3,410. Depreciation was charged @ 40% p.a. You are required to pass the necessary journal entries in the books of Sumit.

Answer:

Journal Entries
In the books of Sumit

Date	Particulars	Dr.(₹)	Cr.(₹)
?	**Purchase of Computer:**	**No Entry**	
	Payment of First Year's Lease: Lease Rent A/c Dr. To, Bank A/c	22,000	22,000
	Depreciation for First Year:	**No Entry**	
?	**Transfer to Profit & Loss Account:** Profit and Loss A/c Dr. To, Lease Rent A/c	22,000	22,000
?	**Payment of Second Year's Lease:** Lease Rent A/c Dr. To, Bank A/c	13,640	13,640
	Depreciation for Second Year:	**No Entry**	
?	**Transfer to Profit & Loss Account:** Profit and Loss A/c Dr. To, Lease Rent A/c	13,640	13,640
?	**Payment of Third Year's Lease:** Lease Rent A/c Dr. To, Bank A/c	6,820	6,820
	Depreciation for Third Year:	**No Entry**	
?	**Transfer to Profit & Loss Account:** Profit and Loss A/c Dr. To, Lease Rent A/c	6,820	6,820
?	**Payment of Fourth Year's Lease:** Lease Rent A/c Dr. To, Bank A/c	3,410	3,410
	Depreciation for Fourth Year:	**No Entry**	
?	**Transfer to Profit & Loss Account:** Profit and Loss A/c Dr. To, Lease Rent A/c	3,410	3,410
	Sale of Lease Assets:	**No Entry**	

(c) From the following information of a company having two primary segments, prepare a statement classifying the same under appropriate heads.

		(₹ in lakh)
Segment Revenue	**A**	**27,150**
Segment Revenue	**B**	**3,280**
Inter Segment Revenue	**A**	**50**
Segment Profit	**A**	**4,640**
Segment Profit	**B Loss**	**197**
Dividend Income		**285**
Interest Expense		**43**
Tax Provision		**1,675**
Capital Expenditure	**A**	**1,300**
Capital Expenditure	**B**	**16**
Non Cash Expenses (excluding depreciation)		
Segment	**A**	**114**
Segment	**B**	**16**
Liabilities	**A**	**3,430**
Liabilities	**B**	**770**
Other Liabilities		**2,200**
Assets	**A**	**19,450**
Assets	**B**	**2,700**
Other Assets		**6,550**
Depreciation	**A**	**110**
Depreciation	**B**	**15**

Answer:

(₹ in lakh)

Particulars	**Segment A**	**Segment B**	**Others**	**Eliminations**	**Total**
I Revenue:					
a) External Revenue	27,150	3,280			30,430
b) Inter segment Revenue	50			-50	
Total	27,200	3,280		-50	30,430

II Result:	4,640	-197			4,443
a) Income from Investment					285
b) Interest Expenses					-43
c) Tax provision					-1,675
d) Net profit					3,010
III Assets:					
a) Segment assets (directly attributable & allocated)	19,450	2,700			22,150
b) Unallocated assets					6,550
IV Liabilities					
a) Segment Liabilities (directly attributable & allocated)	3,440	770			4,200
b) Unallocated liabilities					2,200
V Others:					
a) Depreciation	110	15			125
b) Non cash expenses	114	16			130
c) Capital Expenditure	1,300	16			1,316

(d) Explain the following situations:

- **(i) A firm acquired a fixed asset for ₹ 500 lakhs on which the Government grant received was 40%.**
- **(ii) Capital subsidy received from the Central Government for setting up a plant in the notified backward region. Cost of the plant ₹ 450 lakhs, subsidy received ₹ 150 lakhs.**
- **(iii) ₹ 50 lakhs received from the State Government for the setting up of water-treatment plant.**
- **(iv) ₹75 lakhs received from the local authority for providing medical facilities to the employees.**

Answer:

(i) The total cost of the fixed asset is ₹ 500 lakhs and the grant is 40% i.e., ₹ 200 lakhs. In the balance sheet, the asset will be shown at the net amount (₹ 500 lakhs - ₹ 200 lakhs) i.e., ₹ 300 lakhs only. This will be depreciated over the life of the asset.

(ii) In this case, the subsidy received for setting up a plant in the notified region, should be treated as a capital subsidy. The amount of subsidy i.e., ₹ 150 lakhs be added to the Capital Reserves and the plant should be shown at ₹ 450 lakhs.

(iii) ₹ 50 lakhs received from State Government for setting up of water treatment plant should be deducted from the cost of the plant in the balance sheet.
(iv) It is a case of revenue grant and should be shown in the profit and loss account.

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

Answer:

Notes and Assumptions:

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

Particulars	Dr. (₹)	Cr. (₹)
Interest A/c Dr. To Interest payable A/c (Being total interest accrued for year, i.e. ₹40,00,000 × 9% × 10/12)	3,00,000	 3,00,000
Machinery A/c Dr. To Interest A/c (Being amount of interest capitalized as per AS- 16)	2,10,000	 2,10,000
Interest payable A/c Dr. To Bank A/c (Being Total Interest on loan paid)	3,00,000	 3,00,000
Profit & Loss A/c Dr. To Interest A/c (Being Balance amount of Interest debit to profit and Loss A/c)	90,000	 90,000

Short Notes

15. Please write short note on —

(a) Segment Revenue as per AS 17;
(b) Related Party as per AS 18;
(c) Main characteristics of a company;
(d) Classification of Assets and Liabilities;
(e) Re-insurance;
(f) Cash Flow Statements;
(g) Main Features of the Electricity Act, 2003;
(h) Forfeiture of Shares vis-à-vis reissue of Forfeited Shares.

Answer:

(a) Segment Revenue as per AS 17:

Segment revenue is the aggregate of

(i) the portion of enterprise revenue that is directly attributable to a segment,
(ii) the relevant portion of enterprise revenue that can be allocated on a reasonable basis to a segment, and
(iii) revenue from transactions with other segments of the enterprise. Segment revenue does not include:
(a) extraordinary items as defined in AS 5, Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies;
(b) interest or dividend income, including interest earned on advances or loans to other segments unless the operations of the segment are primarily of a financial nature; and
(c) gains on sales of investments or on extinguishment of debt unless the operations of the segment are primarily of a financial nature.

(b) Related Party as per AS 18:

A related party is essentially any party that controls or can significantly influence the management or operating policies of the company during the reporting period.
AS-18, deals only with the following relationships:

- Enterprises that directly, or indirectly through one or more intermediaries, control, or are controlled by, or are under common control with the reporting enterprise;
- Associates and joint ventures of the reporting enterprise and the investing party or venture in respect of which the reporting enterprise is an associate or a joint venture;
- Individuals owing, directly or indirectly, an interest in the voting power of the reporting enterprise that gives them control or significant influence over the enterprise and relatives of any such individual. Here "relative" means the spouse, son, daughter, brother, sister, father and mother who may be expected to influence, or be influenced by that individual in his/her dealings with the reporting enterprise.
- Key management personnel and relatives of such personnel are those persons who have authority and responsibility for planning, directing and controlling the activities of the reporting enterprise; and enterprise over which individual or key management personnel described as above is able to exercise significant influence.

(c) The main characteristics of a company are:

(i) It is a distinct legal person existing independent of its members;
(ii) Liability of the members is limited to the extent of the face value of shares held by them;
(iii) It has a perpetual succession, i.e, the members of the company may keep on changing from time to time but this does not affect the company's continuity;
(iv) The shares of a company are freely transferable except in case of a Private limited Company;
(v) A company being a legal person is capable of owing, enjoying and disposing of the property in its own name;
(vi) A company, being a separate body can sue and be sued in its own name;
(vii) Though a company is an artificial person yet it acts through human beings who are called directors of the company. There is a divorce between ownership and the management;

(viii) It is a voluntary association of persons usually for profit.

(d) Classification of Assets and Liabilities:

Current Liabilities —
- is expected to be settled in the company normal operating cycle; or
- is held primarily for the purpose of being traded; or
- is due to be settled within twelve months after the reporting date.

Non-Current Liabilities — Liability other than Current liability shall be classified.

Current Assets —
- is expected to be realised, or is intended for sale or consumption, in the company's normal operating cycle; or
- is held primarily for the purpose of being traded;or
- is expected to be realised within twelve months after the reporting date; or
- 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.

Non-Current Assets —
- Asset other than Current Asset shall be classified as non-current assets.

1. In the case of own debentures, interest on own debentures must be reckoned as income or set-off against the gross interest payable on the whole of debentures.
2. If debentures are purchased between two interest dates, and not immediately after payment of interest, then the price paid for debentures depends on the quotation.

(e) Re-insurance:

Sometimes the insurer considers a particular risk too much for his capacity and may re-insure a part of the risk with some other insurer. Such an arrangement between two insurers is referred to as reinsurance. In such a case the first insurer cannot retain all the premium on the policy for himself. Depending on the share of risk undertaken by the second insurer, proportionate premium must be ceded by the first insurer. Likewise if such a policy matures, the claim will have to be shared by both the insurers in the agreed ratio. These adjustments will have to be shown in the accounts of both the insurers. In the accounts of the first insurer amount of claim recovered from the second insurer has to be deducted from the total claim payable by him. Similarly, the premium ceded to the second insurer has to be deducted from the total premium received. In the accounts of the second insurer, claims paid include claims paid on account of Re-insurance and premiums received include premium received on re-insurance business.

(f) Cash Flow Statements

Cash Flow Statement explains cash movements under three different heads, namely
1. Cash flow from operating activities;
2. Cash flow from investing activities;
3. Cash flow from financing activities.

Sum of these three types of cash flow reflects net increase or decrease of cash and cash equivalents.

Operating activities are the principal revenue - producing activities of the enterprise and other activities that are not investing and financing. Operating activities include all transactions that are not defined as investing or financing. Operating activities generally involve producing and delivering goods and providing services. Investment activities are the acquisition and disposal of long term assets and other investments not included in cash equivalents. Financing activities are activities that result in changes in the size and composition of the owners' capital (including preference share capital in the case of a company) and borrowings of the enterprise.

(g) Main Features of the Electricity Act, 2003:

i. The activities like generation, transmission and distribution of power have been separately identifited.
ii. The Act de-licenses power generation completely (except for hydro power projects, over a certain size).
iii. 10% of the power supplied by supplers and distributors to the consumers has to be genrated using renewable and non-conventional sources of energy.
iv. Setting up State Electricity Regulatory Commisson (SERC) made mandatory.
v. Appellate Tribunal to hear appeals against the decision of the CERC and SERCs.
vi. Ombudsman scheme for consumers' grievance redressal.
vii. Provision for private licensees in transmission and entry in distribution through an independent network.
viii. Metering of all electiricity supplied made obligatory.
ix. Provision relating to theft of electricity made more stricter.

(h) Forfeiture of Shares vis-à-vis reissue of Forfeited Shares

When a shareholder fails to pay calls, the company, if empowered by its articles, may forfeit the shares. If a shareholder has not paid any call on the day fixed for payment thereof and fails to pay it even after his attention is drawn to it by the secretary by registered notice, the Board of Directors pass a resolution to the effect that such shares be forfeited. Shares once forfeited become the property of the company and may be sold on such terms as directors think fit. Upon forfeiture, the original shareholder ceases to be a member and his name must be removed from the register of members.

Forfeited shares may be reissued by the company directors for any amount but if such shares are issued at a discount then the amount of discount should not exceed the actual amount received on forfeited shares. The purchaser of forfeited reissued shares is liable for payment of all future calls duly made by the Company.

Section B – Auditing

Objectives

16. (a) Multiple Choice Questions:

(ii) Statutory Auditor can be removed by the

(A) **Shareholders**
(B) Audit committee
(C) BOD
(D) None of the above

(iii) Annual Audit is known as ______.
(A) Tax Audit
(B) Internal Audit
(C) **Final Audit**
(D) All of the above

(iv) SA 210 stands for __________.
(A) Responsibility of Joint Auditor
(B) Overall planning of audit
(C) **Agreeing the terms of Audit Engagements**
(D) None of the above

(iv) Audit Procedures to obtain audit evidences include
(A) Compliance Procedure
(B) Substantive Procedure
(C) **Both (A) and (B)**
(D) Neither (A) nor (B)

(v) ____________ is said to be the essence of Auditing
(A) **Vouching**
(B) Accounting
(C) Costing
(D) None of the above

(vi) Audit is conducted to draw overall opinion on _________.
(A) **Financial Statement**
(B) Cost Statement
(C) Income Statement
(D) None of the above.

(vii) The audit report should be signed in the personal name of the __________
(A) Accountant
(B) **Auditor**
(C) Directors
(D) None of the above.

(viii) Form for Secretarial Audit Report is
(A) MR-2
(B) **MR-3**
(C) MR-4
(D) MR-5

(ix) Remuneration of auditors is covered under Section ____________ of Companies Act, 2013.
(A) **Section 142**

(B) Section 148
(C) Section 139
(B) None of the above

(x) Debenture holders are ______________ of the company.
(A) **Creditors**
(B) Debtors
(C) Members
(D) None of the above

(b) Match the followings:

	Column I		Column-II
1.	Independent appraisal activity	A	Internal Control
2.	Internal Check is a valuable part of	B	maintenance of Cost Records by the Company
3.	CRA - 1	C	Audit Programme
4.	Detail of audit work to be performed	D	Internal Audit
5.	The authority for Govt. Audit	E	Comptroller and Auditor General of India

Answer:

Sl/No.	Answer
1.	D
2.	A
3.	B
4.	C
5.	E

(c) State whether the following statement are true or false.
(i) The concept of true or fair is a fundamental concept in auditing.
(ii) Statutory Auditor is appointed by the shareholder in the general meeting.
(iii) Internal Audit is an Independent accounting activity.
(iv) A partial audit is a non statutory audit.
(v) First auditor of the company is appointed by the BOD within 45 days.
(vi) Audit committee is only luxury to the company.

Answer:

(i) False
(ii) True
(iii) False
(iv) True
(v) False
(vi) False

Study Note 6 — Auditing Concepts

17. (a) 'Internal Control Questionnaire for Cash and Bank Receipts' – Discuss.
(b) List down the advantages of the Statutory Audit.

Answer:

(a) Internal Control Questionnaire for Cash and Bank Receipts

1. Is inward mail opened by persons not connected with handling cash or the Accounts Department?
2. Is the inward mail date stamped?
3. Is there a detailed record of receipts prepared?
4. Are all cheques specially crossed by employees opening mail?
5. Are bank deposits prepared and made by someone other than those responsible for cash receipts and/or personal ledger. Are duplicate (or counterfoils of) receipted deposit slips received from the bank?
6. Is there any comparison of items listed on the duplicate (or counterfoils of) deposit slips with the amounts of cheques recorded in the cash receipts records?
7. Are receipts given for over-the counter collections?
8. Is there reconciliation of such proofs of collection with amounts banked?
9. Are collections of branch offices and sales offices deposited in special bank accounts subject to withdrawal only by the head office?
10. If collections are made by representatives of the company in cash, have serially numbered been issued to them?
11. Is there a system of issuing permanent receipts in lieu of the temporary/provisional receipts issued by bill collections etc.
12. Are such collections promptly received and banked? Are the receipts forms :
    a. Serially numbered?
    b. Kept in safe custody?
    c. Controlled by register?
    d. Unused stocks checked regularly?
    e. Made out by one employee and dispatched by another?
    f. Accounted for, including those cancelled in respect of partially used receipts, books not intended to be used, cancelled. Are cancelled receipts preserved?
13. Is the opening of bank accounts authorized by the Board of Directors (BOD)?
14. Are sundry items, such as, dividends, interest, rent, commissions etc. regularly checked by responsible official to satisfy that correct amount are received?
15. Is there a procedure to ensure that Hundi borrowing as only by cheques crossed "Account Payee"?
16. Is the cash balance verified frequently (incoming money orders. VPP receipts etc.).
17. Are they listed immediately?
18. Are such lists compared with the Cash Book regularly?
19. Is there an arrangement with the postal authorities to receive cheques instead of cash?
20. Are the cashier's duties taken over for a few days, by someone else, occasionally?
21. If rough cash book is maintained:

i. Is a fair cash book written up promptly?
ii. Is the fair cash book checked with the rough cash book, by a person other than the cashier?

(b) Advantages of Statutory Audit

The auditor expresses his independent opinion after following relevant audit procedures and checking the external and internal evidences necessary for the conduct of audit. He comments on the truthfulness and fairness of statement of affairs of the organization as on certain date and also about the fact that no misstatement or misrepresentation has been made in the Financial Statements under report.

Such an independent opinion by the auditor increases the reliability, authenticity and credibility of the Financial Statements which may further be used by different users for various purposes such as:

(i) The members/shareholders/stakeholders, for their economic decisions and for exercising their voting rights.
(ii) For timely tax assessments.
(iii) For determining the purchase or sale consideration in case of ongoing concern.
(iv) Settlement of partners' accounts in case of admission, retirement or death of partner on account of goodwill or otherwise.
(v) Before the court, in case of settlement of disputes with employees, creditors or debtors.
(vi) For determining the actual value of business or shares in case of merger, acquisition, etc.
(vii) For getting financial assistance from financial institutions, banks or investors.
(viii) In case of non-profit organizations, for getting government grants and availing tax exemptions.
(ix) Evaluation of the internal control systems and strengthening it by removing the inherent weaknesses, and checking the efficacy of the internal checks.
(x) For checking the integrity of the management which manages the funds and affairs on behalf of the real owners or shareholders.
(xi) For other users of financial statements like creditors, investors and government agencies, it ensures that any assertions in the Financial Statements are neither overstated/understated nor misrepresented.
(xii) For the proper distribution of profits by way of payment of wages and other benefits.
(xiii) For ensuring of proper distribution of profits as dividends.
(xiv) For ensuring that all legal requirements are fulfilled and statutory compliances are adhered.
(xv) For settlement of insurance claims or other recoveries from government bodies or otherwise.

18. (a) Discuss the types of Internal Controls.
(b) Distinguish between Internal Audit, Internal Control and Internal check.

Answer:

(a) Types of Internal Control Systems

The type of internal control system to be employed in an organization depends upon the requirements and nature of the business.

Generally, there are two types of Internal Control in an Organisation:

Preventive and Detective controls. Both types of controls are essential to an effective internal control system. From a quality standpoint, preventive controls are essential because they are proactive and emphasize quality. However, detective controls play a critical role by providing evidence that the preventive controls are functioning as intended.

i) Preventive Controls are designed to discourage errors or irregularities from occurring. They are proactive controls that help to ensure departmental objectives are being met.

   Examples of preventive controls are:
   - **Segregation of Duties:** Duties are segregated among different people to reduce the risk of error or inappropriate action. Normally, responsibilities for authorizing transactions (approval), recording transactions (accounting) and handling the related asset (custody) are divided.
   - **Approvals, Authorizations, and Verifications:** Management authorizes employees to perform certain activities and to execute certain transactions within limited parameters. In addition, management specifies those activities or transactions that need supervisory approval before they are performed or executed by employees. A supervisor's approval (manual or electronic) implies that he or she has verified and validated that the activity or transaction conforms to established policies and procedures.
   - **Security of Assets (Preventive and Detective):** Access to equipment, inventories, securities, cash and other assets is restricted; assets are periodically counted and compared to amounts shown on control records.

ii) Detective Controls are designed to find errors or irregularities after they have occurred. Examples of detective controls are:
   - **Reviews of Performance:** Management compares information about current performance to budgets, forecasts, prior periods, or other benchmarks to measure the extent to which goals and objectives are being achieved and to identify unexpected results or unusual conditions that require follow-up.
   - **Reconciliations:** An employee relates different sets of data to one another, identifies and investigates differences, and takes corrective action, when necessary.
   - **Physical Inventories**
   - **Audits**

iii) Corrective Controls target at the target at the correction of errors and irregularities as soon as they are detected.

(b) Distinguish between Internal Audit, Internal Control and Internal check

SL No.	Basis	Internal Audit	Internal Control	Internal Check
1.	Way of Checking	In an internal audit system, each component of work is checked.	In internal controls systems, work of one person is automatically checked by	It operates in routine to doubly check every part of a transaction at the time of

			another.	occurrence and recording of the same.
2.	Objective	Its objective is to evaluate the internal control system and to detect frauds and errors.	Its objective is to ensure adherence to management policies, safeguarding of assets, prevention and detection of frauds and errors, accuracy and completeness of accounting records.	Its objective is to ensure that no one employee has exclusive control over any transaction or group of transactions and their recording in the books.
3.	Point of Time	In an internal audit system, work is checked after it is done.	In an internal control system, checking is done simultaneously with the conduct of work. Every transaction is checked as soon as it is entered.	Methods of recording transactions are devised where work of an employee is checked continuously by correlating it with the work of others.
4.	Thrust of system	The thrust of internal system is to detect errors and frauds	The thrust of internal check system is to prevent errors.	The thrust of internal control lies in fixing of responsibility and division of work to avoid duplication.
5.	Cost Involvement	In an internal audit system, work is checked specially; therefore cost is involved in addition to accounting	The system proves to be costly in case of small businesses because more number of employees are engaged	It is a part of internal control and a method of division of work, therefore does not add to the cost.
6.	Report	The internal auditor submits his report to the management.	Internal Controls provide for built in MIS reports.	The summary of day to day transactions work as report for the senior.

19. (a) Discuss the techniques involved in Evaluation of Internal Control System.

(b) 'Internal Audit is an important management tool' – Discuss.

Answer:

(a) Following are the techniques involved in Evaluation of Internal Control System:

i. Narrative Record: It is a complete and exhaustive description of the system. It is appropriate in circumstances where a formal control system is lacking, like in the case of small businesses. Gaps in the control system are difficult to identify using a narrative record.
ii. Check List: It is a series of instructions that a member of the audit staff is required to follow. They have to be signed/ initialed by the audit assistant as proof for having followed the instructions given. A specific statement is required for every weakness area.
iii. Flow Chart: It is a pictorial representation of the internal control system depicting its various elements such as operations, processes and controls, which help in giving a concise and comprehensive view of the organization's working to the auditor. A complete flow chart would depict the process of raising documents, personnel involved in doing so, the flow of documents through various departments, maintenance of records, flow of goods and consideration, and dealing with results. The internal control evaluation process becomes easier through a flow chart as a broad picture of all the controls involved can be gauged in a glimpse.
iv. Internal Control Questionnaire: This is the most widely used method for collecting information regarding the internal control system and involves asking questions to various people at different levels in the organization. The questionnaire is in a pre-designed format to ensure collection of complete and all relevant information. The quest ons are formed in a manner that would facilitate obtaining full information through answers in "Yes" or "No''.

(b) 'Internal Audit is an important management tool' —

Internal audit is an important management tool for the following reasons:

(i) Internal audit ensures compliance of Companies (Auditors Report) Order, 2016.
(ii) It ensures compliance of accounting standards and policies.
(iii) It ensures reliability of MIS through internal audit's independent appraisal and review.
(iv) It looks into the standard of efficiency of business operation.
(v) It can evaluate various problems independently and suggest improvement.
(vi) This system makes the internal control system effective.
(vii) It ensures the adequacy, reliability, accuracy and understandability of financial and operational data.
(viii) It performs as an integral part of 'Management by system'.
(ix) It can add valuable assistance to management in acquiring new business, promoting new products and expansion or diversification of business etc.

20. (a) Distinguish between Permanent and Current Audit File.
(b) Write a note on – 'Missing Vouchers'.

Answer:

(a) Permanent and Current Audit File: In case of recurring audits, some working papers files may be classified into permanent audit files and current audit files while the former is updated with the Information of continuing importance, the latter contains information relating to audit of a single period. The contents of these files are given below:

Sl/No.	Permanent Audit File	Current Audit File
1	Legal and organizational structure of the entity, e.g. Memorandum of Association and Article of Association in case of a company	Correspondence relating to acceptance of annual reappointment.
2	Extracts or copies of legal documents, agreements and minutes relevant to the audit.	Extracts of important matters in the minutes of Board Meetings and General Meetings relevant to the audit.
3	A record of study and evaluation of internal controls.	Copies of management letters.
4	Analysis of significant ratios & trends.	Analysis of transactions and balances.
5	Copies of the audited financial statements of previous year(s).	Copies of communication with other auditors, experts and third parties.
6	Notes regarding significant accounting policies.	Audit programme
7	Significant audit observations of the earlier years.	Conclusions reached on significant aspects of audit.

(b) 'Missing Vouchers' —

(a) A missing voucher can be any of the following:
Missing Cash Memo, missing page in a Cash Collection Statement, missing inward challan for goods received, missing Inspection Report for material, missing TDS Certificate for tax deductions at source, missing Resolution to authorize increase in borrowing power by the company, missing Bank Statement for a day or a month, etc.

(b) A voucher could become missing due to: i. Wrong or careless filing of document. E.g., missing Bank Statement for a day or a month, missing TDS Certificate. ii. Unintentional non-awareness of statutory requirements. e.g., missing Resolution to authorize increase in borrowing power by the company, or accidental fire, or lost otherwise. iii. Intention to hide the misappropriation by a person. e.g., non-recording of Purchas Invoices received later for goods received and taken in stocks, missing Cash Memo, etc.

(c) The auditor should be careful and should carry out cross verification processes from other sources and documents to be able to form a firm opinion in the case of missing vouchers.

(d) The auditor should qualify his report or give a Disclaimer of Opinion in this case, or may give an adverse report with reasoning on a particular issue depending upon the materiality of the missing voucher as necessary evidence on the issue.

21. List the functions of Internal Audit.

Answer:

Functions of Internal Audit: Very large organizations and some small and medium size organizations also have found the need for internal audit in addition to the external audit. Internal auditors are employees of the organization and work exclusively for the organization. Their functions partly overlap those of the external auditors and in part are quite different.

The functions of internal auditors can be described as follows:

1. An appraisal function: The internal auditor's job is to appraise the activity of others, not to perform a specific part of data processing. For example, a person who spends his time checking employee expense claims is not performing an internal audit function. But an employee who spends some times reviewing the system of checking employee expense claims may be performing an internal audit function.
2. As a service to the organization: The management requires that the auditor ensures the following:
   (i) That its policies are fulfilled.
   (ii) That the information it requires to manage effectively is reliable and complete; this information is not only that which is provided by the accounting system.
   (iii) That the organisation's assets are safeguarded.
   (iv) That the internal control system is well designed.
   (v) That the internal control system works in practice. The internal auditor's activities will be directed to ensure that these requirements are met. The internal auditor can be seen as the notice of the board within the enterprise.
3. Other duties: other duties may include the following events:
   (i) Being concerned with the implementation of social responsibility policies adopted by top management.
   (ii) Being concerned with the response of the internal control system to errors and required changes to prevent errors.
   (iii) Being concerned with the response of the internal control system to external stimuli. The internal control system must continually upgrade itself to deal with change.
   (iv) Acting as a training officer in internal control matters.
   (v) Auditing the information given to management particularly interim accounts and management accounting reports.
   (vi) Taking a share of the external auditor's responsibility in relation to the figures in the annual accounts and vii. Being concerned with the compliance with external regulations such as those on the environment, financial services, related parties etc.

22.(a) Is examination in depth required?

(b) List the importance of an audit report.

(c) Discuss the methods to obtain Audit Evidences.

Answer:

Examination in depth/auditing in depth: "walk through test"

The process of examination in depth explains its meaning and importance. It is stated as under:

i. Fixation of the maximum tolerable error limit/desired confidence level.
ii. Selecting a few transactions in each area of audit to be checked.
iii. Verification of those selected transactions- 100% by verifying the accounting aspects, internal control aspects, documentation and audit trail.
iv. Audit trail refers to the documents, records, books and files, which enable an auditor to trace a transaction from its source till it is summed up, recorded and presented in an accounting report.
v. Analysis of the results with the maximum tolerable error limit.

(b) Following are the importance of an audit report**:**

i. An Audit report is the end product of the auditing and is very important & concluding part of the audit process.
ii. Audit report gives the auditor's opinion on the accounts & record of the company, as examined by him.
iii. Audit Report reflects the work done by the auditor.
iv. Audit report is the instrument which, measures the auditors responsibility in regard to the true & fairness of the financial statement of the company.
v. Audit Report indicates the real position of the financial status of the company & which is used by different people as a reliable document.

(c) Auditor obtains evidence in performing compliance and substantive procedures by any one or more of the following methods –

(a) **Inspection -** It consists of examining records, documents, or tangible assets. Inspection of records and documents provides evidence of varying degrees of reliability depending on their nature, source and the effectiveness of internal controls over their processing.
(b) **Observation -** It consists of witnessing a process or procedure being performed by others.
(c) **Inquiry and Confirmation -** Inquiry consists of seeking appropriate information from a knowledgeable person inside or outside the entity, Confirmation consists of the response to an inquiry to corroborate information contained in the accounting records.
(d) **Computation -** It consists of checking the arithmetical accuracy of source documents and accounting records or performing independent calculations.
(e) **Analytical Review -** It consists of studying significant ratios and trends and investigating unusual fluctuations and items.

Study Note 7 — Provision Relating to Audit Under Companies Act

23. Discuss the provisions relating to eligibilities qualifications and disqualifications of an Auditor.

Answer:

(1) A person shall be eligible for appointment as an auditor of a company only if he is a chartered accountant: Provided that a firm whereof majority of partners practicing in India are qualified for appointment as aforesaid may be appointed by its firm name to be auditor of a company.

(2) Where a firm including a limited liability partnership is appointed as an auditor of a company, only the partners who are chartered accountants shall be authorised to act and sign on behalf of the firm.

(3) The following persons shall not be eligible for appointment as an auditor of a company, namely:—

(a) a body corporate other than a limited liability partnership registered under the Limited Liability Partnership Act, 2008;

(b) an officer or employee of the company;

(c) a person who is a partner, or who is in the employment, of an officer or employee of the company;

(d) a person who, or his relative or partner—

(i) is holding any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company: Provided that the relative may hold security or interest in the company of face value not exceeding one thousand rupees or such sum as may be prescribed;

(ii) is indebted to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, in excess of such amount as may be prescribed; or

(iii) has given a guarantee or provided any security in connection with the indebtedness of any third person to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, for such amount as may be prescribed;

(e) a person or a firm who, whether directly or indirectly, has business relationship with the company, or its subsidiary, or its holding or associate company or subsidiary of such holding company or associate company of such nature as may be prescribed;

(f) a person whose relative is a director or is in the employment of the company as a director or key managerial personnel;

(g) a person who is in full time employment elsewhere or a person or a partner of a firm holding appointment as its auditor, if such persons or partner is at the date of such appointment or reappointment holding appointment as auditor of more than twenty companies;

(h) a person who has been convicted by a court of an offence involving fraud and a period of ten years has not elapsed from the date of such conviction;

(i) a person whose relative is a director or is in the employment of the company as a director or key managerial personnel of the company. [Section 141(3)(f)].

(j) A person who is in the full time employment elsewhere or a person or a partner of a firm holding appointment as its auditor if such person or persons is at the date of such appointment or reappointment holding appointment as auditor of more than twenty companies. [Section 141(3)(g)].

(k) A person who has been convicted by a court for an offence involving fraud and a period of ten years has not elapsed from the date of such conviction. [Section 141(3)(h)].

(l) a person who, directly or indirectly, renders any service referred to in section 144 to the company or its holding company or its subsidiary company. Such services are —

(i) accounting and book keeping services

(ii) internal audit
(iii) design and implementation of any financial information system
(iv) actuarial services
(v) investment advisory services
(vi) investment banking services
(vii) rendering of outsource d financial services
(viii) management services.

24. Discuss – ' Appointment and tenure of First Auditor of a Company'.

Answer:

First auditor of the company, other than a Government company, shall be appointed

- by the BOD within 30 days from the date of registration of the company;
- If BOD fails to appoint, by the member of the company within 90 days at an extraordinary general meeting appoint the first auditor;
- In case of Government company, first auditor shall be appointed by CAG within 60 days from the date of registration;
- If CAG fails to appoint, by the BOD of the company within next 30 days;
- If again BOD fails to appoint the first auditor of the company, by the member of the company within 60 days at an extraordinary general meeting;
- Tenure of the first auditor of the company in both the above cases till the conclusion of the first annual general meeting;

25. ZZ Ltd was incorporated on 1St August 2016. Mr. X, who is related to the chairman of the company, is appointed as the Auditor of the Company by the Board of Director (BOD) at its first meeting on 4th September. Is the appointment valid as per the provision of the Act prevailing for appointment of Auditor?

Answer:

Under section 141(3)(f) a person whose Relative is a Director or is in the employment of the Company as a Director or Key Managerial Personnel, is not eligible for appointment as Auditor. Hence, Mr. X who is related to the Chairman is primarily not qualified for appointment.

The Board of Director can appoint First Auditor within 30 days from the date of incorporation of the company. In this case, the First Auditor should have been appointed within 30 days i.e within 31st August.

Hence the appointment of Mr. X by the BOD on 4th September is invalid. In this case the company in General Meeting is empowered to make the appointment. Members shall appoint the Auditor within 90 days in an AGM.

26. Discuss the Punishment under section 147 of the Companies Act,2013.

Answer:

Punishment for Contravention [Section 147]

(1) If any of the provisions of sections 139 to 146 (both inclusive) is contravened, the company shall be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than ten thousand rupees but which may extend to one lakh rupees, or with both.

(2) If an auditor of a company contravenes any of the provisions of section 139, section 143, section 144 or section 145, the auditor shall be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees or four times the remuneration of the auditor, whichever is less. Provided that if an auditor has contravened such provisions knowingly or willfully with the intention to deceive the company or its shareholders or creditors or tax authorities, he shall be punishable with imprisonment for a term which may extend to one year and with fine which shall not be less than one lakh rupees but which may extend to twenty-five lakh rupees or eight times the remuneration of the auditor, which is less.

(3) Where an auditor has been convicted under sub-section (2), he shall be liable to —
   (i) refund the remuneration received by him to the company; and
   (ii) pay for damages to the company, statutory bodies or authorities or to the members of creditors of company for loss arising out of incorrect or misleading statements of particulars made in his audit report.

(4) The Central Government shall, by notification, specify any statutory body or authority or an officer for ensuring prompt payment of damages to the company or the persons under clause (ii) of sub- section (3) and such body, authority or officer shall after payment of damages to such company or persons file a report with the Central Government in respect of making such damages in such manner as may be specified in the said notification.

(5) Where, in case of audit of a company being conducted by an audit firm, it is proved that the partner or partners of the audit firm has or have acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to or by, the company or its directors or officers, the liability, whether civil or criminal as provided in this Act or in any other law for the time being in force, for such act shall be of the partner or partners concerned of the audit firm and of the firm jointly and severally. Provided that in case of criminal liability of

an audit firm, in respect of liability other than firms, the concerned. Partner or partners, who acted in a fraudulent manner or abetted or as the case may be, colluded in any fraud, shall only be liable.

27. Discuss – 'Cost Audit Report'

Answer:

Cost Audit Report —

As per sub-rule (4) of Rule 6 of the Companies (Cost Records and Audit) Rules 2014 as amended, a Cost Auditor is required to submit the Cost Audit Report along with his or its reservations or qualifications or observations or suggestions, if any, in form CRA-3 to Board of Directors of the company within a period of one hundred and eighty days from the closure of the financial year to which the report relates.

Form for filing Cost Audit Report with the Central Government

As per sub-rule (6) of Rule 6 of the Companies (Cost Records and Audit) Rules 2014 as amended, every company to whom cost auditor submits his or its report shall, within a period of thirty days from the date of receipt of a copy of the cost audit report, furnish the Central Government with such report along with full information and explanation on every reservation or qualification contained therein, in form CRA-4 along with fees specified in the Companies (Registration Offices and Fees) Rules, 2014.

It is to be noted that the cost audit report is required to be filed in XBRL format.

28.(a) Discuss the significance of Opening Paragraph of an Audit Report
(b) Discuss the matters to be looked into while conducting the audit of Issue of Bonus Shares.

Answer:

(a) Significance of Opening Paragraph:

(a) The Opening or Introductory Paragraph identifies the Financial Statements of the entity that have been audited, including the date of and period covered by the Financial Statements.
(b) The 'Opening Paragraph' seeks to bring to the notice of the Users of Financial Statements, that preparation of the accounts is the responsibility of the Management of the enterprise, whereas the responsibility of the Auditor is to express an opinion on the said accounts based on the audit carried out by him.
(c) Through the Opening Paragraph, the Auditor communicates the basic message that the preparation of Financial Statements requires Management to make significant accounting estimates and judgements, as well as to determine the appropriate accounting principles and methods used in preparation of the said Financial Statements.

(b) Following are the matters to be looked into while conducting the audit of Issue of Bonus Shares:

Issue of Bonus Shares [Section 63]

i. Confirm that issue of Bonus Share was authorized by articles.
ii. Verify the minutes of the Board meeting and ordinary resolution passed in the general meeting in which the approval of members is obtained.
iii. Check that the company has issue fully paid-up bonus shares to its members only.
iv. Confirm that the issue of bonus shares shall not be made by capitalising reserves created by the revaluation of assets.
v. Check whether the company has made any default in payment of interest or principal in respect of fixed deposits or debt securities issued by it.
vi. Check whether the company has made any default in payment of statutory dues of the employees, such as, contribution to provident fund, gratuity and bonus.
vii. Whether the partly paid-up shares are made fully paid-up.
viii. Check whether the bonus shares shall not be issued in lieu of dividend.

29. Discuss 'Audit of Hospitals'.

Answer:

The following points are to be considered necessary for conducting an audit of Hospital.

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

(xi) The capital expenditure should be incurred under proper authorization by a valid resolution of the trustees or the Managing Committee.
(xii) Verify the system of internal check as regards purchases and issue of stores, medicines etc.
(xiii) Examine that the appointment of the staff, payment of salaries etc. are duly authorized.
(xiv) Physically verify the investments, fixed assets and inventories.
(xv) Check that adequate depreciation has been provided on all the depreciable assets.

Short Notes

30. Write short notes on the following:

(a) The essential features of auditing;
(b) Advantages of Auditing for Sole Proprietors;
(c) Different steps of an Environment Audit ;
(d) Disclaimer of Opinion;
(e) Need of Internal Audit;
(f) Functions and powers of Audit Committee;
(g) Propriety Audit;
(h) Audit Risk .

Answer:

(a) The essential features of auditing are enumerated below;

(i) It involves evaluation of the relevance, reliability and adequacy of evidence in support of verifiable information.
(ii) It is analytical, critical and investigative.
(iii) The information audited may be financial or non-financial.
(iv) There should be standards or criteria for evaluation of the information.
(v) The auditor should be competent and independent.
(vi) It ensures reliability of information and authenticity of assertions made in the financial statements relating to enterprises, whether profit-oriented or not and whether it is required by law or not, to enable the auditor to form his opinion on these statements with regard to true and fair view

(b) Advantages of Auditing for Sole Proprietors :

(i) It evaluates the internal control system and strengthens it by removing weaknesses, if any.
(ii) It increases the reliability and authenticity of Financial Statements.
(iii) It helps in timely finalization of Annual Financial Statements and tax assessments.
(iv) It keeps a moral check on the working of employees.
(v) It helps them in obtaining funds easily from financial institutions, based on more reliable Financial Statements available to the banks and financial institutions.
(vi) It helps in settling:

- Trade disputes
- Labour disputes
- Insurance claims

(c) Different steps of an Environment Audit

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

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

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

i. Identify and control the environmental impact of its activities, products or services.
ii. Improve its environmental performance continually.
iii. Implement a systematic approach to setting environmental objectives and targets, to achieving these and to demonstrating that they have been achieved.

(d) Disclaimer of Opinion

A Disclaimer of Opinion Report is given when the Auditor is unable to form an overall opinion about the matters contained in the Financial Statements.

A Disclaimer of Opinion should be expressed when the possible effect of a limitation on scope is so material and pervasive that the Auditor has not been able to obtain sufficient appropriate audit evidence and is, accordingly, unable to express an opinion on the Financial Statements.

It may happen in situations such as -- (a) when books of account of the Company seized by Income-Tax Authorities, (b) when it is not possible for the Auditor to obtain certain information or (c) when scope of audit work is restricted.

The Auditor will state in his Report that he is unable to term an opinion on the Financial Statements. Such Report is called as "Disclaimer of Opinion Report".

(e) Need of Internal Audit

The need for internal audit has becoming in demand due to the enunciated reasons:

i. Increased size and complexity of businesses.
ii. Enhanced compliance requirements.
iii. Focus on risk management and internal controls to manage them.
iv. Unconventional business models.
v. Intensive use of information technology.
vi. Stringent norms mandated by regulators to protect investors.
vii. An increasingly competitive environment.

(f) Functions and powers of Audit Committee -

Function of Audit Committee: The various Functions of the Audit Committee is enumerated below;

(i) For the appointment and fixation of the remuneration of Auditor.
(ii) Examination of the Financial Statement.
(iii) Scrutiny of Inter Corporate Loans and Investment,
(iv) Valuation of the Assets of the Company,
(v) Evaluation of the internal financial control and risk management system of the entity.
(vi) Evaluation of the use of the funds rose through public offers.
(vii) Evaluation of any related party transaction.

Powers of the Audit Committee: The powers of the Audit Committee are enumerated below;

(i) Audit Committee has the power to call for comments of the Auditor about Internal Control Systems and the scope of the Audit including its observation.
(ii) Before submission of the report to the Board the Audit Committee have the power to review the Financial Statement.
(iii) Power to discuss any issues with the Statutory & Internal Auditor and the Management of the Company in relation to matter contained in the Financial Statement.

(g) Propriety Audit:

A propriety audit is not just concerned with the truthfulness and fairness of the Financial Statements and books of accounts of the client, but also ensures that the transactions entered into by the client, business practices and activities undertaken are not against public interest. Its objective is to see that the business lives upto standards of proper conduct. Legal, economic and financial are all equally important aspects that require to be looked into during the course of the audit. It is an essential element of a Government Audit.

The Comptroller and Auditor General (CAG) examines the propriety of all government expenditures to ensure that they have been incurred in the interest of the general public, and are not influenced by personal interests of the government authorities sanctioning it.

(h) Audit Risk

In very broad terms, audit risk is the risk of a material misstatement of a financial statement item that is or should be included in the audited financial statements of an entity. In theory, audit risk ranges anywhere from zero, where there is complete certainty of no material misstatement, to one, where there is complete certainty of a material misstatement. In practice, however, audit risk is always greater than zero. There is always some risk of material misstatement as it is not possible, (except for the audit of the simplest of financial statements), due to the limitations inherent in both accounting and auditing, to be absolutely certain that a material misstatement will not exist. “Audit risk” is the risk that the auditor gives an inappropriate audit opinion when the financial statements are materially misstated. Such misstatements can result from either fraud or error.

i. Inherent risk – It is the susceptibility of a account balance or class of transaction to misstatements that could be material, either individually or when taken together with misstatements in other balance or classes, assuming that there were no internal controls.
ii. Control risk- It is the risk that misstatement, that could occur in an account balance or class of transactions and that could be material, either individually or when taken together with misstatements in other balances or classes, will not be prevented/detected/corrected on timely basis by the accounting and internal control systems
iii. Detection risk -It is the risk that an auditor’s substantive procedures (the procedures designed to obtain evidence as to the completeness, accuracy and validity of the data produced by the accounting system) will not detect a misstatement that exists in account balance or class of transactions that could be material, either individually or when taken together with misstatements in other balances or classes