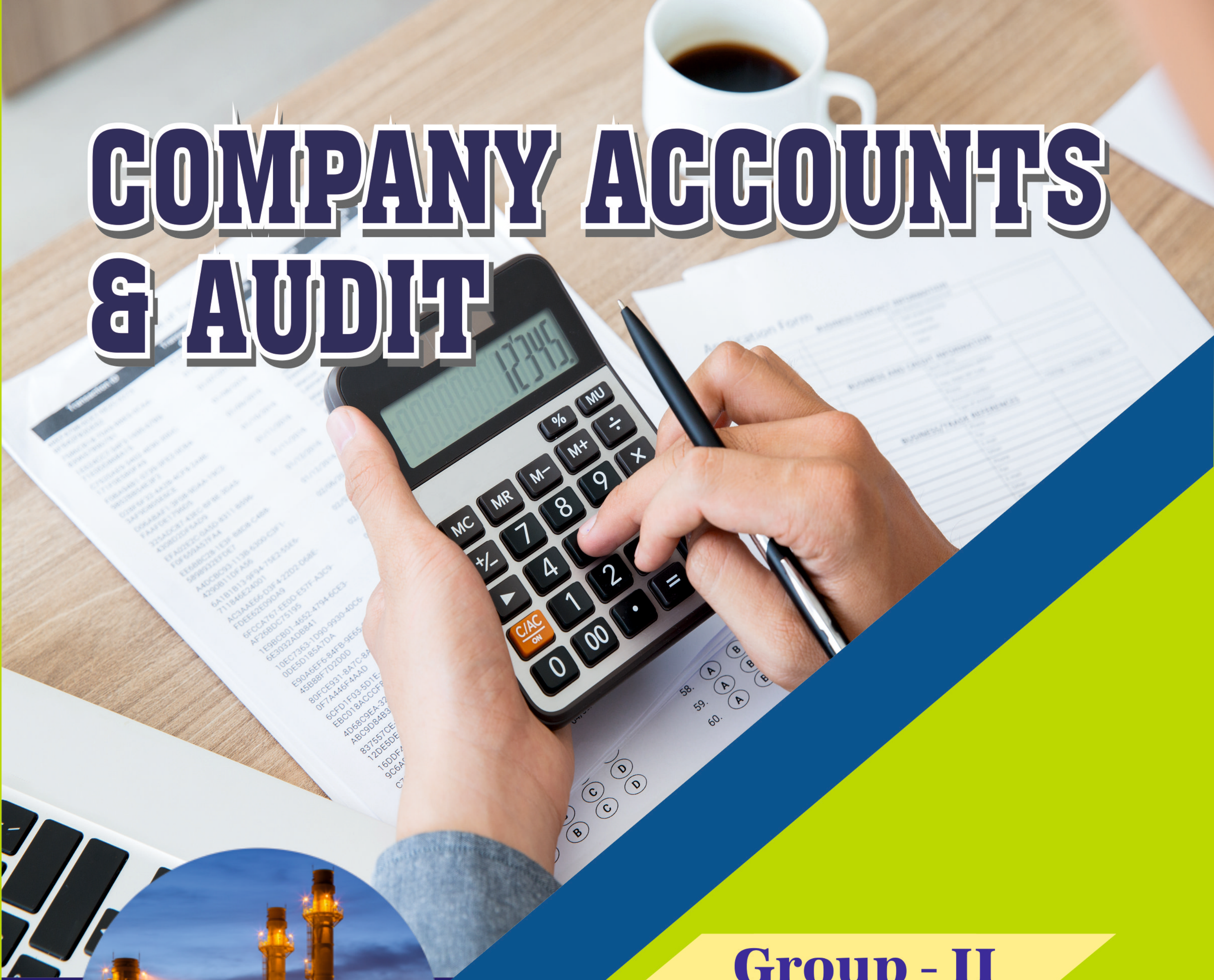
COMPANY ACCOUNTS & AUDIT



Group - II

Paper - XII

THE INSTITUTE OF COST ACCOUNTANTS OF INDIA

(Statutory body under an Act of Parliament)

www.icmai.in

SYLLABUS - 2016

WORK BOOK

COMPANY ACCOUNTS AND AUDIT

FINAL

GROUP – II

PAPER – 12

The Institute of Cost Accountants of India

(Statutory body under an Act of Parliament)

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Preface

Professional education systems around the world are experiencing great change brought about by the global demand. Towards this end, we feel, it is our duty to make our students fully aware about their curriculum and to make them more efficient.

Although it might be easy to think of the habits as a set of behaviours that we want students to have so that we can get on with the curriculum that we need to cover. It becomes apparent that we need to provide specific opportunities for students to practice the habits. Habits are formed only through continuous practice. And to practice the habits, our curriculum, instruction, and assessments must provide generative, rich, and provocative opportunities for using them.

The main purpose of this volume is to disseminate knowledge and motivate our students to perform better, as we are overwhelmed by their response after publication of the first edition. Thus, we are delighted to inform our students about the **e-distribution of the second edition of our 'Work book'.**

This book has been written to meet the needs of students as it offers the practising format that will appeal to the students to read smoothly. Each chapter includes unique features to aid in developing a deeper under-standing of the chapter contents for the readers. The unique features provide a consistent reading path throughout the book, making readers more efficient to reach their goal.

Discussing each chapter with illustrations integrate the key components of the subjects. In the second edition, we expanded the coverage in some areas and condensed others.

It is our hope and expectation that this second edition of work book will provide further an effective learning experience to the students like the first edition.

The Directorate of Studies,

The Institute of Cost Accountants of India

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INDEX

Suggested Marks Distribution from Examination Point of View

Only for Practice Purpose

		Paper-5/6/7/8/11	Paper-9/10/12
Total 100 Marks [3 Hours]	Objective	= 25 Marks	= 28 Marks
	Others	= 75 Marks	= 72 Marks

Objective Question

25 Marks/28 Marks (1 Mark each questions)	MCQ	1 mark
	Match	1 mark
	True/False	1 mark
	Fill in the Blanks	1 mark

Short Notes / Case Study

Minimum Marks for each Questions	4 Marks
Maximum Marks for each Questions	10 Marks

Practical Problem

Minimum Marks for each Questions	4 Marks
Maximum Marks for each Questions	15 Marks

Study Note – 1

ACCOUNTING OF SHARES AND DEBENTURES

Learning Objective: *After studying this chapter, students should able to*

- *Accounting of Issue of shares, rights issue, bonus issue, sweat equity shares, forfeiture of share, buy-back of shares*
- *Accounting of Issue and redemption of preference shares, debentures*

1. Multiple choice questions: ***Choose the correct alternative*****:**

(i) Which of the following is not a condition of buy-back of securities?

(a) Both fully and partly paid-up securities can be bought back.

(b) Buy-back must be authorised by the Articles of Association.

(c) Buy-back must be authorised by passing a special resolution in general meeting.

(d) Buy-back should be completed within 1 year from the state of passing of special resolution.

(ii) Which of the following is the modern approach of fixation of issue price of shares?

(a) Fixed price method.

(b) Mark-to-Market method.

(c) Book Building method.

(d) None of the above

(iii) Which of the following is/ are advantage(s) of Rights issue?

(a) Control in the hands of existing shareholders.

(b) Less costly

(c) No dilution in existing value of shares.

(d) All of the above.

(iv) When an entire issue of securities is underwritten by two or more underwriters jointly, it is referred to as

(a) Full underwriting

(b) Firm underwriting

(c) Regular underwriting

(d) Syndicate underwriting

(v) **Which of the following is not a feature of sweat equity shares?**

  (a) These are only to its directors or employees.

  (b) They are issued only for acquisition of tangible assets.

  (c) They are are by nature equity shares

  (d) All of the above

(vi) **Which of the following cannot be used for issue of bonus shares as per the Companies Act?**

  (a) Revaluation Reserve

  (b) Securities Premium Account

  (c) Capital Redemption Reserve

  (d) General Reserve

(vii) **According to Section 52 of the Companies Act, 2013 the amount in the Securities Premium A/c cannot be used for the purpose of**

  (a) Issue of fully paid bonus shares

  (b) Writing off losses of the company

  (c) For purchase of own securities

  (d) Issue of partly paid bonus shares

(viii) **Which of the following statement is true?**

  (a) A debenture holder is an owner of the company

  (b) A debenture holder can get his money back only on the liquidation of the company

  (c) A denture issued at a discount can be redeemed at a premium

  (d) Debentures cannot be redeemed during the life time of the company

Answer:

(i) (a)

(ii) (c)

(iii) (d)

(iv) (d)

(v) (b)

(vi) (a)

(vii) (b)

(viii) (c)

2. Match the following:

	Column A		Column B
1.	Private placement	A	Shares are offered to the existing shareholders at a price below market price
2.	Offer for sale	B	shares are offered to the existing shareholders free of cost
3.	Public offer	C	Shares are placed to a small number of selected investors
4.	Rights issue	D	company offers its entire issue of shares to an issuing house
5.	Bonus issue	E	Shares are offered directly to the investing public

Answer:

1. C
2. D
3. E
4. A
5. B

3. Fill in the blanks:

(i) **In case of redemption of preference shares, an amount equal to the nominal value of the shares redeemed out of profits and free reserves is to be transferred to _____________ Account.**

(ii) **The conditions for issue of bonus shares are covered u/s _____ of Companies Act, 2013.**

(iii) **_____ ______ are equity shares issued by a company to its directors or employees at a discount or for consideration, other than cash, for providing their know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called.**

(iv) **The issue of ________ shares is also called Capitalisation Issue.**

(v) **The application forms which are collected by an investor from an underwriter are called ______ applications.**

Answer:

(i) Capital Redemption Reserve

(ii) 63

(iii) Sweat Equity

(iv) Bonus

(v) Marked

4. **State whether the following statements are true or false:**

   (i) The provisions regarding redemption of preference shares are covered u/s 80 of Companies Act, 2013.

   (ii) Rights issue is usually made at a price that is above the face value but lower than the market price.

   (iii) Debentures form part of owned capital of an entity.

   (iv) A bonus issue can be made only out of free reserves built out the genuine profits or Securities Premium collected in cash only.

   (v) Issue of bonus shares does not cause any change in the paid-up capital of the issuing company.

Answer:

(i) False

(ii) True

(iii) False

(iv) True

(v) False

ISSUE OF SHARES

5. **D Ltd. has authorised capital of ₹ 8,00,000. The company issues 20,000 equity shares of ₹10 each at a premium of ₹5 per share payable as:**

   On application — ₹ 6 (including premium ₹ 3)

   On allotment — ₹ 5 (including balance of premium), and balance in two calls.

   Applications were received for 35,000 shares. The applicants were divided in the following groups: Group A — Applying for 5,000 shares allotted fully

   Group B — Applying for 20,000 shares are made prorata allotment for 15,000 shares Group C — Applying for total 10,000 shares are, refunded.

   Directors while making allotment adjust the excess amount received on application against allotment money due. When second and final calls were made, shareholders holding 500 shares failed to pay the final call money. The director's forfeited these shares. All the forfeited shares were reissued at ₹ 9 per share.

   It is agreed that brokerage @ 3% and underwriting commission @3% will be paid for this issue. Claims of brokers and underwriters are satisfied by issuing to them additional equity shares of ₹ 10 each at a premium of ₹ 5 per share (without any cash payment).

   Show Journal entries in the books of the company.

Answer:

In the Books of D Ltd.

Journal

	Particulars		Dr.	Cr.
	Bank Account A/c	Dr.	2,10,000	
	To Equity Share Application A/c			2,10,000
	(Being Application money received on 35,000 share @ ₹6 per share)			
	Equity Share Application A/c	Dr.	60,000	
	To Bank A/c			60,000
	(Being Application money received on 10,000 shares refunded)			
	Equity Share Application A/c	Dr.	1,20,000	
	To Equity Share Capital A/c			60,000
	To Security Premium A/c			60,000
	(Being Application money on 20,000 share transferred to Share Premium and Share Capital)			
	Equity Share Application A/c	Dr.	30,000	
	To Equity Share Allotment A/c			30,000
	(Being Application money received on Application transferred to Share Allotment Account as per board's resolution no... dated...)			
	Equity Share Allotment A/c	Dr.	1,00,000	
	To Equity Share Capital A/c			60,000
	To Security Premium A/c			40,000
	(Being first and final call made as per board resolution No.... date ....)			
	Bank A/c	Dr.	70,000	
	To Equity Share Allotment A/c			70,000
	(Being amount received and calls in arrears on first and final call)			
	Equity Share first Call A/c	Dr.	40,000	
	To Equity Share Capital A/c			40,000
	(Being Call money due on 20,000 share @ ₹2 share)			
	Bank A/c	Dr.	40,000	
	To Equity Shares First call A/c			40,000
	(Being first Call money received)			
	Equity Share final call A/c	Dr.	40,000	
	To Equity Share Capital A/c			40,000
	(Being call many due on 20,000 share @ ₹2 per share)			
	Bank A/c	Dr.	39,000	
	Calls in arrear A/c	Dr.	1,000	
	To Equity Share Final call A/c			39,000
	(Being Call money on 19,500 share received)			

	Equity Share Capital A/c (500 x 10)	Dr.	5,000	
	To Calls in Arrear A/c			1,000
	To Share Forfeiture A/c (500 x 8)			4,000
	(Being 500 Share forfeited)			
	Bank A/c	Dr.	4,500	
	Share Forfeiture A/c	Dr.	500	
	To Equity Share Capital A/c			5,000
	(Being 500 share re-issued @ ₹9 per share)			
	Share forfeiture A/c	Dr.	3,500	
	To Capital Reserve A/c			3,500
	(Being profit on forfeiture transferred to Capital Reserve)			
	Brokerage A/c	Dr.	9,000	
	Commission A/c	Dr.	9,000	
	To Equity Share Capital A/c			12,000
	To Security Premium A/c			6,000
	(Being Commission and Brokerage Paid by issue of equity shares at of ₹10 each at a premium of ₹5)			

6. E Ltd. issued 30,000 shares of ₹ 10 at ₹ 12 per share payable ₹ 3 on application, ₹ 5 on allotment including premium, ₹ 2 on first call and ₹ 2 on final calls. Applications were received for 40,000 shares and the Company refunded the Application money of 4,000 shares and rest of the excess Application money was adjusted with Allotment. All money were duly paid except Mr. A holding 300 shares failed to pay the Allotment and on his failure to pay to 1st Call his shares were forfeited. B holding 200 shares failed to pay the 1St Call and on his failure to pay the final call his shares were forfeited. C holding 100 shares failed to pay the final call. The Company reissued 450 forfeited shares (including the shares of A) at the rate of ₹ 10 per share.

Pass Journal entries in the Books of the Company.

Answer:

- Issued 30,000 share of 10 each at ₹ 12
- Payable as follows : On application ₹ 3; On allotment ₹ 5 (Including ₹ 2 Premium); On first call ₹ 2; On final call ₹ 2.
- 30,000 shares were issued against application for 36,000 shares, i.e., in 5:6
- Advance or adjustment against allotment per share = (6×3 – 5×3)/5 = 0.60.
- So, net due on allotment per share = 5 - 0.60 = 4.40

Books of E Ltd.

Journal

	Particulars		Dr.	Cr.
	Bank A/c	Dr.	1,20,000	
	To Share Application A/c			1,20,000
	(Being Application money received of 40000 share)			
	Share Application A/c	Dr.	1,20,000	
	To Share Capital A/c			90,000
	To Bank A/c			12,000
	To Share Allotment A/c (30,000 × 0.60)			18,000
	(Being Application money adjusted with Share Capital and Allotment money and 4,000 Share			
	Share Allotment A/c	Dr.	1,50,000	
	To Share Capital A/c			90,000
	To Security Premium A/c			60,000
	(Being Allotment money/due @ ₹5 per Share including premium)			
	Bank A/c	Dr.	1,30,000	
	Calls in Arrear A/c [300×4.40] or (300x5 – 300×0.60)	Dr.	1,320	
	To Share allotment			1,32,000
	Share First Call A/c	Dr.	60,000	
	To Share Capital A/c			60,000
	(Being Share first Call money due)			
	Bank A/c	Dr.	59,000	
	Calls in Arrear A/c [500×2]	Dr.	1,000	
	To Share First Call A/c			60,000
	(Being Cash received from First Call except 500 shares who failed to pay)			
	Share Capital A/c (300 x 8)	Dr.	2,400	
	Securities Premium A/c (300x2)	Dr.	600	
	To Calls in Arrear A/c [(300×(4.40+2)]			1,920
	To Share forfeiture A/c [300×(3+0.60)]			1,080
	(Being 300 Share Forfeited)			
	Share Final Call A/c	Dr.	59,400	
	To Share Capital A/c			59,400
	(Being Final Call made on 29,700 Shares @ ₹2)			
	Bank A/c [29,400×2]	Dr.	58,800	
	Calls in Arrear A/c [(200+100)×2]	Dr.	600	
	To Share Final Call A/c			59,400
	(Being Cash received except on 300 share)			

Share Capital A/c [200×10]	Dr.	2,000	
To Calls in Arrear A/c [200×(2+2)]			800
To Share Forfeiture A/c [200×(3+3)]			1,200
(Being 200 share are Forfeited)			
Bank A/c [450×10]	Dr.	45,000	
To Share Capital A/c			45,000
(450 forfeited shares reissued at ₹10 as fully paid)			
Share forfeiture A/c	Dr.	1,980	
To Capital Reserve A/c [(300×3.60)+(150×6)			1,980
(Profit on reissue transferred)			

7. G Ltd. offered for public subscription 5,000 equity shares of ₹ 10 each at a premium of ₹ 2.50 per share payable as follows:

On Application	**₹**	**2.00 per share**
On Allotment	**₹**	**4.50 per share (including premium)**
On First Call	**₹**	**4.00 per share**
On Second Call	**₹**	**2.00 per share**

Applications were received for 8,500 shares, letters of regret being issued to applicants for 1,000 shares and allotment was made pro-rata against the balance. Money over paid on application by the allottees was adjusted with allotment amount.

Rahim to whom 100 shares were allotted failed to pay the allotment money and on his failure to pay the first call, his shares were forfeited.

Haq, the holder of 150 shares failed to pay last two calls and his shares were forfeited after the second call was made.

Of the shares forfeited, 200 were allotted as fully paid up to Karim for ₹8 per share paid in cash.

Show the journal entries to record the forfeiture and reissue of forfeited shares including those relating to cash, assuming that the whole of Rahims shares have been re-issued.

Answer:

- Ratio of allotment = 5000:7500 = 2:3
- Advance or adjustment against allotment per share = (3×2 – 2×2)/2 = ₹1.
- So, net due on allotment per share = 4.50 - 1.00 = 3.50 [capital =1 and premium = 2.50]

In the Books of G Ltd.

Journal

	Particulars		Dr.	Cr.
	Equity Share Capital A/c [100×8]	Dr.	800	
	Security Premium A/c [100×2.50]	Dr.		250
	To Calls in arrear A/c [100×(3.50+4)]			
	To Forfeited Shares A/c [100×(2+1)]			
	(Being the forfeiture of 100 shares held by Rahim for non-payment of Allotment and First Call money as follows:)			
	Equity Share Capital A/c [150×10]	Dr.	1,500	
	To Calls in arrear A/c [150×(4+2)]			900
	To Share Forfeited A/c [150×(2+2)]			600
	(The forfeiture of 150 shares held by hag for non-payment of first and second call of ₹ 4 and 2 respectively: money paid on application and allotment ₹ 4 per share forfeited.)			
	Bank A/c [200*8]	Dr.	1,600	
	Share Forfeited A/c [200×2]	Dr.	400	
	To Equity Share Capital A/c [200×10]			2,000
	(Being the amount received against reallotment of 200 shares as fully paid at ₹8 per share)			
	Forfeited Shares A/c	Dr.	300	
	To Capital Reserve A/c [100×(3-2) + 100×(4-2)]			300
	(Being the profit on re-issue of 200 forfeited share transferred assuming that the whole of Rahim's shares, have been re-issued)			

Note:- The amount of ₹ 200/- in respect of 50 shares forfeited (50×4 = 200) but not yet re-issued, will remain in the Forfeited Share Account under sub-head Reserve & Surplus A/c in Balance Sheet.

8. P Limited has Authorised Capital of ₹ 10,00,000. The Company issued 75,000 equity shares of ₹ 10 each at a premium of ₹ 4 per share payable as follows:

On application ₹ 7 (including Premium of ₹ 2), on allotment ₹ 5 (including the balance premium), and the balance in two calls of equal installments.

Applications received for 1,00,000 shares The applicants were divided and allotted shares as follows:

(a) Those who applied for 25,000 shares were allotted in full,

(b) Those who applied for 60,000 shares were allotted 50,000 shares on pro rata

(c) The applicants for the balance applications were refunded in full. Excess payment received on application to whom shares were allotted was adjusted against allotment money.

Shareholders holding 5,000 shares failed to pay when the second and final call was made. These shares were forfeited and reissued at ₹ 9 per share.

Answer:

In the Books of P Ltd.

Journal

	Particulars		Dr.	Cr.
	Bank A/c	Dr.	7,00,000	
	To Share Application A/c			7,00,000
	(Being Application money received)			
	Share Application A/c	Dr.	7,00,000	
	To Bank A/c			1,05,000
	To Share Capital A/c			3,75,000
	To Security Premium A/c			1,50,000
	To Share Allotment A/c			70,000
	(Being Application money adjusted)			
	Share Allotment A/c	Dr.	3,75,000	
	To Share Capital A/c			2,25,000
	To Security Premium A/c			1,50,000
	(Being amount due on Allotment along with Share Premium)			
	Bank A/c	Dr.	3,05,000	
	To Share Allotment A/c			3,05,000
	(Being allotment money received)			
	Share First Call A/c	Dr.	75,000	
	To Share Capital A/c			75,000
	(Being First Call money receivable)			
	Bank A/c	Dr.	75,000	
	To Share First Call A/c			75,000
	(Being Share First Call money received)			
	Share Second Call A/c	Dr.	75,000	
	To Share Capital A/c			75,000
	(Being Share Second Call money receivable)			
	Bank A/c	Dr.	70,000	
	Calls in Arrear A/c	Dr.	5,000	
	To Share Second Call A/c			75,000
	Being Share Second Call money received)			
	Share Capital A/c	Dr.	50,000	
	To Share Forfeiture A/c			45,000
	To Calls in arrear A/c			5,000
	(Being Share Forfeiture on non-payment of Second			

	Call)			
	Bank A/c	Dr.	45,000	
	Share Forfeiture A/c	Dr.	5,000	
	To Share Capital A/c			50,000
	(Being re-issue of Forfeited Shares)			
	Share Forfeiture A/c	Dr.	40,000	
	To Capital Reserve A/c [5,000×(9-1)]			40,000
	(Being balance in the Share Forfeiture A/c transferred to Capital Reserve A/c)			

BONUS ISSUE

9. Following items appear in the Trial Balance of A Ltd. as on 31st March, 2014:

Particulars	Amount (₹)
4,500 Equity Shares of 100 each	4,50,000
Capital Reserve (including 40,000 being profit on sale of Plant)	90,000
Securities Premium	40,000
Capital Redemption Reserve	30,000
General Reserve	1,05,000
Profit and Loss Account (Cr. Balance)	65,000

The company decided to issue to equity shareholders bonus shares at the rate of 1 share for every 3 shares held. Company decided that there should be the minimum reduction in free reserves. Pass necessary Journal Entries in the books A Ltd.

Answer:

In the books of A Ltd.
Journal

	Particulars		L.F.	Dr. (₹)	Cr. (₹)
1.	Capital Reserve A/c	Dr.		40,000	
	Capital Redemption Reserve A/c	Dr.		30,000	
	Securities prem. A/c	Dr.		40,000	
	General Reserve A/c	Dr.		40,000	
	To Bonus to shareholders A/c				1,50,000
	(Being, declaration of Bonus issue of 1 share for every 3 share held, by utilising various reserves)				
2.	Bonus to shareholders A/c	Dr.		1,50,000	
	To Equity shares capital A/c				1,50,000
	(Being, Capitalisation of profit)				

10. Following is the extract from the Balance Sheet of M/s. Y Ltd. as at 31st March, 2017: In

	₹
Authorised Capital:	
50,000, 10% preference share of ₹ 10 each	**5,00,000**
2,00,000 equity shares of ₹ 10 each	**20,00,000**
Issued and Subscribed Capital:	
40,000, 10% preference shares of ₹ 10 each fully paid	**4,00,000**
1,80,000, equity shares of ₹ 10 each, of which ₹ 7.50 paid up	**13,50,000**
Reserve and Surplus:	
General Reserve	**2,40,000**
Capital Reserve	**1,50,000**
Securities Premium	**50,000**
Profit and Loss Account	**3,00,000**

On 1st April, 2017, the company has made a final call @ ₹ 2.50 each on 1,80,000 equity shares. The call money was received by 30th April, 2017. There after the company decided to capitalize its reserves by issuing bonus shares at the rate of one share for every three shares held. Securities premium of ₹ 50,000 includes a premium of ₹ 20,000 for shares issued to vendor for purchase of a special machinery. Capital reserve includes ₹ 60,000 being profit on exchange of plant and machinery.

Show necessary Journal Entries in the books of the company and prepare the extract of the Balance Sheet after bonus issue. Necessary assumption, if any should form part of your answer.

Answer:

Assumptions:

1. According to SEBI Guideline, only Capital Reserve and Securities Premium collected in cash can be utilized for the purpose of issue of bonus shares. it is assumed that balance of capital reserve and securities premium is collected in cash only.
2. It is also assumed that necessary resolutions have been passed and requisite legal requirements related to the issue of bonus shares have been complied with before issue of bonus shares.

Working Note:

On the basis of the above assumptions, the Authorized Capital should be increased as under:

Required for bonus issue	₹ 6,00,000
Less: Balance of authorized equity share capital (available)	₹ (2,00,000)
Authorized capital to be increased	₹ 4,00,000
Total authorized capital after bonus issue (₹ 20,00,000 + 4,00,000)	= 24,00,000

Date	Particular		Dr.	Cr.
1.4.2017	Equity share final call A/c	Dr.	4,50,000	
	To Equity share capital A/c			4,50,000
	(Being the final call of 2.50 per share on 1,80,000 equity shares made)			
30.4.2017	Bank A/c	Dr.	4,50,000	
	To Equity share final call A/c (Being final call money on 1,80,000 shares received)			4,50,000
30.4.2017	Securities premium A/c (50,000 - 20,000)	Dr.	30,000	
	Capital reserve A/c (1,50,000 - 60,000)	Dr.	90,000	
	General reserve A/c	Dr.	2,40,000	
	Profit and loss A/c	Dr.	2,40,000	6,00,000
	To Bonus to shareholders A/c (Being utilization of reserves for bonus issue of one share for every three shares held)			
30.4.2017	Bonus to equity shareholders A/c	Dr.	6,00,000	
	To Equity share capital A/c 1e shares issued			6,00,000

Extract of Balance Sheet (After bonus issue)

	₹
Authorized Capital :	
50,000, 10% Preference shares of ₹ 10 each	5,00,000
2,40,000, Equity shares of ₹ 10 each (refer W.N.)	24,00,000
Issued and subscribed capital:	
40,000, 10% Preference shares of ₹ 10 each fully paid	4,00,000
2,40,000, Equity shares of ₹10 each fully paid	24,00,000
Out of the above, 60,000 equity shares of ₹ 10 each have been issued by way of bonus	
Reserves and Surplus:	
Capital reserve	60,000
Securities premium	20,000
Profit and loss A/c (3,00,000 - 2,40,000)	60,000

11. **The following notes pertain to T Ltd.'s Balance Sheet as on 31st March 2017 :**

	Notes :		₹ In lakhs
1.	**Share Capital**		
	Authorized:		
	20 crore shares of ₹ 10 each		20,000
	Issued and Subscribed:		
	10 crore Equity Shares of ₹ 10 each		10,000
	2 crore 11% Cumulative Preference Shares		
	of ₹ 10 each		2,000
		Total	12,000
	Called and paid up :		
	10 crore Equity Shares of ₹ 10 each, ₹ 8		8,000
	per share called and paid up		
	2 crore 11% Cumulative Preference Shares		
	of ₹ 10 each, fully called and paid up		2,000
		Total	10,000
	Reserve and Surplus:		
2.	Capital Reserve		485
	Capital Redemption Reserve		1,000
	Securities Premium		2,000
	General Reserve		1,040
	Surplus i.e. credit balance of Profit & Loss		
	(Appropriation) Account		
		Total	4.789

On 2nd April, 2017 the company made the final call on equity shares @ ₹ 2 per share, The entire money was received in the month of April, 2017.

On 1st June, 2017 the company decided to issue to equity shareholders bonus shares at the rate of 2 shares for every 5 shares held and for this purpose, it decided to utilize the capital reserves to the maximum possible extent.

Pass journal entries for all the above mentioned transactions. Also prepare the notes on Share Capital and Reserves and Surplus relevant to the Balance Sheet of the company immediately after the issue of bonus shares.

Answer:

In the books of T Ltd.

Journal

Date	Particulars		Dr. ₹ in lakhs	Cr. ₹ in lakhs
2017	Equity Share Final Call A/c	Dr.	2,000	
April 2	To Equity Share Capital A/c			2,000
	(Final call of ₹ 2 per share on ₹ 10 crore equity shares made due)			
	Bank A/c	Dr.	2,000	
	To Equity Share Final Call A/c			2,000
	(Final call money on ₹ 10 crore equity shares received)			
June 1	Capital Reserve A/c	Dr.	485	
	Capital Redemption Reserve A/c	Dr.	1,000	
	Securities Premium A/c	Dr.	2,000	
	General Reserve A/c	Dr.	515	
	To Bonus to Shareholders A/c			4,000
	(Bonus issue of two shares for every five shares held by utilizing various reserves as per Board's resolution dated…….)			
	Bonus to Shareholders A/c	Dr.	4,000	
	To Equity Share Capital A/c			4,000
	(Capitalization of profit)			

Notes on Share Capital and Reserves & Surplus

	Particulars		₹ In lakhs
1.	Share Capital		
	Authorised share capital		
	20 crore shares of ₹ 10 each		20,000
	Issued, subscribed and fully paid up share capital		
	14 crore Equity shares of ₹10 each, fully paid up		14,000
	(Out of the above, 4 crore equity shares @ ₹ 10 each were issued by way of bonus)		
	2 crore, 11% Cumulative Preference share		2,000
	Capital of ₹ 10 each, fully paid up		16,000
2.	**Reserves and Surplus**		
	Capital Reserves	485	
	Less: Utilized for bonus issue	(485)	Nil
	Capital Redemption reserve	1,000	
	Less: Utilized for bonus issue	(1,000)	Nil
	Securities Premium	2,000	
	Less: Utilized for bonus issue	(2,000)	Nil
	General Reserve	1,040	
	Less: Utilized for bonus issue	(515)	525
	Surplus (Profit and Loss Account)		73
	Total		798

Notes : As per SEBI Guidelines, Capital reserve and Securities premium have been assumed as realized in cash and hence can be used for issue of fully paid-up bonus shares.

BUY BACK OF SHARES

12. The following balances are appearing in the Books of X Ltd. on 1-4-2017 :

	₹
Redeemable Preference Share Capital (Shares of 10 each)	**2,00,000**
Calls-in-Arrear	**2,000**
General Reserve	**1,00,000**
Share Premium	**5,000**

The preference shares are fully called up and due for redemption at a premium of 10%. Calls-in-Arrear are in respect of final call at the rate of 4 per share and these shares are held by Mr. H whose whereabouts are not known.

The Board of Directors decided that 50% of the General Reserve is to be utilized for the purpose of redemption of redeemable preference share capital and to meet the further requirement of funds, further 14,500 numbers of equity shares of ₹ 10 each were issued at a premium of 20%.

The redemption of preference shares were duly carried out and subsequently the company utilized the balance of Capital Redemption Reserve Account to issue equity shares at ₹ 10 each as bonus to shareholders.

You are required to show necessary journal entries in the Books of All Xerox Ltd.

Answer:

In the books of T Ltd.

Journal

Date	Particulars		Dr. (₹)	Cr. (₹)
	Redeemable Preference Share Capital A/c	Dr.	1,95,000	
	Premium on Redemption on Pref. Shares A/c	Dr.	19,500	
	To Preference Shareholders A/c			2.14.500
	(Being 19,500 fully paid Redeemable Pref. Shares along with premium payable on redemption as per Board resolution no…. dt….)			
	General Reserve A/c	Dr.	50,000	
	To Capital Redemption Reserve A/c			50,000
	[Being face value of shares redeemed out of profit (General Reserve) transferred]			
	Bank A/c	Dr.	1,74,000	
	To Equity Shares capital A/c			1,45,000
	To Equity Shares Premium A/c			29,000
	(Being issue of 14,500 Equity shares at a premium of 20%)			
	Share Premium A/c	Dr.	5,000	
	General Reserve A/c	Dr.	14,500	
	To Premium on Redemption on Pref. Shares A/c			19,500
	(Being premium payable adjusted)			
	Preference Shareholders A/c	Dr.	2,14,500	
	To Bank A/c			2,14,500
	(Being amount paid off to Pref. shareholders)			
	Capital Redemption Reserve A/c	Dr.	50,000	
	To Bonus to Shareholders A/c			50,000
	(Being Bonus declared and transferred from Capital Redemption Reserve account)			
	Bonus to Shareholders A/c	Dr.	50,000	
	To Equity Share capital A/c			50,000
	(Being amount transferred to Equity Share capital)			

13. **Ashok Ltd. furnishes you with the following summarized position as at 31st March, 2017:**

(₹ in crores)

Sources of Funds		
Share Capital: -		
Authorised		100
Issued:		
12% redeemable preference shares of ₹100 each fully paid	75	
Equity shares of ₹10 each fully paid	25	100
Reserves and surplus:		
Capital reserve	15	
Securities Premium	25	
Revenue reserves	260	300
		400
Application of Funds		
Fixed Assets : cost	100	
Less: Provision for depreciation	(100)	Nil
Investments at cost (Market value ₹400 Cr.)	100	
Current Assets	340	
Less: Current Liabilities	(40)	300
		400

The company redeemed preference shares on April 1, 2017. It also bought back 50 lakh equity shares of ₹10 each at 50 per share. The payments for the above were made out of the huge bank balances, which appeared as a part of current assets.

You are required to pass Journal entries to record the above transactions.

Answer:

In the books of T Ltd.

Journal

Date	Particulars		Dr.	Cr.
2017 Apr. 1,	12% Preference share capital A/c To Preference share holders A/c (Being preference share capital account transferred to shareholders account)	Dr.	75	75
	Preference share holders A/c To Bank A/c (Being payment made to share holders)	Dr.	75	75
	Shares buy back A/c Dr. To Bank A/c (Being 50 Lakhs equity shares bought back @ ₹ 50 per share)	Dr.	25	25
	Equity share capital A/c (50 Lakhs x ₹10) Securities premium A/c (50 Lakhs x ₹40) To Shares buy back A/c (Being cancellation of shares bought back)		5 20	25
	Revenue reserve A/c To Capital Redemption Reserve A/c (Being creation of capital redemption reserve to the extent of the face value of preference shares redeemed and equity shares bought back)	Dr.	80	80

14. **The following was the assets and liabilities of D Ltd. as at 31.03.2017:**

(₹ in crores)

Liabilities		Assets	
1 lakh Equity Shares of ₹10 each fully paid	10.00	Plant & Machinery	13.50
Securities Premium	3.50	Furniture	2.40
General Reserves	3.10	Investments	1.80
Profit & Loss Account	1.10	Stock	7.20
14% Debentures	7.50	Sundry debtors	2.30
Sundry creditors	5.00	Bank	3.00
	30.20		30.20

On 01.04.2017, the company decided to buy-back 20% of its equity shares at a premium of ₹ 10 per share. For this purpose, the company sold its entire investments for 2.30 lakhs and issued 15000, 12% Preference shares of ₹ 100 each at par. The amount payable was ₹ 60 on application and 40 on allotment. The, issue was fully subscribed. Thereafter the company issued bonus shares of ₹ 10 at the rate of one bonus share for every five equity shares.

Show Journal entries and Balance Sheet after the above transactions were completed.

Answer:

In the books of D Ltd.
Journal

2017			₹ in Lakhs	₹ in Lakhs
April 1	Bank A/c To Investments A/c To P and L A/c (Being Investments Sold)	Dr.	2.30	 1.80 0.50
April 1	Bank A/c To Preference share application A/c (Being application money @ 60/- each received on 1,500 Preference Shares)	Dr.	0.90	0.90
April 1	Preference Share application A/c To 12% PSC A/c (Being allotment made)	Dr.	0.90	 0.90
April 1	Preference share allotment A/c To 12% PSC A/c (Being allotment money due on 1,500 pref shares @ 40/- each)	Dr.	0.60	 0.60
April 1	Bank A/c To preference Share allotment A/c	Dr.	0.06	 0.06
April 1	Equity Share Capital A/c Security Premium A/c To Equity shareholders A/c (Being 20% Eq. Shares bought back at a premium of 10/- each as per board resolution dated...........)	Dr. Dr.	2.00 2.00	 4.00
April 1	Equity share holders A/c To Bank A/c (Being amount paid to equity shareholders against buy back)	Dr.	4.00	 4.00

April 1	General Reserve A/c Dr. To Capital Redemption Reserve A/c (Being amount transferred from General Reserve to CRR A/c) [Refer WN:1]	Dr.	0.50	 0.50
April 1	Capital Redemption Resave A/c Security Premium A/c To Bonus to Shareholders A/c (Being profits transferred to issue bonus shares in the ratio of 1:5) [Refer WN: 2]	Dr. Dr.	0.50 1.10	 1.60
April 1	Bonus to Shareholders A/c To Equity Share Capital A/c (Being Bonus Shares issued in the ratio of 1:5 as per board resolution no.... dated ....)	Dr.	1.60	 1.60

Balance Sheet of D Ltd. as on 1.4.2012

I.	**Equity & Liabilities**	**Note**	**₹ Lacs**
	1. **Shareholders Fund**		
	(a) Share Capital	B1	11.10
	(b) Reserve & Surplus	B2	4.60
	2. **Non Current Liabilities**		NIL
	3. **Current Liabilities**		
	(a) Short Term Borrowings	B3	7.50
	(b) Trade Payables		5.00
	(c) Other current liabilities		NIL
	Total		**28.20**
II.	**Assets**		
	1. **Non Current Assets**	B4	
	(a) Fixed Assets		15.90
	(b) Non-current Investments		NIL
	(c) Long term loans & advances		NIL
	2. **Current Assets**		
	(a) Inventories		7.20
	(b) Trade Receivables		2.30
	(c) Cash & Cash Equivalents		2.80
	Total		**28.20**

Working Notes:

Sources for buy-back of shares : **Buy Back of Shares can be done out of two sources ₹ 2,00,000**

↓

Out of proceeds of issue of new shares
1500 Ref. Shares x 100/-= 1,50,000

Out of Free Profit
↓
General Reserve Balance ₹ 50,000

W.N. (2) No. of Bonus Shares to be issued

$= 80,000 \times \frac{1}{5} = 16,000$ Shares

ACCOUNTING FOR PREFERENCE SHARES

15. X Ltd. has the following assets and liabilities as on 31.3.2017:

Liabilities	₹	Assets	₹
Share Capital		Fixed Assets	22,00,000
Issued, Subscribed and fully paid-up		Current Assets	8,00,000
10,000 Equity Shares of ₹ 100 each	10,00,000		
5,000 Preference Shares of ₹ 100 each	5,00,000		
Capital Reserve (revaluation profit)	1,00,000		
Securities Premium A/c	1,00,000		
General Reserve	2,00,000		
Profit & Loss A/c	1,00,000		
Current Liabilities	10,00.000		
	30,00,000		30,00,000

The Preference Shares are to be redeemed at 10% premium. Fresh issue of equity shares is to be made to the extent it is required under the Companies Act for the purpose of this redemption. The shortfall in funds for the purpose of the redemption after utilizing the proceeds of the fresh issue are to be met by taking a bank loan. Show Journal Entries.

Answer:

Books of X Ltd.

Journal

	Particulars		Dr. (₹)	Cr. (₹)
	Bank A/c	Dr.	2,00,000	
	To Equity Share Capital A/c			2,00,000
	(Being the issue of 2000 Equity Share of ₹100 each for redemption of Preference Shares, as per Board's Resolution no. dated)			
	General Reserve A/c	Dr.	2,00,000	
	Profit and Loss A/c	Dr.	1,00,000	
	To Capital Redemption Reserve A/c			3,00,000
	(Being the amount transferred to Capital Redemption Reserve)			
	Preference Share Capital A/c	Dr.	5,00,000	
	Premium on Redemption of Presence Shares A/c	Dr.	50,000	
	To Preference Shareholder A/c			
	(Being the amount payable on redemption preference shares transferred to shareholders A/c)			5,50,000
	Bank A/c	Dr.	3,50,000	
	To Bank Loan A/c			3,50,000
	(Being the necessary amount taken from Bank as loan for redeeming the Preference Shares)			

	Preference Shareholders A/c To Bank A/c (Being the Preference Shareholder Paid-off on Redemption)	Dr.	5,50,000	 5,50,000
	Securities Premium A/c To Premium on Redemption of Preference Shares A/c (Being the Premium payable on Redemption Transferred to Securities Premium A/c)	Dr.	50,000	 50,000

Working Notes:

1. **Calculation of No. of Shares to be Issued**

Face Value of Shares Redeemed	₹ 5,00,000
Less Profits available for Dividend	₹ 3,00,000
∴ Face value of preference shares to be issued	₹ 2,00,000

∴ No. of Shares to be issued ₹ 2,00,000 / ₹ 100 = 2,000 shares

2. **Amount of loan from Bank**

Amount required for payment to Preference Shareholders = ₹ 5,50,000. Amount received by issuing Equity Share is ₹ 2,00,000. Therefore, ₹ 3,50,000 is to be taken from bank.

16. The summarized financial position of A Ltd. as on 30th June 2017 is as under :

Share capital:	
10% Redeemable Preference Shares of ₹ 100	**10,00,000**
Equity shares of ₹ 10 each	**15,00,000**
12% Debentures	**7,00,000**
Revenue reserves	**40,00,000**
Total	**72,00, 000**
Represented by Net assets	**72,00,000**

The redeemable preference shares were due for redemption on 31st August 2017 and were redeemed and duly paid off. The company is permitted to redeem the debentures at any time at a premium of 10% and did so on 30th September 2017.

The company was in a reasonably liquid position but to assist in providing funds for redemption of the redeemable preference shares, a rights issue of equity shares was made. 20,000 equity shares were issued for cash at a premium of ₹ 20 per share, ₹ 12.50 payable on application on 15th July 2017 and the balance on allotment on 31st July 2017. All cash due was received on the due dates.

Pass journal entries to record the above transactions.

Answer:

Books of A Ltd.

Journal

S. No.	Particulars		L.F. (₹	Dr. (₹)
15.7.17	Bank A/c (20,000 x 12.5)	Dr.	2,50,000	
	To Equity Share Application A/c			2,50,000
	(Being share application money received)			
31.7.17	Equity Share Application A/c	Dr.	2,50,000	
	Share Allotment A/c(20,000 x 17.50)		3,50,000	
	To Equity Share Capital A/c (20,000 x 10)			2,00,000
	To Securities Premium A/c (20,000 x 20)			4,00,000
31.7.17	Bank A/c	Dr.	3,50,000	
	To Share Allotment A/c(20,000 x 175)			3,50,000
	(Being Share Allotment amount received)			
31.8.17	10% Preference Shares A/c	Dr.	10,00,000	
	To Preference Shareholders A/c			10,00,000
	(Being preference shares transferred to preference Shareholders A/c)			
''	Preference Shareholders A/c	Dr.	10,00,000	
	To Bank A/c			10,00,000
	(Being amount of Preference Shareholders Due paid to them.			
''	Revenue Reserve A/c	Dr.	8,00,000	
	To Capital Redemption Reserve A/c			8,00,000
	(Being 10,00,000 Preference Shares with 2,00,000 of equity capital and hence balance is net from reserved)			
30.9.17	12% Debentures A/c	Dr.	7,00,000	
	Securities Premium A/c	Dr.	70,000	
	To Debentures Holders Dr.			7,70,000
	(Being debentures transferred to debentures holders A/c)			
''	Debentures holders A/c	Dr.	7,70,000	
	To Bank A/c			7,70,000
	(Being amount paid & debenture holders)			

17. The following is the summary of assets and liabilities of H Ltd. as on 31.03.2016 :

Liabilities	₹	Assets		₹
Share Capital:		Fixed Assets:	6,00,000	
Authonsed		Gross Block	2,00,000	
20,000, 10% redeemable		Less Depreciation		4,00,000
Preference shares of ₹		Investments		2,00,000
10 each	2,00,000	Current Assets,		
1,80,000 Equity Shares		Loans & Advances		
of ₹ 10 each	18,00,000	Inventory	50,000	
	20,00,000	Debtors	50,000	
Issued, Subscribed and		Cash & Bank		
paid up capital :		Balances	1,00,000	2,00,000
		Miscellaneous		
20000, 10% redeemable		Expenditure to the		40,000
preference share of		extent not written off		
₹ 10 each	200.000			
20,000 equity shares				
of ₹ 10 each	2,00,000			
	4,00,000			
Reserve and Surplus:	2,40,000			
General Reserve	1,40,000			
Securities premium				
Profit and Loss	37,000			
Account				
Current Liabilities				
& Provision	23,000			
	8,40,000			8,40,000

For the year ended 31.3.2017, the company made a net profit of 30,000 after providing for ₹ 40,000 depreciation and writing off miscellaneous expenditure of ₹ 40,000. The following additional information is available with regard to company's operation.

(1) The preference dividend for the year eneded 31.3.2017 was paid before 31.3.2017.

(2) Except cash & bank balances, other current assets and current liabilities on 31.3.2017, was the same as on 31.3.2016.

(3) The company redeemed the preference share at a premium of 10%.

(4) The company issued bonus shares in the ratio of 1 share for every two equity shares held as on 31.3.2017.

(5) To meet the cash requirements of redemption, the company sold a portion of the investments, so as to leave a minimum balance of ₹ 60,000 after such redemption.

(6) Investments were sold at 90% of cost as on 31.3.2016.

You are required to prepare:

(i) Necessary journal entries to record redemption and issue of shares.

(ii) Cash & Bank Account.

Answer:

Books of H Ltd.

Journal

10% Redeemable Preference share capital A/c	Dr.	2,00,000	
Premium on redemption of preference shares A/c	Dr.	20,000	
To Preference shareholders A/c			2,20,000
(Being the amount payable to preference shareholders on redemption)			
General Reserve A/c	Dr.	2,00,000	
To Capital Redemption Reserve A/c			2,00,000
(Being transfer to the latter A/c on redemption of shares)			
Bank A/c	Dr.	90,000	
Profit & Loss A/c	Dr.	10,000	
To Investments A/c			1.00.000
(Being amount realized on sale of investments of loss thereon adjusted)			
Preference Shareholders A/c	Dr.	2,20,000	
To Bank A/c			2,20,000
Security premium A/c	Dr.	20,000	
To Premium on redemption of preference shares A/c			20,000
(Being amount of premium payable on redemption of Preference shares)			
Capital redemption reserve A/c	Dr.	1,00,000	
To Bonus to shareholders A/c			1,00,000
(Being amount adjusted for issuing bonus shares in the ratio of 1 : 2)			
Bonus to shareholders A/c	Dr.	1,00,000	
To Equity share capital A/c			1,00,000
(Being balance of farmer account transferred to latter)			

Dr. **Cash & Bank A/c** **Cr.**

Particulars		Amount	Particulars	Amount
To Balance b/d		1,00,000	By Preference dividends	20,000
To Cash from operations			By Preference shareholders	2,20,000
Profit			By Balance c/d	60,000
Add : dep.				
Add : misc.		1,10,000		
	30,000	90,000		
	40,000			
	40,000			
To Investments (sale being bal. fig)				
		3,00,000		**3,00,000**

Working Notes:

1.	Sale of Investments		
	Cost of Investments (book value = 90,000*100/90)		1,00,000
	Less: Cash received		90,000
	Loss on sale of investments		10,000
	Total Investments		2,00,000
	Less: Cost on investments sold		1,00,000
	Cost of Investment in hand		1,00,000
2.	Profit & loss A/c		
	Balance as per last year		37,000
	Add: Profit for the year		30,000
			67,000
	Less : Preference dividend	20,000	
	Less : Loss on sale of Investments	10,000	30,000
			37,000

18. Following is the extract of the Balance Sheet of X Ltd. as on 31st March 2018.

	₹
Authorised Capital	**6,00,000**
60,000, 12% Preference Shares of ₹ 10 each	**60,00,000**
6,00,000 Equity Shares of ₹ 10 each	**66,00,000**
Issued and Subscribed Capital	
48,000 12% Preference Shares of ₹ 10 each fully paid	**48,00,000**
5,40,000 Equity Shares of ₹ 10 each, ₹ 8 paid up	**43,20,000**
Reserves and Surplus	
General Reserve	**7, 20,000**
Capital Redemption Reserve	**2,40,000**
Securities Premium (collected in cash)	**1,50,000**
Profit and Loss Account	**12,00,000**

On 1st April 2018, the company has made final call @ ₹ 2 each on 5,40,000 equity shares. The Call money was received by 20th April 2018. Thereafter, the company decided to capitalize its reserves by way of bonus at the rate of one share for every four shares held.

Show necessary journal entries in the books of the company and prepare the extract of the balance sheet as on 3oth April 2018 after bonus issue.

Answer:

Books of X Ltd.

Journal

Date	Particulars		Dr.	Cr.
1-4-18	Equity Share Final Call A/c	Dr.	10,80,000	
	To Equity Share Capital A/c			10,80,000
	(Being final calls of ₹ 2 per share on 5,40,000 equity shares due as per Board's Resolution No—Dated---)			
20-4-18	Bank A/c	Dr.	10,80,000	
	To Equity Share Final call A/c			10,80,000
	(Being final call money on 5,40,000 equity shares received)			
20-4-18	Securities Premium A/c	Dr.	1,50,000	
	Capital Redemption Reserve A/c	Dr.	2,40,000	
	General Reserve A/c	Dr.	7,20,000	
	Profit and Loss A/c (b.f)	Dr.	2,40,000	
	To Bonus to Shareholders A/c			13,50,000
	(Being making provision for bonus issue of one share for every four shares held)			
20-4-18	Bonus to Shareholders A/c	Dr.	13,50,000	
	To Equity Share Capital A/c			13,50,000
	(Being issue of bonus share)			

Extract of Balance Sheet as on 30th April 2018 (after bonus issue)

Authorised Capital	₹
60,000 12% Preference Shares of ₹ 10 each	6,00,000
7,35,000 Equity Shares of ₹ 10 each	73,50,000
Issued and Subscribed Capital	
48,000 12% Preference Shares of ₹ 10 each fully paid	48,00,000
7,35,000 Equity Shares of ₹ 10 each, fully paid	73,50,000
Reserves and Surplus	
Profit and Loss A/c	9,60,000

Working Note:

Authorised Capital (Existing)	₹ 60,00,000
Add: Issue of Bonus Share Capital	₹ 13,50,000
Total:	₹ 73,50,000

ACCOUNTING FOR DEBENTURES

19. The following balances appeared in the books of P Ltd. on 1.4.2016: 12% Debentures – ₹ 4,00,000; Sinking Fund – ₹3,00,000; Sinking Fund Investment – ₹3,00,000 (represented by 10% ₹3,60,000 secured bonds of Government of India).

Annual contribution to the Sinking Fund was ₹64,000 made on 31 December each year. On 31.03.2017, balance at bank was ₹2,00,000 after receipt of interest. The company sold the investments at 80% and debentures were paid off.

You are required to prepare the following accounts for the year ended 31-03-2017:

(a) Debentures Account;

(b) Sinking Fund Account;

(c) Sinking Fund Investment Account;

(d) Bank Account.

Answer:

Dr. 12% Debentures Account Cr.

Particulars	Amount	Particulars	Amount
31.3.2017 To Bank A/c	4,00,000	1.4.2016 By Balance b/d	4,00,000
	4,00,000		**4,00,000**

Dr. Sinking Fund Account Cr.

Particulars	Amount	Particulars	Amount
31.3.2017 To General Reserve No	4,00,000	1.4.2016 By Balance b/d By Sinking Fund Investment A/c By Profit & loss A/c	 3,00,000 36,000 64,000
	4,00,000		**4,00,000**

Dr. Sinking Fund Investment Account Cr.

Particulars	F.V.	Cost	Income	Particulars	F.V.	Cost	Income
1.4.2016 To Balance b/d To Sinking Fund A/c	 3,60,000 ----	 3,00,000 ----	 --- 36,000	31.3.2017 By Bank A/c (Intt. received) By Bank (sold) By Profit & Loss A/c (Loss)	 ---- 3,60,000	 ---- 2,88,000 12,000	 36,000 --- ---
	3,60,000	**3,00,000**	**36,000**		**3,60,00**	**3,00,000**	**36,000**

Dr.	Bank Account		Cr.
Particulars	**Amount**	**Assets Particulars**	**Amount**
31.3.2017 To Balance b/d (B/F) To Sinking Fund Investment A/c	 2,00,000 2,88,000	31.3.2017 By 12% Debentures A/c 31.3.2017 By Balance cid	 4,00,000 88,000
	4,88,000		**4,88,000**

20. The following is the Summary of assets and liabilities of B Ltd. as at 31st March, 2017:

Sources of Funds	**Amount (₹)**
Authorized Capital	
50,000 Equity shares of ₹10 each	**5,00,000**
10,000 Preference shares of ₹100 each	**10,00.000**
	15,00.000
Issued subscribed and paid up	
30,000 Equity shares of ₹10 each	**3,00,000**
5,000 Redeemable 8% Preference shares of ₹100 each	**5,00,000**
Reserves & Surplus	
Securities Premium	**6,00,000**
General Reserve	**6,50,000**
Profit & Loss A/c	**1,80,000**
2500, 9% Debentures of ₹100 each	**2,50,000**
Sundry Creditors	**1,70,000**
	26,50,000
Application of Funds	
Fixed Assets (net)	**7,80,000**
Investments (market value ₹5,80,000)	**4,90,000**
Deferred Tax Assets	**3,40,000**
Sundry Debtors	**6,20,000**
Cash & Bank balance	**2,80,000**
Preliminary expenses	**1,40,000**
	26,50,000

In Annual General Meeting held on 20th June, 2017 the company passed the following resolutions:

(i) To split equity share of ₹10 each into 5 equity shares of ₹2 each from 1st July, 09.

(ii) To redeem 8% preference shares at a premium of 5%.

(iii) To redeem 9% Debentures by making offer to debenture holders to convert their holdings into equity shares at 10 per share or accept cash on redemption.

(iv) To issue fully paid bonus shares in the ratio of one equity share for every 3 shares held on record date.

On 10th July, 2017 investments were sold for 5,55,000 and preference shares were redeemed. 40% of Debenture holders exercised their option to accept cash and their claims were settled on 1st August, 2017. The company fixed September, 2017 as record date and bonus issue was concluded by 12th September, 2017.

You are requested to journalize the above transactions including cash transactions and prepare Balance Sheet as at 30th September, 2017. All working notes should form part of your answer.

Answer:

B Ltd.

Journal

Date	Particulars		Dr. (₹)	Cr. (₹)
2017 July 1	Equity Share Capital (₹10) A/c To Equity Share Capital (₹ 2)A/c (Being equity share of ₹10 each splited into 5 equity shares of ₹2 each)	Dr.	3,00,000	 3,00,000
July 10	Bank A/c To Investment A/c To Profit & Loss A/c (Being investment sold out and profit on sale credited to Profit & Loss A/c)	Dr.	5,55,000	 4,90,000 65,000
July 10	8% Redeemable Pref. Share capital A/c Premium on redemption of Pref. Sh. A/c To Preference shareholders A/c (Being amount payable to preference share holders on redemption)	Dr. Dr.	5,00,000 25,000	 5,25,000
July 10	Preference Shareholders A/c To Bank A/c (Being amount paid to preference shareholders)	Dr.	5,25,000	 5,25,000
July 10	General Reserve A/c To Capital Redemption Reserve A/c (Being amount equal to nominal value of preference shares transferred to Capital Redemption Reserve A/c on its redemption as per the law)	Dr.	5,00,000	 5,00,000
Aug. 1	9% Debentures A/c Interest on debentures A/c To Debentureholders A/c (Being amount payable to debentureholders along with interest payable)	Dr. Dr.	2,50,000 7,500	 2,57,000

Aug. 1	Debenture holders A/c To Cash & bank A/c (1,00,000 + 7,500) To Equity share capital A/c To Securities premium A/c (Being claims of debenture holders satisfied)		2,57,000	 1,07,500 30,000 1,20,000
Sept. 5	Securities premium A/c To Bonus to shareholders A/c (Being securities premium capitalized to issue bonus shares)		1,10,000	 1,10,000
Sept.12	Bonus to shareholders A/c To Equity share capital A/c (Being 55,000 fully paid equity shares of ₹ 2 each issued as bonus in ratio of 1 share for every 3 shares held)		1,10,000	 1,10,000
Sept.30	Securities Premium A/c To Premium on Redemption of Pref. Sh A/c (Being premium on preference shares adjusted from securities premium account)	Dr.	25,000	 25,000
Sept.30	Profit & Loss A/c To Interest on Debentures A/c (Being interest on debentures transferred to Profit and Loss Account).	Dr.	7,500	 7,500

Note : For capitalization of Bonus shares and transfer to CRR account any other free reserves given in the balance sheet may also be used.

B Ltd.

Balance Sheet as on 30th September, 2017

Equity and Liabilities			Notes	₹
1.	**Shareholder's funds**			
	(a) Share capital		1	4,40,000
	(b) Reserves and Surplus		2	13,32,00
2.	**Current liabilities**			
	(a) Trade Payables			1,70,000
		Total		**19,42,500**
Assets				
1.	**Non-current assets**			
	(a) Fixed assets			
	Tangible assets			7,80,000
	(b) Deferred tax asset			3,40,000
2.	**Current assets**			
	Trade receivables			6,20,000
	Cash and cash equivalents			2,02,500
		Total		**19,42,500**

Notes to accounts:

			₹	₹
1.	**Share Capital**			
	Authorized share capital			
	2,50,000 Equity shares of ₹ 2 each		5,00,000	
	10,000 Preference shares of ₹ 100 each Issued, subscribed and paid up		10,00,000	15,00,000
	2,20,000 Equity shares of ₹ 2 each			4,40,000
2.	**Reserves and Surplus**			
	Securities Premium A/c			
	Balance as per balance sheet		6,00,000	
	Add: Premium on equity shares issued			
	on conversion of debentures (15,000 x 8)		1,20,000	
			7,20,000	
	Less: Adjustment for premium on preference Shares		25,000	
	Balance			6,95,000
	Capital Redemption Reserve (5,00,000-1,10,000)			3,90,000
	General Reserve (6,50,000-5,00,000)			1,50,000
	Profit & Loss A/c		40,000	
	Add: Profit on sale of investment		65,000	
	Less: Interest on debentures		7,500	97,500
		Total		**13,32,500**

Working Notes:

		₹
1.	**Redemption of preference share:**	
	5,000 Preference shares of ₹ 100 each	5,00,000
	Premium on redemption @ 5%	25,000
	Amount Payable	5,25,000
2.	**Redemption of Debentures**	
	2,500 Debentures of ₹100 each	2,50,000
	Less: Cash option exercised by 40% holders	(1,00,000)
	Conversion option exercised by remaining 60%	
	Equity shares issued on conversion	1,50,000
	= 15,000 shares	
	Issue of Bonus Shares	
3.	Existing equity shares after split (30,000 x 5)	1,50,000 shares
	Equity shares issued on conversion	15,000 shares
	Equity shares entitled for bonus	1,65,000 shares
	Bonus shares (1 share for every 3 shares held) to be issued	55,000 shares
	Cash and Bank Balance	

4.	Balance as per balance sheet Add: Realization on sale of investment Less: Paid to preference share holders Paid to Debenture holders (7,500 + 1,00,000) Balance	2,80,000 5,55,000 8,35,000 (5,25,000) (1,07,500) 2,02,500
5.	Interest of ₹ 7,500 paid to debenture holders have been debited to Profit & Loss Account.	

21. X Ltd. issued 6% 1000 Debentures of ₹ 100 each at 5% Premium on 1.4.2012. The Debentures are redeemable at the end of 2016-17 at 10% premium as below :

***Either* by way of conversion into equity shares of ₹ 10 each at its market price of ₹ 12.50 per share.**

***Or* by payment in cash**

***Or* by conversion into 8% New Debentures at par.**

On 31-03-2017 the Debenture holders opted as below –

50% for conversion into Equity Shares, 30% for New Debentures and rest for cash.

Show necessary Journal entries in 2012-13 and in 2016-17 assuming that Debenture Interest is payable annually and the Debenture Redemption Reserve balance is ₹ 30,000.

Answer:

Journal entries:

Date	Particulars		Dr. (₹)	Cr. (₹)
1.4.12	Bank A/c To 6% Debenture A/c To Securities Premium A/c	Dr.	1,05,000	 1,00,000 5,000
31.3.13	Debenture Interest A/c To Bank A/c	Dr.	6,000	 6,000
	Profit & loss A/c To Debenture Interest A/c	Dr.	6,000	 6,000
31.3.17	Debenture Interest A/c To Bank A/c	Dr.	6,000	 6,000
	6% Debenture A/c Premium on Redemption of Deb A/c To Debenture Redemption or Debentureholders' A/c	Dr. Dr.	1,00,000 10,000	 1,10,000
	Profit & Loss A/c To Premium on Redemption of Deb A/c	Dr.	10,000	 10,000
	Debenture Redemption A/c To Equity Share Capital A/c [55,000/12.50=4400] To Securities Premium A/c [4400*2.50] To New Debenture A/c To Bank A/c	Dr.	1,10,000	 44,000 11,000 33,000 22,000
	Debenture Redemption Reserve A/c To General Reserve A/c	Dr.	30,000	 30,000

22. **Swastika Ltd. has issued 10,000 12% Debentures of ₹ 100 each on 1.4.2014. These Debentures are redeemable after 3 years at 5% premium. Interest is payable annually on March 31.**

On 1.10.15 it purchases 1500 own Debentures from the market at ₹ 98 (Cum. Int.). These are sold away on 30.6.16 at 105 (cum).

On 1.1.16it buys 1000 Own Debentures at 104 (cum) and cancelled on 30.06.16.

On 1.10.16 it buys 2000 own Debentures at ₹ 102 (ex-int) per Debenture for immediate cancellation.

Other Debentures are redeemed on 31.03.17.

Give necessary Journal entries for the years 2014-15, 2015-16 & 2016-17.

Answer:

Journal

Date	Particulars		Dr. (₹)	Cr.(₹)
1.4.14	Bank A/c	Dr.	10,00,000	
	To 12% Debenture A/c			10,00,000
31.3.15	Debenture Interest A/c	Dr.	120,000	
	To Bank A/c			120,000
	Profit & loss A/c	Dr.	120,000	
	To Debenture Interest A/c			120,000
	Profit & Loss A/c or Statement of Profit or Loss	Dr.	250,000	
	To Debenture Redemption Reserve A/c			250,000
	(25% of face value of debentures transferred to DRR) – assumed			
1.10.15	Own Debenture A/c	Dr.	138,000	
	Interest on Own Debenture A/c [1500*100*12%*6/12]		9,000	
	To Bank A/c [1500*98]			147,000
1.1.16	Own Debenture A/c	Dr.	95,000	
	Interest on Own Debenture A/c [1000*100*12%*9/12]	Dr.	9,000	
	To Bank A/c [1000*104]			1,04,000
31.3.16	Debenture Interest A/c [1000,000*12%]	Dr.	120,000	
	To Interest on Own Debenture A/c [2500*100*12%]			30,000
	To Bank A/c			90,000
	Profit & Loss A/c	Dr.	120,000	
	To Debenture Interest A/c			120,000
	Interest on Own Debenture A/c	Dr.	12,000	
	To Profit & Loss A/c [30,000-9,000-9,000]			12,000
30.6.16	Bank A/c [1500*105]	Dr.	157,500	
	To Own Debenture A/c [balance being ex-int amount]			153,000
	To Interest on Own Debenture A/c [150000*12%*3/12]			4,500
	Own Debenture A/c	Dr.	15,000	
	To Profit on Sale of Own Deb A/c [153000-138000]			15,000

	12% Debenture A/c	Dr.	100,000	
	To Own Debenture A/c (cost)			95,000
	To Profit on Cancellation A/c			5,000
	Debenture Interest A/c	Dr.	3,000	
	To Interest on Own Debenture A/c [100000×12%×3/12]			3,000
1.10.16	12% Debenture A/c	Dr.	200,000	
	Debenture Interest A/c [200000×12%×6/12]	Dr.	12,000	
	Loss on Cancellation A/c	Dr.	4,000	
	To Bank A/c [(2000×102)+12,000(interest)]			216,000
31.3.17	Debenture Interest A/c	Dr.	84,000	
	To Bank A/c [700,000×12%]			84,000
	12% Debenture A/c	Dr.	700,000	
	Premium on Redemption of Debenture A/c	Dr.	35,000	
	To Debenture Redemption A/c			735,000
	Profit & Loss A/c	Dr.	35,000	
	To Premium on Redemption of Debenture A/c			35,000
	Debenture Redemption A/c	Dr.	735,000	
	To Bank A/c			735,000
	Profit on Cancellation A/c	Dr.	5,000	
	To Loss on Cancellation A/c			4,000
	To Capital Reserve A/c			1,000
	Profit on Sale of Own Deb A/c	Dr.	15,000	
	To Profit & Loss A/c			15,000
	Profit & Loss A/c	Dr.	99,000	
	To Debenture Interest A/c			99,000
	Interest on Own Debenture A/c	Dr.	7,500	
	To Profit & Loss A/c			7,500
	Debenture Redemption Reserve A/c	Dr.	250,000	
	To General Reserve A/c			250,000

23. The Liabilities and Assets of X Ltd. as on 31.03.17 are presented as below :

Eq. Share Cap. (₹ 10)	**5,00,000**	**Fixed Assets**	**12,00,000**
Capital Reserve	**20,000**	**Current Assets**	**4,20,000**
General Reserve	**2,00,000**	**Investment in Own Deb**	
Profit & Loss A/c.	**3,50,000**	**(F.V. ₹ 1,00,000)**	**85,000**
Debenture Redemption Reserve	**1,00,000**		
6% Debentures	**4,00,000**	**Cash at Bank**	**87,000**
Accrued Deb. Int. (6 months)	**12,000**		
Creditors	**2,10,000**		
	17,92,000		**17,92,000**

The 6% Debentures are due for redemption on 31.03.17 at a premium of 5%. The Co. decided –

(i) to issue 25000 Eq. Shares of ₹ 10 each at ₹ 15 per share.

(ii) to redeem the Debentures together with interest due for last 6 months.

(iii) to give the Debenture holders an option to receive either cash in repayment or new 6% Debs. at par. The holders of ₹ 1,00,000 of the Old Debentures accepted new Debentures. The Debentures which the company held as an investment were cancelled.

***Note:* Interest on own debenture as held by the company not yet adjusted in the books of account.**

Give the necessary Journal entries and the Balance Sheet of the Co. on 1.4.17 after redemption.

Answer:

Journal

Date	Particulars		Dr.(₹)	Cr. (₹)
	Bank A/c	Dr.	375,000	
	To Equity Share Capital a/c			250,000
	To Securities Premium A/c			125,000
	Accrued Debenture Interest A/c	Dr.	12,000	
	To Profit & Loss A/c (interest on own debenture)			3,000
	To Bank A/c			9,000
	6% Debenture A/c	Dr.	100,000	
	To Own Debenture A/c			85,000
	To Capital Reserve A/c (profit on cancellation)			15,000
	6% Debenture A/c	Dr.	300,000	
	Securities Premium A/c (premium on redemption)	Dr.	15,000	
	To Debenture Redemption A/c			315,000
	Debenture Redemption A/c	Dr.	315,000	
	To 6% New Debenture A/c			105,000
	To Bank A/c			210,000
	Debenture Redemption Reserve A/c	Dr.	100,000	
	To General Reserve A/c			100,000

X Ltd.

Balance Sheet as at 01-04- 2017

Equity and Liabilities			Notes	₹
1.	**Shareholder's funds**			
	(a) Share capital			750,000
	(b) Reserves and Surplus			798,000
2.	**Non-Current liabilities**			105,000
	Long-term Borrowing (New Debenture)			
	Current liabilities			210,000
	(a) Trade Payables	**Total**		**1863,000**
Assets				
1.	**Non-current assets**			
	(a) Fixed assets			
	Tangible assets			1200,000
2.	**Current assets**			
	Sundry Current Assets			420,000
	Cash and cash equivalents			243,000
	[87,000+375,000-9,000-210,000]	**Total**		**1863,000**

Note on Reserve & Surplus

Securities Premium [125,000-15,000]		110,000
Capital Reserve: Balance	20,000	
Add. Profit on cancellation	15,000	35,000
General reserve: Balance	200,000	
Add. Transfer from DRR	100,000	300,000
Profit and Loss : Balance	350,000	
Add. Interest on own debenture	3,000	353,000
		798,000

24. The summarized financial position of Exchange Ltd. as on 31.3.17 stood as follows :

Eq. Sh. Cap. (₹ 10)	**50,00,000**	**Fixed Assets**	**1,60,00,000**
General Reserve	**75,00,000**	**Deb. Red. Fund Invest**	**40,00,000**
Deb. Red. Fund	**50,00,000**	**Cash & Bank**	**50,00,000**
13.5% Convertible		**Other current assets**	**2,00,00,000**
Deb (₹ 100)	**1,00,00,000**		
Other Loans	**50,00,000**		
Current Liab. & Provs.	**1,25,00,000**		
	4,50,00,000		**4,50,00,000**

The Debentures are due for redemption on 1.4.17. The terms of issue of Debentures provided that they were redeemable at a premium of 5% and also conferred option to the Debenture holders to convert 20% of their holding into equity shares at a predetermined price of ₹ 15.75 per share and the payment in cash.

Assuming that :

(i) except for 100 Deb holders holding totally 25,000 Debs., the rest of them exercised the option for maximum conversion.

(ii) the investments realise ₹ 44 lakhs on sale; and

(iii) all the transactions are put through, without any lag on 1.4.17.

Redraft the Balance Sheet of the Co. as on 1.4.17 after giving effect to the redemption.

Show your calculations in respect of the number of equity shares to be allotted and the cash payment necessary.

Answer:

Working notes:

(a) Profit on sale of Fund Investment = 4400,000 – 4000,000 = 400,000

(b) Debenture Redemption Fund and transfer to General Reserve:

Balance given	5000,000
Less. Premium on redemption of debenture	(500,000)
Add. Profit on sale of Fund Investment	400,000
Balance after redemption transferred to General Reserve	49,00,000

(c) Equity shares issued and cash paid:

		Conversion	Cash (for balance)
Face value of debentures redeemed	10000,000		
Premium on redemption	500,000		(10500,000-1575,000) =
	10500,000		
Value for which conversion opted [(100,000-25,000)*20%*105]		1575,000	8925,000
Number of equity shares issued (1575,000/15.75)		100,000	

Exchange Ltd.

Balance Sheet as at 01-04- 2017

Equity and Liabilities			Notes	₹
1.	**Shareholder's funds**			
	(a) Share capital			60,00,000
	(b) Reserves and Surplus [(75+49+5.75)L]			129,75,000
2.	**Non-Current liabilities**			
	Long-term Borrowing (Loans)			50,00,000
	Current liabilities			125,00,000
		Total		**364,75,000**
Assets				
1.	**Non-current assets**			
	(a) Fixed assets			
	Tangible assets			160,00,000
	Current assets			
2.	Sundry Current Assets			200,00,000
	Cash and cash equivalents[(50+44-89.25)L]			4,75,000
		Total		**364,75,000**

25. **On 1st July 2014, ND Limited issued 10,000 6% Debentures of Rs 150 each at par, the interest being payable half-yearly on 1st January and 1st July.**

According to the terms of the issue the debenture-holders had the option of getting the debentures converted into equity shares of Rs 100 each at a premium of Rs 50 each on 1st January, 2017. The company had the right to buy at any time its debentures in the open market for cancellation.

On 1st May 2015 the company purchased 1,000 debentures at Rs 148 cum-interest and on 1st November 2016 it purchased 1,500 debentures at Rs 146 ex-interest; the debentures being cancelled immediately in both the cases. On 1st January, 2016 holders of 4,000 debentures exercised their option getting their debentures converted into equity shares.

The company closed its books of account every year on 31st March. You are required to show journal entries for all the transactions relating to debentures during 2014-15, 2015-16 and 2016-17.

Answer:

Journal

Date	Particulars		Dr. (₹)	CR.(₹)
1.7.14	Bank A/c	Dr	15,00,000	
	To 6% Debenture A/c			15,00,000
1.1.15	Debenture Interest A/c	Dr.	45,000	
	To Bank A/c [int for 6 months =15,00,000*6%*6/12]			45,000
31.3.15	Debenture Interest A/c		22,500	
	To Accrued Interest A/c [3 months =15,00,000*6%*3/12]			22,500
	Profit & Loss A/c	Dr.	67,500	
	To Debenture Interest A/c (transfer to P/L)			67,500
	Profit & Loss A/c	Dr.	3,75,000	
	To Debenture Redemption Reserve A/c			3,75,000
	-created equivalent to 25% of FV of Debentures(assumed)			
1.4.15	Accrued Interest A/c	Dr.	22,500	
	To Debenture Interest A/c (reversal of last year's closing accrued)			22,500
1.5.15	6% Debenture A/c [1000×150]	Dr.	1,50,000	
	Debenture Interest A/c [150,000×6%×1/12]	Dr.	750	
	To Bank A/c [1000×148]			1,48,000
	To Profit on Cancellation A/c			2,750
1.7.15	Debenture Interest A/c	Dr.	40,500	
	To Bank A/c [int for 6 months = 9,000×150×6%×6/12]			40,500
1.1.16	Debenture Interest A/c	Dr.	40,500	
	To Bank A/c [int for 6 months = 9,000×150×6%×6/12]			40,500
31.3.16	Debenture Interest A/c	Dr.	20,250	
	To Accrued Interest A/c [3 months = 9,000×150×6%×3/12]			20,250
	Profit & Loss A/c	Dr.	77,750	
	To Debenture Interest A/c (transfer to P/L)			77,750
	Profit on Cancellation A/c	Dr.	2,750	
	To Capital Reserve A/c (transfer)			2,750

1.4.16	Accrued Interest A/c To Debenture Interest A/c (reversal of last year's closing accrued)	Dr.	20,250	20,250
1.7.16	Debenture Interest A/c To Bank A/c [int for 6 months = 9,000×150×6%×6/12]	Dr.	20,500	20,500
1.11.16	6% Debenture A/c [1500×150] Debenture Interest A/c [2,25,000×6%×4/12] To Bank A/c [(1500×146)+4,500] To Profit on Cancellation A/c	Dr. Dr.	2,25,000 4,500	2,23,500 6,000
1.1.17	Debenture Interest A/c To Bank A/c [int for 6 months = 7,500×150×6%×6/12]	Dr.	33,750	33,750
1.1.17	6% Debenture A/c [4000×150] To Equity Share Capital A/c [4,000×100] To Securities Premium A/c [4,000×50] - conversion as per option	Dr.	6,00,000	4,00,000 2,00,000
	6% Debenture A/c [3,500×150] To Debenture Redemption A/c [3,500×150] Payable in cash on redemption	Dr.	5,25,000	5,25,000
	Debenture Redemption A/c To Bank A/c	Dr.	5,25,000	5,25,000
	Profit & Loss A/c To Debenture Interest A/c (transfer to P/L)	Dr.	38,750	38,750
	Profit on Cancellation A/c To Capital Reserve A/c (transfer)	Dr.	6,000	6,000
	Debenture Redemption Reserve A/c To General Reserve A/c	Dr.	3,75,000	3,75,000

UNDERWRITING

26. C Ltd. came out with an issue of 45,00,000 equity shares of ₹10 each at a premium of ₹2 per share. The promoters took 20% of the issue and the balance was offered to the public. The issue was equally underwritten by A & Go; B & Co. and C &.Co.

Each underwriter took firm underwriting of 1,00,000 shares each. Subscriptions for 31,00,000 equity hares were received with marked forms for the underwriters as given below:

A & Co	**7,25,000**	**shares**
B & Co.	**8,40,000**	**shares**
C & Co.	**13,10,000**	**shares**
Total	**28,75,000**	**shares**

The underwriters are eligible for a commission of 5% on face value of shares. The entire amount towards shares subscription has to be paid along with application.

You are required to:

(a) Compute the underwriters liability (number of shares)

(b) Compute the amounts payable or due to underwriters; and

(c) Pass necessary Journal entries in the books of C Ltd. relating to underwriting.

Answer:

Particulars	A & Co. (₹)	B & Co. (₹)	C & Co. (₹)
Gross Liability	12,00,000	12,00,000	12,00,000
Less: Firm Underwriting	(1,00,000)	(1,00,000)	(1,00,000)
	11,00,000	11,00,000	11,00,000
Less: Marked Application	(7,25,000)	(8,40,000)	(13,10,000)
	3,75,000	2,60,000	(2,10,000)
Less: Unmarked Application (In Gross Liability Ratio)	(75,000)	(75,000)	(75,000)
	3,00,000	1,85,000	(2,85,000)
Less: Surplus of C & Co. transfer to A & Co. & B & Co. in Gross Liability Ratio	(1,42,500)	(1,42,500)	2,85,000
∴ Net Liabilities	1,57,500	42,500	—
Add: Firm underwriting	1,00,000	1,00,000	1,00,000
∴ Total Liabilities	2,57,500	1,42,500	1,00,000

Total subscriptions received for 31,00,000 shares out of which marked shares were 28,75,000. Hence unmarked shares received were 2,25,000 shares which will be distributed between A & Co and B & Co only equally (agreed ratio underwriting).

No of shares purchased by Underwriters collectively will be 5 Lakh shares as under:

Total Shares Issued	45,00,000
Less: Purchased by Promoters etc.	9.00.000
Shares offered to the Public	36,00,000
Total Subscription received	31,00.000
Shares purchased by Underwriters including firm commitment	5,00.000

When Calculation of Amount Receivable & Payable to Underwriters

Gross Liability (12,00,000 Shares @ ₹ 10)	1,20,00,000	1,20,00,000	1,20,00,000
Amount Receivable @ 12 per share (A) Commission Payable (5% on 12 lakhs shares @ 10 ₹ each) (B)	30,90,000 (6,00, 000)	17,10,000 (6,00,000)	12,00,000 (6,00,000)
∴ Net Amount Receivable (A – B)	24,90,000	11,10,000	6,00,000

Journal

	Particulars		L.F	Dr. (₹)	Cr. (₹)
1.	Underwriting Commission A/c	Dr.		18,00,000	
	To A & Co. A/c				6,00,000
	To B & Co. A/c				6,00,000
	To C & Co. A/c				6,00,000
	(Being underwriting commission on the shares under written equally)				
2.	A & Co. No	Dr.		30,90,000	
	B & Co. A/c	Dr.		17,10,000	
	C & Co. A/c	Dr.		12,00,000	
	To Equity Share Capital A/c				50,00,000
	To Securities Premium A/c				10,00,000
	(Being shares & firm underwritten shares allotted to the underwriters)				
3.	Bank A/c	Dr.		42,00,000	
	To A & Co. A/c				24,90, 000
	To B & Co. A/c				11,10,000
	To C & Co. A/c				6,00,000
	(Being the amount received towards shares allotted to underwriting after deducting underwriting commission due to them)				

27. B. Ltd. issued 50,00,000 Equity shares of ₹ 10 each. The whole issue was underwritten by A, B and C as below:

A	**15,00,000 shares**
B	**25,00,000 shares**
C	**10,00,000 shares**

Applications were received for 48,50,000 shares of which the marked applications were as follows:

A	**12,00,000 shares**
B	**25,00,000 shares**
C	**08,50,000 shares**

Calculate the number of shares to be taken up by the underwriters.

Answer:

Statement of Net Liabilities of Underwriters

Particulars	A	B	C	Total
Gross Liability (3:5:2) Less: Marked applications	15.00,000 12,00,000	25,00,000 25,00,000	10,00,000 8,50,000	50,00,000 45,50,000
	3,00,000	Nil	1,50,000	4,50,000
Loss: Unmarked Applications* in 3:5:2 ratio	90,000	1,50,000	60,000	3,00000
 Less: Surplus of B allocated to A 8 C in 3 : 2 ratio	2,10,000 90,000	(1,50,000) 1,50,000	90,000 60,000	1,50,000 1,50,000
Number of shares to be taken up by the underwriters (Net liability)	1.20,000	Nil	30,000	

Unmarked Application = Total Application received - Marked

Application 48,50,000 - 45,50,000 = 3,00,000.

28. A Company entered into an underwriting agreement with Mr. B for 60% of the issue of ₹50,00,000, 15% debentures, with a firm underwriting of ₹5,00,000. Marked applications were in respect of debentures worth ₹35,00,000. Compute liability of Mr. B and commission payable to him.

Answer:

Gross Liability (₹ 50,00,000 x 60%)	30,00,000
Less: Marked applications ₹35,00,000 which is more than the Liability but credit will not be given more than gross liability,	30,00,000
Net liability	NIL
Add: Firm underwriting	5,00.000
Total liability	5,00,000
Calculation of underwriting commission = 30,00,000 x2.5/100 = ₹ 75,000	
Underwriting Commission payable @ 2.5%	₹ 75,000

29. ABC Ltd. came up with public issue of 3,00,000 Equity Shares of ₹15 per share. P, Q and R took underwriting of the issue in ratio of 3: 2 : 1 with the provisions of firm underwriting of 20,000, 14,000 and 10,000 shares respectively.

Applications were received for 2,40,000 shares excluding firm underwriting.

The marked applications from public were received as under:

P — 60,000

Q — 50,000

R — 60,000

Compute the liability of each underwriter as regards the number of shares to be taken up assuming that the benefit of firm underwriting is not given to individual underwriters.

Answer:

Calculation of liability of each underwriter (in shares) assuming that the benefit of firm underwriting is

	P	Q	R	Total
Gross Liability	1,50,000	1,00,000	50,000	3,00,000
Less: Marked applications(excluding firm underwriting)	(60,000)	(50,000)	(60,000)	(1,70,000)
Balance	90,000	50,000	(10,000)	1,30,000
Less: Surplus of R allocated to P and Q in the ratio of 3:2	(6,000)	(4,000)	10,000	-
Balance	84,000	46,000	-	1,30,000
Less: Unmarked applications inclu. firm underwriting (W.N.)	(57,000)	(38,000)	(19,000)	(1,14,000)
Net Liability	27,000	8,000	(19,000)	16,000
Less: Surplus of R allocated to P and Q in the ratio of 3:2	(11,400)	(7,600)	(19,000)	-----
	15,600	400	---	16,000
Add: Firm underwriting	20,000	14,000	10,000	44,000
Total Liability	35,600	14,400	10,000	60,000

Working Note:

Applications received from public	2,40,000 shares
Add: Shares underwritten firm (20,000 + 14,000 + 10,000)	44,000 shares
Total applications	2,84,000 shares
Less: Marked applications (60,000 + 50,000 + 60,000)	(1.70,000 shares)
Unmarked applications including firm underwriting	1,14,000 shares

30. A company issued 1,50,000 shares of ₹10 each at a premium of ₹10. This was underwritten- as follows:

X — 90000 shares (Firm underwriting 12000 shares)

Y — 37500 shares (Firm underwriting 4500 shares)

Z — 22500 shares (Firm underwriting 15000 shares)

Total subscriptions received by the company (excluding firm underwriting and marked applications) were 22500 shares.

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

X — 15000 shares ; Y — 30000 shares and Z— 7500 shares

Commission payable to underwriters is at 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 amounts payable or due from underwriters; and

(iii) Pass Journal Entries in the books of the company relating to underwriters.

Answer:

(i) Calculation of Total Liability of Underwriters

Particulars	(In Shares)			
	X	Y	Z	Total
Gross liability	90,000	37,500	22,500	1,50,000
Les: Marked applications (excluding firm underwriting)	(15.000)	(30.000)	(7,500)	(52.500)
	75,000	7,500	15,000	97,500
Less: Unmarked applications in the ratio of gross liabilities of 12:5:3 (excluding firm underwriting)	(13,500)	(5,625)	(3,375)	(22,500)
	61,500	1,875	11,625	75,000
Less: Firm underwriting	(12,000)	(4.500)	(15,000)	(31,500)
	49,500	(2,625)	(3,375)	43,500
Less: Surplus of Y and Z adjusted in X's balance (2,625 + 3,375)	(6,000)	2,625	3,375	
Net liability	43,500	Nil	Nil	43,500
Add: Firm underwriting	12,000	4,500	15.000	31,500
Total liability	55,500	4,500	15,000	75,000

(ii) Calculation of amount payable to or due from underwriters

Particulars	X	Y	Z	Total
Total Liability in shares	55,500	4,500	15,000	75,000
Amount receivable @ ₹ 20 from underwriter (in ₹)	11,10,000	90,000	3,00,000	15,00,000
Less: Underwriting Commission payable @ 5% of 20 (in ₹)	(90,000)	(37,500)	(22,500)	(1,50,000)
Net amount receivable (in ₹)	10,20,000	52,500	2,77,500	13,50,000

(iii) **Books of the Company**

Journal

	Particulars		Dr. (₹)	Cr. (₹)
1.	X A/c	Dr.	11,10,000	
	Y A/c	Dr.	90,000	
	Z A/c	Dr.	3,00,000	
	To Share Capital A/c			7,50,000
	To Securities Premium Ale			7,50,000
	(Being allotment of shares to underwriters)			
2.	Underwriting commission A/c	Dr.	1,50,000	
	To X A/c			90,000
	To Y A/c			37500
	To Z A/c			22,500
	(Being amount of underwriting commission payable)			

3.	Bank A/c To X A/c To Y A/c To Z A/c (Being net amount received by underwriters for shares allotted less underwriting commission)		13,50,000	 10,20,000 52,500 2,77,500

31. (a) What are provisions for issuing Sweat Equity Shares?

(b) When buy back of shares is permissible?

Answer:

(a) As per section 53 of the Companies Act, a company may issue sweat equity shares of a class of shares already issued, if the following conditions are fulfilled, namely:—

(i) the issue is authorised by a special resolution passed by the company;

(ii) the resolution specifies the number of shares, the current market price, consideration, if any, and the class or classes of directors or employees to whom such equity shares are to be issued;

(iii) not less than one year has, at the date of such issue, elapsed since the date on which the company had commenced business; and

(iv) where the equity shares of the company are listed on a recognised stock exchange, the sweat equity shares are issued in accordance with the regulations made by the Securities and Exchange Board in this behalf and if they are not so listed, the sweat equity shares are issued in accordance with such rules as may be prescribed.

The rights, limitations, restrictions and provisions as are for the time being applicable to equity shares shall be applicable to the sweat equity shares issued under this section and the holders of such shares shall rank pari passu with other equity shareholders.

(b) Buy-back is permissible:

(A) From the existing security holders on a proportionate basis through the tender offer; or

(B) From the open market through

(i) Book-building process,

(ii) Stock exchange;

(C) From odd lots, that is to say, where the lot of securities of a public company whose shares are listed on a recognized stock exchange is smaller than such marketable lot as may be specified by the stock exchange: or

(D) by purchasing the securities issued to employees of the company pursuant to a scheme of stock option or sweat equity.

Study Note – 2

PRESENTATION OF FINANCIAL STATEMENTS (As per Schedule III)

Learning Objective: *Presentation of Financial Statements as per Schedule III*

Fill in the blanks of the followings:

1. Loss on Foreign Currency Transactions and Translation should be considered as expenses under the heads of ________ in the statement of P/L
2. Net Gain/Loss on Sale of Investments should be considered as income under the heads of ________ in the statement of P/L
3. A Company shall disclose as additional information by way of Notes, additional information regarding the Aggregate Expenditure and Income items which exceeds ____ of Revenue from Operations or ________ whichever is higher
4. ________ is a Reserve of a Corporate Enterprise which is not available for distribution as Dividend.
5. ________ is a Reserve created on the revaluation of Assets or Net Assets of an Enterprise represented by the surplus of the estimated Replacement Cost or estimated market values over the Book Values thereof.
6. For "Equity and Liabilities" items list of Shareholders holding ________ shares as on the Balance Sheet Date should be disclosed separately.
7. If the Company's Issued Capital is more than the Authorized Capital, and approval of increase in Authorized Capital is pending, the amount of Share Application Money received over and above the Authorized Capital should be shown under the head ________ .

Answer:

1. Finance Costs
2. Other Income
3. 1%, ₹ 1,00,000
4. Capital Rserve
5. Revaluation Reserve
6. more than 5%
7. "Other Current Liabilities"

Answer the following questions:

1. How the assets are disclosed in the Balance Sheet as per schedule III.

Answer:

As per schedule III, the assets in the balance sheet are disclosed as follows.

(i) Non Current Assets:

(a) Fixed Assets

(i) Tangible Assets

(ii) Intangible Assets

(iii) Capital WIP

(iv) Intangible assets under development

(b) Non-Current Investments

(c) Deferred Tax Asset (net)

(d) Long term Loans and Advances

(e) Other Non-Current assets

(ii) Current Assets:

(a) Current Investments

(b) Inventories

(c) Trade Receivables

(d) Cash and Cash equivalents

(e) Short term loans & Advances

(f) Other Current Assets

2. How do you disclose shareholder's fund in the balance as per schedule III ?

Answer:

As per schedule III, the shareholder's fund are disclosed as follows:-

(a) Share Capital

(b) Reserves and Surplus

(c) Money Received against share warranty

3. How the liabilities are disclosed in the balance sheet as per schedule III?

Answer:

As per schedule III, the liabilities in the balance sheet are disclosed as follows.

I. Non-Current Liabilities

a. Long-term borrowings

b. Deferred Tax liabilities(net)

c. Other Long Term Liabilities

d. Long-term Provision

II. Current liabilities

a. Short term borrowings

b. Trade Payables

c. Other Current Liabilities

d. Short term Provisions

4. From which year the schedule III is applicable and for which companies?

Answer:

Schedule III is mandatorily applicable for all listed companies w.e.f. 1st April 2014.

5. How do you identify current assets for the purpose of schedule III ?

Answer:

An asset may be considered as current asset it fulfills the following condition.

(i) It is expected to be realized or is intended for sale or consumption in the company's normal operating cycle.

(ii) It is held primarily for the purpose of being traded.

(iii) It is expected to the realized within 12 months after reporting date.

(iii) It is cash or cash equivalent unless it is restricted from being exchanged or used to settle a liability for at least 12 months after the reporting date.

6. How do you classify a liability as current liability for the purpose of schedule III?

Answer:

A current liability should satisfy the following condition for the purpose of schedule III.

(i) It is expected to be settled in the company's normal operating cycle.

(ii) It is held primarily for the purpose of being traded.

(iii) It is due to be settled within 12 month after the reporting date.

(iv) The company does not have an unconditional right to defer settlement of the liability for at least 12 months after the reporting date.

7. How the debit balance in the statement of Profit and Loss is disclosed in the balance sheet?

Answer:

The debit balance in the statement of Profit and Loss is to be shown as a negative figure under the head "surplus". The aggregate amount of the balance of Reserve and Surplus is to be shown (after adjusting the negative balance of surplus, if any) under Shareholders' Fund even if the net result is negative.

8. How do you disclose "Cash Unpaid" by subscribers of MoA?

Answer:

Unpaid amount towards shares subscribed by the subscribers of Memorandum of Association should be considered as subscribed and paid up capital in the balance sheet and debts due from the subscribers should be disclosed as an asset in the balance sheet.

9. How do you disclose "Total Revenue" in the Profit and Loss statement?

Answer:

For a company other a Finance company, the Total Revenue is disclosed as

(i) Revenue from operation

(ii) Other Income

"Revenue from operation shall disclose separately in the Notes as Revenue from-

(a) Sale of Products

(b) Sale of Services

(c) Other operating Revenues

(d) Excise duty (to be deducted)

"Other Income" Shall disclose separately in the Note as.

(a) Interest Income

(b) Dividend Income

(c) Net gain / loss as sale of investment

(d) Other non-operating income.

10. How the Contingent liability is shown?

Answer:

Contingent liabilities are those liabilities which may or may not arise because they are dependent on a happening in future. It is not recorded in the books of accounts but is disclosed in the " Notes to Accounts" for the information of the users.

11. Describe the items which are generally disclosed under Inventories as per schedule III.

Answer:

The following items are generally disclosed under "Inventories" in the Balance Sheet.

i. Raw materials

ii. Wash-in-progress

iii. Finished goods

iv. Stock in trade

v. Stares & spares

vi. Loose tolls

12. What is the purpose of schedule III?

Answer:

Section 129 of the Companies Act 2013 requires the company to prepare its financial statements every year in prescribed form i.e. schedule III of the Companies Act 2013.

As per section 2(40) of the companies Act 2013, financial statements include.

i. Balance sheet

ii. Statement of Profit and Loss i.e. income statement

iii. Notes to Accounts

iv. Cash Flow Statement

13. State under which major headings the following items will be presented in the balance sheet as per schedule III.

Answer:

i. Trade marks

ii. Capital Redemption Reserve

iii. Office equipments

iv. Long term borrowings

v. Proposed dividend

vi. Calls in Advance

vii. Computer software

viii. Interest on call in advance

Items	Major heads
(a) Trade Mark	i. Non current Assets
(b) Capital Redemption Reserve	ii. Shareholders' Fund
(c) Office equipments	iii. Non – Current Assets
(d) Long term borrowings	iv. Non – Current Liabilities
(e) Proposed dividend	v. Current Liabilities
(f) Call in Advance	vi. Current Liabilities
(g) Computer Software	vii. Non-Current Assets (Intangible)
(h) Interest on Calls in Advance	viii. Current liabilities

14. How the floating assets are dealt with?

Answer:

Floating assets mean those current assets that are manufactured or purchased during the normal course of business. They are held for a shorter period and may be converted into cash within a year. Hence they will be disclosed accordingly.

e.g. finished goods. W-I-P Raw material, Sundry Debtors, Sundry Receivables.

15. What is meant by operating cycle?

Answer:

The operating cycle of an entity is the time between the acquisition of assets for processing and their realization in cash or cash equivalents. When the entity's normal operating cycle is not clearly identifiable it is assumed to be twelve months.

Operating cycle can be more than 12 months. An asset can be current even if it is realized after 12 months if it is realizable within the operating cycle. Operating cycle is the length of time that a company takes to convert its inventory purchase to sale revenue.

16. How the Capital Redemption Reserve A/c. is created?

Answer:

The Capital Redemption Reserve is required to be created in the following two case.

(i) As per section 55 of the Companies Act 2013, where the redemption of preference shares is out of profits, an amount equal to nominal value of share redeemed out of such profit is to be transferred to a reserve called capital redemption reserve.

(ii) Under section 69 of the Act, if the buy back of shares is out of free reserves, the nominal value of the share so purchased is required to be transferred to capital redemption Reserve from distributable profit.

17. What is debenture redemption reserve?

Answer:

According to section 71 of the companies Act 2013 where a company issues debenture, it is required to create a debenture redemption reserve for the redemption of such debentures. The company is required to credit adequate amounts out of its profits every year to debenture redemption reserve, until such debentures are redeemed.

On redemption of the debentures for which the reserve is created, the amount no longer necessary to be retained in this account need to be transferred to the General Reserve.

18. How do you disclose about the FOREX Information in the P/L A/c as per schedule III reporting?

Answer:

FOREX Information**:** The P&L A/c shall also contain by way of a Note the following Information, namely –

(a) Value of Imports Calculated on CIF basis by the Company during the Financial Year in respect of – (I) Raw Materials, (II) Components and Spare Parts, (III) Capital Goods,

(b) Expenditure in Foreign Currency during the Financial Year on account of Royalty, Know-How, Professional and Consultation Fees, Interest, and Other Matters,

(c) Total Value if all Imported Raw Materials, Spare Parts and Components consumed during the Financial Year and the Total Value of all Indigenous Raw Materials, Spare Parts and Components similarly consumed and the Percentage of each to the Total Consumption,

(d) Amount remitted during the year in Foreign Currencies on account of Dividends with a specific mention of the total number of Non-Resident Shareholders, the Total Number of Shares held by them on which the Dividends were due and the year to which the Dividends related.

(e) Earnings in Foreign Exchange classified under the following heads, namely-

- Export of Goods calculated on FOB Basis,
- Royalty, Know-How, Professional & Consultation Fees,
- Interest and Dividend,
- Other Income, indicating the nature thereof.

19. What is the disclosure requirement regarding shares held by its Holding Company?

Answer:

Shares held in the Company held by its Holding Company or its ultimate Holding Company including Shares held by or by Subsidiaries or Associates of the Holding Company or the ultimate Holding Company in aggregate should disclose number of Shares held by the entire chain of Subsidiaries and Associates starting from the Holding Company and ending right up to the Ultimate Holding Company.

All such disclosures should be made separately representing for each class of Shares, (for both Equity and Preference Shares)

20. What do you understand about Deferred Payment Liabilities?

Answer:

Deferred Payment Liabilities would include any liability for which payment is to be made on deferred credit terms, e.g. Deferred Sales Tax Liability, Deferred Payment for Acquisition of fixed Assets, etc.

21. What is Trade Investment?

Answer:

"Trade Investment" is normally understood as an Investment made by a Company in Shares or Debentures of another Company, to promote the trade or business of the first Company.

22. How do you disclose the following items in the balance sheet?

Trade Receivable ₹5,00,000, Out of which 10% is considered as doubtful. Provision for doubtful receivable being ₹75000.

Answer:

The amount of Trade Receivable would be shown as follows-

Notes to Financial Statements :

Trade Receivable :

Considered good	4,50,000
Doubtful (10%)	50,000
	5,00,000
Provision for Doubtful Receivable	75,000
	4,25,000

Trade Receivable - ₹ 4,25,000

To be shown in the Balance Sheet under the head Current Assets.

N.B. Aggregate amount of Trade Receivable outstanding for a period exceeding six months from the date they are due for payment should be separately stated.

23. Z Ltd took a loan of ₹ 40,00,000 at 12% p.a. interest on 01-09-2016 on the terms that it will be repaid in 5 equal half-yearly instalments starting from August 31, 2017. State how the loan should be classified for the purpose of Balance Sheet as at 31-03-2017 as per Schedule III.

Answer:

Date of payment	Amount payable	Whether Current or Non-current
31-08-2017	8,00,000	Due within 12 months from the reporting date 31-03-2017. So, 16,00,000 should be classified as Current Liability.
28-02-2018	8,00,000	
31-08-2018	8,00,000	Due after 12 months from the reporting date 31-03-2017. Therefore, 24,00,000 should be classified as Non-Current Liability.
28-02-2019	8,00,000	
31-08-2019	8,00,000	

24. While preparing the Balance Sheet as on 31-03-2017, the Accountant of A.Ltd is confused regarding classification of following Trade Payables into current and non-current.

Sl No.	Amount due (₹)	Due from	To be settled on
1	**1,60,000**	**01-06-2016**	**18-12-2017**
2	**2,10,000**	**01-08-2016**	**30-10-2018**
3	**90,000**	**01-12-2016**	**20-07-2018**
4	**40,000**	**01-02-2016**	**30-04-2018**
5	**2,30,000**	**06-03-2017**	**05-07-2018**
6	**5,60,000**	**12-09-2016**	**31-07-2017**

The normal operating cycle of the company is 15 months. Advise the Accountant on classification with reason.

Answer:

Sl No.	Amount due (₹)	15 months from the reporting date 31-03-2017	Date of settlement	Whether on/before 30-06-2018	Whether Current or Non-current
1	1,60,000	**30-06-2018**	18-12-2017	Before	Current
2	2,10,000		30-10-2018	After	Non-Current
3	90,000		20-07-2018	After	Non-Current
4	40,000		30-04-2018	Before	Current
5	2,30,000		05-07-2018	After	Non-Current
6	5,60,000		31-07-2017	Before	Current

25. **Example on Income Statement:**

Following information has been extracted from the books of a company. You are required to prepare the Statement of Profit and Loss for the year.

(₹ in lakhs)

Opening inventory:		Factory rent	90
Stock of goods	25	Sundry other expenses	20
Raw materials	100	Repairs	40
Semi finished goods	20	Contribution to PF	30
Finished goods	115	Staff welfare exps	80
Purchase of:		Bonus to employees	100
Raw materials	840	Loss on sale of machine	10
Stock of goods	320	Sales revenue	3200
Freight inward:		Other income	150
Raw materials	30	Interest:	
Stock of goods	10	on debenture	50
Transit insurance on raw materials	20	on overdraft	20
Delivery exps/Freight outward	40	on other borrowing	10
Bad debt	10	Office rent	40
Salaries & Wages	280	Administration expenses	70
Salary to salesmen	110	Extraordinary losses	30
Dividend paid	10	Dividend distribution tax paid	1.5

Following points are to be taken into account:

(1) Closing Inventory:

Raw material	80
Stock of goods	15
Semi finished goods	30
Finished goods	105

(2) Depreciation to be charged : on Building 5%; Plant & Machinery 30% and Furniture 10% WDV are - Building 200; Plant & Machinery 300; and Furniture 100

(3) Patent right to be amortised 50

(4) Expenses yet to be paid: Factory rent 20 and Audit fees 10

(5) Rate of Income tax 40%

Now also show the Note on Reserve and Surplus taking into account the following information:

General Reserve	**90**
Development reserve	**50**
Securities premium	**30**
P/L (1-4)	**140**

The company decided to -

transfer 10% of profit to general reserve

Last year's tax is assessed at 130, whereas the provision was for 120.

Answer:

Statement of Profit & Loss for the year ended ………………….. ₹

I	**Revenue from Operation**		3200
II	**Other Income**		150
III	**Total Revenue**		3350
IV	**Expenses:**		
	Cost of materials consumed	1	910
	Purchases of Stock-in-Trade		320
	Changes in inventories of finished goods		0
	work-in-progress and Stock-in-Trade	2	10
	Employee benefits expense	3	600
	Finance costs	4	80
	Depreciation and amortization expense	5	160
	Other expenses	6	310
	Total expenses		2390
V	**Profit before exceptional and extraordinary**		
	items and tax (III-IV)		960
VI	**Exceptional items- loss on sale of machine**		-10
VII	**Profit before extraordinary items and tax (V - VI)**		950
VII	**Extraordinary Items**		-30
IX	**Profit before tax (VII- VIII)**		920
X	**Tax expenses- provision @ 40%**		368
XI	**Profit (Loss) after tax for the period from continuing**		552
XII	**operations (VII-VIII)** **Profit /Loss from Discontinued Operations**		0
XIII	**Profit / Loss for the period**		552

Note: Reserve & Surpluses:

Development Reserve		50.00
Revaluation Reserve		20.00
Securities Premium		30.00
General Reserve: 1/4	90.00	
Trans during the year	55.20	145.20
Profit & Loss A/c: 1/4	140.00	
Profit during the year	552.00	
Trans to Reserve - 10%	-55.20	
Dividend paid	-10.00	
Dividend Distribution Tax paid	-1.50	
Tax for last year - under provision	-10.00	615.30
		860.50

Notes:

1	Cost of Materials consumed -	
	Purchas of raw materials	840
	Freight inward	30
	Transit insurance on raw materials	20
		890
	Changes in inventories of RM	20
		910
2	Changes in inventories:	
	Decrease in Stock of goods	10
	Increase in WIP	-10
	Decrease in FG	10
		10
3	Employee benefits expense	
	Salaries & Wages	280
	Cont to PF	30
	Staff welfare exps	80
	Bonus	100
	Salary to salesmen	110
		600
4	Finance costs	
	Interest on debenture	50
	on O/D	20
	other interest	10

5	Depreciation and amortization expense	
	on Building	10
	on Machinery	90
	on Furniture	10
	Amortization of Patent right	50
		160
6	Other expenses	
	Delivery expenses	40
	Bad debt	10
	Rent including o/s	110
	Repairs	40
	Office rent	40
	Administration expenses	40
	Sundries	20
	Audit fees	10
		310

26. Example on Balance Sheet:

Following is the Trial Balance of Zed Ltd after preparation of Profit & Loss Account as on 31-03-2017.

Debit balances	₹	Credit balances	₹
Plant & Machinery	1,44,000	Equity Share (₹ 10 each)	1,80,000
Furniture & Fixture	39,000	Reserves	30,000
Investments	60,000	Profit & Loss A/c (01-04-16)	66,000
Inventory	16,000	15% Loans	60,000
Debtors	80,000	Creditors	40,000
Cash & Bank	36,000	Bills Payable	16,000
Advance to suppliers	24,000	Outstanding wages	5,000
Advance tax	36,000	Profit for the year	58,000
Patent	24,000	Provision for tax (16-17)	25,000
Prepaid expenses	6,000	Provision for tax (15-16)	20,700
Bills receivables	15,000		
Proposed dividend	18,000		
Dividend distribution tax	2,700		
	4,80,700		4,80,700

Draw up the Balance Sheet of Zed Ltd as per Schedule III as at 31-03-2017 after taking into account the following:

- **Advance tax includes 15,000 for 2015-16. Tax for the year 2015-16 is assessed at 18,000.**
- **Transfer 5% of net profit to reserve**
- **30% of Investments represent short-term investments.**

Answer:

Balance Sheet as at ....

(Rupees in…)

		Particulars	Note No.	Current	Previous
I	**EQUITY AND LIABILITIES**				
	(1)	**Shareholders' Funds**			
		Share Capital		1,80,000	
		Reserves & Surplus		1,36,000	
	(3)	**Non-current liabilities**			
		Long-term borrowings **(15% loans)**		60,000	
	(4)	**Current Liabilities**			
		Trade payables		56,000	
		Other current liabilities		8,000	
		Short-term provisions ***(provision for tax)***		25,000	
		TOTAL		**4,65,000**	
II	**ASSETS**				
	(1)	**Non-current Assets**			
		Fixed Assets Tangible			
		Assets Intangible		183,000	
		Assets		24,000	
		Non-current Investments		42,000	
	(2)	**Current Assets**			
		Current Investments		18,000	
		Inventories		16,000	
		Trade receivables		95,000	
		Cash and cash equivalent		36,000	
		Short-term loans and advances		45,000	
		Other current assets		6,000	
		TOTAL		**4,65,000**	

Notes:

Reserve & Surplus:			**Trade payables:**	
General Reserve: 01-04	30,000		Creditors	40,000
Addition during the year	2,900	32,900	Bills Payable	15,000
Profit & Loss: 01-04	66,000			55,000
PAT for the year	58,000			
			Other Current Liabilities:	
Transfer to Reserve (58,000×5%)	(2,900)		Outstanding wages	5,000
Dividend paid	(18,000)		Tax liability for 15-16	3,000
DT paid	(2,700)			
Over-provision of tax for 2015-16	2,700	1,03,100		8,000
		1,36,000		

Trade Receivables:		**Short term Loans & Advances:**	
Debtors	80,000	Advance to Supplier	24,000
Bills Receivables	15,000	Advance tax (36000 –15000)	21,000
	95,000		45,000

27. Following is the trial balance of the business of A Ltd as on 31.03.2017.

(all figures are in ₹ lakhs)

Machinery	**50,000**	**Share Capital (₹ 10 each)**	**40,000**
Debtors	**22,000**	**Creditors**	**18,000**
Stock (01.04.2016)	**10,000**	**Sales**	**2,04,000**
Purchases	**98,000**	**Bills payable**	**33,000**
Salaries	**23,000**	**Interest received**	**4,000**
Contribution to PF	**9,000**	**General Reserve**	**15,000**
Bills receivable	**14,000**	**PF payable**	**2,000**
Rent	**18,000**	**Surplus balance on 01-04-2016**	**5,000**
Investments (40% short-term) Copyright	**25,000**	**Provision for Tax (15-16)**	**4,600**
Furniture	**18,000**	**TDS (16-17)**	**400**
Administration exps	**13,000**		
Advance income tax (15-16)	**14,000**	**10% Debenture**	
Advance Income Tax (16-17)	**4,000**	**Bank Overdraft**	**8,000**
Cash	**5,000**	**Provision for Depreciation**	**2,000**
Bank	**3,000**		**10,000**
Debenture Interest paid	**10,000**		
Land	**600**		
Loss on sale of fixed assets	**8,000**		
Advance to suppliers	**400**		
	1,000		
	3,46,000		**3,46,000**

You are required to prepare the Statement of Profit & Loss for the year ended 31.03.2015 and the Balance Sheet as on that date after considering the following:

(a) Unsold stock on 31.03.2015 is valued at: 19,000.

(b) Depreciation is to be charged @ 10% on original cost on all fixed assets.

(c) 1/9 th of copyright is to be amortised

(d) Income tax to be provided @ 30%

(e) Dividend to be proposed @ 10% and the rate of Dividend Distribution tax is 10%.

(f) 5% of profit is to be transferred to Reserve.

(g) Rent outstanding 1,000

(h) Income tax for the year 2015-16 is assessed at 4,200.

Answer:

Statement of Profit & Loss for the year ended …………………..

		₹
I	**Revenue from Operation**	204,000
II	**Other Income**	4,000
III	**Total Revenue**	208,000
IV	**Expenses:**	
	Purchases of Stock-in-Trade	98,000
	Changes in inventories of Stock-in-Trade	-9,000
	Employee benefits expense	32,000
	Finance costs	800
	Depreciation and amortization expense	8,300
	Other expenses	33,400
	Total expenses	163,500
IX	**Profit before tax (VII- VIII)**	44,500
X	**Tax expenses- provision @ 30%**	(13,350)
XI	**Profit (Loss) after tax**	31,150

Balance Sheet as at ....

(Rupees in…)

		Particulars	Note No.	Current
I	**EQUITY AND LIABILITIES**			
	(1)	**Shareholders' Funds**		
		Share Capital		40,000
		Reserves & Surplus		47,150
	(3)	**Non-current liabilities**		
		Long-term borrowings (10% Debenture)		8,000
	(4)	**Current Liabilities**		
		Trade payables		51,000
		Other current liabilities (2000+400+2000+1000+200+200)		5,800
		Short-term provisions (13350+4000+400)		17,750
		TOTAL		**169,700**
II	**ASSETS**			
	(1)	**Non-current Assets**		
		Fixed Assets Tangible		
		Assets Intangible		54,700
		Assets		16,000
		Non-current Investments		15,000
	(2)	**Current Assets**		
		Current Investments		
		Inventories		10,000
		Trade receivables		19,000
		Cash and cash equivalent		36,000
		Short-term loans and advances		13,000
		Other current assets		6,000
		TOTAL		**169,700**

Note: Reserve & Surpluses:

General Reserve: 1/4	15,000	
Trans during the year	1,558	16,558
Profit & Loss A/c: 1/4	5,000	
Profit during the year	31,150	
Trans to Reserve - 5%	-1,558	
Proposed Dividend	-4,000	
Provision for DDT	-400	
Tax for last year - over provision	400	30,592
		47,150

** Other notes are not shown. Students are requested to give the notes in their examination paper wherever it is necessary. In case of two or three items they may ignore preparing notes in the examination; otherwise it will take substantial time to complete the paper.

**** Presently proposed dividend are not shown in Balance Sheet. However, in this example it is shown to give an understanding of its treatment for academic interest.

Study Note – 3

CASH FLOW STATEMENT

Learning Objective: *Disclosure of Cash Inflows and application of cash of an enterprise in the Cash Flow Statement*

Fill in the blanks:

1. **Cash Flow Statement is one of the tools for assessing the ________ and ________ of the enterprise.**
2. **________ of an asset is the present value of future cash flows expected to be derived from the asset.**
3. **A cash flow statement explains the reasons for change in the cash and cash equivalent between ________ ________.**
4. **________ are activities that result in changes in the size and composition of the owners' capital and borrowings of the enterprise.**
5. **SEBI requires computation of cash flow from operating activities using ________.**
6. **Cash payments to suppliers for goods and services are ________ in the cash flow statement.**
7. **For a financial institutions Cash advances and loans made by it is cash flow from ________.**
8. **Cash payments to acquire shares, warrants or debt instruments of other enterprises are an element of ________ in the cash flow statement.**
9. **Cash advances and loans made to third parties is ________ in the cash flow statement.**
10. **Cash repayments of amounts borrowed are considered as cash flow from ________.**

Answer:

1. liquidity solvency
2. Economic value
3. two financial statement dates
4. Financing activities
5. indirect method
6. Operating Activity
7. Operating Activity

8. Investment Activity
9. Investment Activity
10. financing activities

Answer the following questions:

1. Why Cash Flow Statement is Prepared?

Answer:

Cash Flow Statement is considered to be a summarized statement showing sources of Cash Inflows and application of cash outflows of an enterprise during a particular period of time. It is prepared on the basis of the published data as disclosed by the Financial Statement of two different financial periods. It is an essential tool for managerial decision-making. Cash Flow reports the management Net Cash Flow (i.e. cash inflow less cash outflow or vice versa) from each activity of the enterprise as well as of the overall business of the enterprise. The management of the enterprise gets a picture of movement of cash resources from the Cash Flow Statement and can assess the stronger and weaker area of movement of cash for different activities of the business for drawing up the future planning.

2. What do you understand by the term 'cash and cash equivalent'?

Answer:

Cash means cash in hand and balance of foreign currency. Cash equivalent implies bank balance and other risk-free short term investments, and advances which are readily encashable. Cash equivalent means short term highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value. An investment of short maturity, say three months or less from the date of acquisition is generally considered as cash equivalent. Equity investments are not considered as cash equivalent because of high market risk. Investments in call money market, money market mutual funds, repo transactions, badla transactions, etc., are usually classified as cash equivalents.

3. Rana Ltd. gives you the following information for the year ended 31st March 2018.

I. Sales for the year ₹ 40,00,000. No credit sales

II. Amounts paid to trade creditors during the year ₹ 36,40,000.

III. Selling expense paid ₹ 25,000.

IV. Tax paid during year ₹ 52,000.

V. Calculate the Net Cash from operating activities.

Answer:

Calculation for Cash Flow from operating activities (Direct Method)

Particulars	Amount (₹)	Amount (₹)
Cash receipts against sales		40,00,000
Less:		
i. Cash paid to suppliers (creditors)		
ii. Selling expenses	36,40,000	
	25,000	
		36,65,000
Cash Flow from Operation		3,35,000
Less: Tax paid		52,000
Net cash from Operating Activities		2,83,000

4. A Company gives you the following information of Balance Sheet for the year ended 31.03.2018. You are required to Calculate Net Cash operating activities.

Figures as Per Balance Sheet

Particulars	31.03.2017	31.03.2018
Plant & Machinery	**15,00,000**	**25,50,000**
(-) Depreciation	**3,80,000**	**5,10,000**
	11,20,000	**20,50,000**
S. Debtors	**9,20,000**	**12,75,000**
(-) Provision for Bad Debts	**75,000**	**1,25,000**
	8,45,000	**11,50,000**
Inventories	**7,10,000**	**6,25,000**
S. Creditors	**3,35,000**	**2,80,000**
Outstanding Expenses	**1,80,000**	**2,75,000**
Cash	**40,000**	**48,000**
Prepaid expenses	**72,000**	**1,00,000**

Additional Information :-

(a) Net profit for the year ended 31.03.2018. after charging depreciation ₹ 130,000 is ₹ 10,75000.

(b) Sundry debtors of ₹ 35,000 were bad and written off against the provision of doubtful debts during year.

Answer:

Calculation for Net Cash from Operating Activities (Indirect Method)

Particulars	Amount (₹)	Amount (₹)
Net Profit	10,75,000	
Add: Adjustment for depreciation ₹ (5,10,000 – 38,000) Operating Profit before working capital changes	1,30,000	
Add: Decrease in current assets and Increase in current liabilities		12,05,000
i. Decrease in inventories ₹ (7,10,000 – 6,25,000)	85,000	
ii. Outstanding Expenses (2,75,000 – 1,80,000)	95,000	
		1,80,000
Less: Increase in current assets and decrease in current liabilities.		13,85,000
i. Sundry Debtors (net) ₹ [11,50,000 – 8,45,000]	3,05,000	
ii. Sundry Creditors ₹ (3,35,000 – 2,80,000)	55,000	
iii. Prepaid expense ₹ (1,00,000 – 72,000)	28,000	3,88,000
Net cash from operating activities.		9,97,000

5. Following are the Balance Sheet of Raghubir CO. Ltd. as on March 31,2017 and as on March 31,2018.

Particulars	Note No.	31.03.2017	31.03.2018
LIABILITIES:			
I. Equality and Liabilities:			
(a) Equity Share capital		3,00,000	3,50,000
(b) 7% Pref. share Capital		1,50,000	1,00,000
(c) General Reserve		40,000	75,000
(d) Security Premium		20,000	25,000
(e) Capital Reserve		---------	20,000
(f) Profit & Loss		30,000	73,000
II. Non-Current Liabilities:			
(a) 8% Debentures		50,000	50,000
III. Current Liabilities:			
(a) Creditors		55,000	83,000
(b) Bills Payable		20,000	16,000
(c) Provision for Taxation		40,000	50,000
(d) Proposed Dividend		42,000	50,000
Total		**7,47,000**	**8,92,000**

ASSETS:			
I. Non-Current Assets			
(a) Land & Building at Cost		2,50,000	2,20,000
(b) Plant & Machinery		80,000	2,00,000
(c) Goodwill		1,00,000	89,000
II. Non-Current Investment			
Investment		20,000	35,000
III. Current Assets			
(a) Stock		77,000	1,00,000
(b) Debtors		1,40,000	1,70,000
(c) Bills Receivable		20,000	30,000
(d) Cash at bank		16,000	11,000
(e) Cash in hand		9,000	7,000
IV. Other Non-current Assets			
Preliminary Exp.		35,000	30,000
		7,47,000	8,92,000

Additional information:

1. One piece of land was sold at a profit and the profit was transferred to Capital Reserve.
2. One Machine was sold for ₹ 15,000 (written down value on the date of sale was ₹ 18,000.
3. Depreciation charged on Plant & Machinery amounted to ₹ 16,000.
4. Dividend of ₹ 4,000 was received from Investment of which ₹ 2,000 was credited to Investment A/c being dividend declared from pre-acquisition profit.
5. Actual amount of taxes paid were ₹ 38,000.

You are required to prepare a Cash Flow Statement for the year ending on March 31,2018.

Answer:

Cash Flow Statement for the year ended 31.03.2018

Particulars	Amount (₹)	Amount (₹)
I. Cash flow from Operating Activities		
Operating Profit before working changes (WN2)	2,13,000	2,13,000
Add: Decrease in current assets and Increase in Current Liabilities		
Creditors (83,000-55,000)	28,000	
Less: Increase in current assets and Decrease in current liabilities		
Stock (1,00,000 – 77,000)	(23,000)	
Debtors (1,70,000 – 1,40,000)	(30,000)	
Bills Receivable (30,000 – 20,000)	(10,000)	
Bills payable (20,000 – 16,000)	(4,000)	
		(-)39,000
		1,74,000
Less: Tax Paid		38,000
		1,36,000
Net cash flow from operating activities		
II. Cash flows from Investing Activities		
Sale of land & Building	50,000	
Sale of Plant & Machinery	15,000	
Dividend received	4,000	
	69,000	
Less: Purchase & Plant & Machinery	(1,54,000)	
Investments	(17,000)	(-)1,02,000
Net cash flow from Investing Activities		
III. Cash Flows from Financing Activities		
Issue of share including premium	55,000	
Less: Redemption of Preference share	(50,000)	
Dividend Paid	(42,000)	
Interest on Debenture	(4,000)	
		(-)41,000
Net cash flow from Financing Activities		(-)7,000
Decrease in cash over the year		
Add: Opening balance of cash & cash equivalent ₹ (16000+9000)		25,000
Closing cash & cash equivalent ₹ (11000+7000)		18,000

Working Note:

(1)

Goodwill A/C				Land & Buildings A/C			
To Bal	1,00,000	By P/L	11,000	To, Bal	2,50,000	By, Bank Sold	50,000
				To, Cap. Resv	20,000		
		By Bal	89,000			By Bal	2,20,000
	1,00,000		1,00,000		27,00,000		2,70,000

Plant & Mach A/c				Investment A/C			
To, Bal	80,000	By, Bank	15,000	To, Bal	20,000	By, Dividend	
Bank Purchase	1,54,000	By, P/L (Loss)	3,000	To, Bank	17,000	By, Bal	2,000
		By, P/L (Depr)	16,000	Purchase			35,000
		By, Bal	2,00,000				
	2,34,000		2,34,000		37,000		37,000

Preliminary Exp. A/c.				Equity Share Capital A/c			
To, Bal	35,000	By, P/L	5,000	To		By, Bal	3,00,000
		By, Bal	30,000	To, Bal	3,50,000	By, Bank Issue	
							50,000
	35,000		35,000		3,50,000		3,50,000

Pref. Share Capital A/c				Share Premium A/c			
To, Bank Redemp	50,000	By, Bal	1,50,000	To, Bal	25,000	By, Bal	20,000
To, Bal						By, Bank	5,000
	1,00,000						
	1,50,000		1,50,000		25,000		25,000

Capital Res A/c				Prov. For Taxation A/c			
		By, Land &		To, Bank	38,000	By, Bal	40,000
To, Bal	20,000	Building	20,000	To, Bal	50,000	By, P/L	48,000
	20,000		20,000		88,000		88,000

Proposed Dividend A/c				Gen Reserve A/c			
To, Bank	42,000	By, Bal	42,000			By, Bal	40,000
To, Bal	50,000	By, P/L	50,000	To, Bal	75,000	By, P/L	35,000
	85,000		85,000		75,000		75,000

(2) **Adjusted Profit & Loss A/c.**

To, Goodwill	11,000	By, Bal B/d	30,000
Plant & Mach (loss)	3,000	Dividend on Investment	2,000
Plant & Mach (Dep)	16,000	Operating Profit – Bal Figure	2,13,000
Preliminary (exp)	5,000		
Prov. For tax	48,000		
Proposed Dividend	50,000		
General Reserve	35000		
Debenture Interest	4,000		
Bal Closing c/d	73000		
	2,45,000		2,45,000

6. Following are the Balance Sheet of Fox Ltd. As on March 31, 2017 and as on March 31, 2018.

LIABILITIES	Note No.	31.03.2018	31.03.2017
Equity and Liabilities :			
(a) Equity Share Capital		1,50,000	1,00,000
(b) Securities Premium		35,000	15,000
(c) Profit & Loss		70,000	28,000
(d) Premium on redemption of debenture		(1,000)	
Non-Current liabilities:		30,000	70,000
10% Debenture			
Current Liabilities:			
Creditors		48,000	34,000
Bank overdraft		-	14,000
Proposed dividend		20,000	15,000
Unclaimed Interim Dividend		3,000	-
TOTAL		4,22,000	3,34,000
ASSETS:			
Non-Current Assets:			
(a) Fixed Assets-			
i. Freehold Property		1,30,000	1,10,000
ii. Plant & Machinery		97,000	75,000
iii. Furniture		14,000	11,000
(b) Current Assets:			
Stock		51,000	37,000
Debtors		44,000	43,000
Bank		19,000	-
TOTAL		4,22,000	3,34,000

Additional information:

(i) There had been no disposal of Freehold Property in the year.

(ii) The Machine which had cost ₹ 8,000 and in respect of which ₹ 6,000 depreciation had been provided was sold for ₹ 3,000 and Furniture which cost ₹ 5,000 in respect of which of ₹ 5,000 had been provided were sold for ₹ 1,000. The profits or losses on these transactions had been dealt with through the Profit & Loss A/c.

(iii) The actual premium on redemption of Debenture was ₹ 2,000 of which ₹ 1,000 had been written off to the Profit & Loss A/c. Debentures were redeemed at the beginning of the year.

(iv) ₹ 21,000 interim dividend has actually been paid during the year as ₹ 3,000 left unpaid. (v) Income tax charged and paid during the year ₹ 25,000.

(vi) Balances of Provision for depreciation were:

	31-03-2018	31-03-2017
On Plant & Machinery	**54,000**	**45,000**
On Furniture	**15,000**	**13,000**

You are asked to prepare a cash flow statement for the year ended March 31,2018.

Answer:

Cash flow statement for the year ended March 31, 2018.

Particulars	**Amount (₹)**	**Amount (₹)**
I. Cash Flows from Operating Activities :		
Operating Profit before working capital changes (WN-2)	1,35,000	
Add: Decrease in current Asset and Increase in current liabilities	14,000	
Creditors ₹ (48,000 – 34,000)		
Less: Increase in current Assets and Decrease in current Liabilities		
Stock ₹ (51,000 – 37,000)	(14,000)	
Debtors ₹ (44,000 - 43,000)	(1,000)	
	1,34,000	
Less. Tax paid	(25,000)	
Net Cash Flows from Operating Activities		1,09,000
II. Cash Flows from Investing Activities.		
Purchase of freehold property	(20,000)	
Purchase of Plant & Machinery	(39,000)	
Purchase of Furniture	(10,000)	
Plant & Machinery sold	3,000	
Furniture Sold	1,000	(-)65,000
Net cash Flows from Investing Activities		
III. Cash Flows from Financing Activities :		
Issue of share including premium	70,000	
Debenture redemption including premium	(42,000)	
Interest on debenture	(3,000)	
Proposed Dividend paid	(15,000)	
Interim Dividend paid	(21,000)	
		(-)11,000
Net cash flows from financing activities		33,000
Opening Cash & Cash Equivalent (overdraft)		(14,000)
Closing Cash & Cash Equivalent		19,000

Working Notes:

Freehold Property A/c				Plant & Machinery A/c			
To, Bal	1,10,000			To, Bal	1,20,000	By, Prof. for	6,000
To, Bank Purch	20,000	By, Bal	1,30,000	To, P/L- Profit		Depr	
				To, On sale	1,000	By, Bank	3,000
				To, Bank - Purch		– Sold	
					39,000	By, Bal	1,51,000
	1,30,000		1,30,000		1,60,000		1,60,000

Furniture A/c				Prov. For Deprt. On P & M A/c			
To, Bal	24,000	By, Bank –	10,000	To, P & M	6,000	By, Bal	45,000
To, P/L- Profit on		Sold		To, Bal	54,000	By, P/L- Loss	
Sale	1,000	By, Prov for	5,000				15,000
To, Bank –		Deprt.					
Purchase	10,000	By, Bal	29,000				
	35,000		35,000		60,000		60,000

Prov. For Depr. On Furniture A/c				Equ. Share capital A/c			
To, Furniture	5,000	By, Bal	13,000			By, Bal	1,00,000
To, Bal	15,000	By, P/L	7,000	To, Bal	1,50,000	By, Bank-	
						issue	
							50,000
	20,000		20,000		1,50,000		1,50,000

Securities Premium A/c				10% Debenture A/c			
		By, Bal	15,000	To, Bank-Paid		By Bal	70,000
To, Bal	35,000	By, Bank	20,000	To, Bal	40,000		
					30,000		
	35,000		35,000		70,000		70,000

Proposed Dividend A/c				Prem. On Redem on Deb A/c			
To, Bank – Paid	15,000	By, Bal	15,000	To, Bank	2,000	By, P/L	1,000
To, Bal	20,000	By, P/L	20,000			By, Bal	1,000
	35,000		35,000		2,000		2,000

Adjusted Profit & Loss A/c.			
To, Prov for Depr on P/M	15,000	By, Bal	28,000
To, Prov for Depr on Furniture	7,000	By, Plant & Mach.	1,000
To, Proposed Dividend	20,000	By, Furniture	1,000
To, Prem. On Debenture redemption	1,000	By, Operating profit- Bal Figure	1,35,000
To, Debenture Interest	3,000		
To, Interim Dividend declared	24,000		
To, Income Tax	25,000		
To, Bal	70,000		
	1,65,000		**1,65,000**

7. Calculate Net Cash Flow from Operating Activities to be shown in Cash Flow Statement (CFS) for the year 2016-17(using both direct and indirect method):

Income Statement for the year 2016-17

Sales	**80,000**
Operating Exp (ex. Dep)	**(44,000)**
Depreciation	**(10,000)**
Interest on loan	**(6,000)**
Extraordinary income	**5,000**
PBT	**25,000**
Provision for tax	**10,000**
PAT	**15,000**

Balances relating to current items are-

	31-03-16	**31-03-17**
Debtors	**8,000**	**6,000**
Inventory	**6,500**	**7,000**
Creditors	**9,000**	**8,500**
O/S Expenses	**1,000**	**1,500**

Included in operating expenses is a loss on sale of machinery-₹ 2,000. Actual tax paid in respect of 2016-17: ₹ 9,000.

Answer:

Cash from Operation (direct method)

Collection from Sales:		
Sales	80,000	
Add: Decrease in Debtors [add. Opening & less. Closing]	2,000	82,000
Payment for Purchases & Expenses:		
Total operating expenses excl. loss, i.e., purchases & Others	42,000	
Add: Increase in Inventory [add. Closing & less. Opening]	500	
Add: Decrease in Creditors [add. Opening & less. Closing]	500	
Less: Increase in O/S expenses [add. Opening & less. Closing]	(500)	(42,500)
CASH FLOW FROM ORDINARY ACTIVITIES		39,500
Extraordinary Income		5,000
		44,500
Less: Tax Paid		9,000
NET CASH FLOW FROM OPERATING ACTIVITIES (To be shown in CFS)		35,500

Cash from Operation (indirect method)

PBT	25,000	
Less. Extraordinary Income	(5,000)	
Add. Interest on Loan	6,000	
Add. Depreciation	10,000	
Add. Loss on Sale of Machinery	2,000	
Operating Profit before working capital changes	38,000	
Add. Decrease in Debtors	2,000	
Less. Increase in Inventory	(500)	
Less. Decrease in Creditors	(500)	
Add. Increase in O/S expenses	500	
CASH FLOW FROM ORDINARY ACTIVITIES		39,500
Extraordinary Income		5,000
		44,500
Less. Tax Paid		9,000
NET CASH FLOW FROM OPERATING ACTIVITIES (To be shown in CFS)		35,500

8. **From the following information, prepare Cash Flow Statement for the year ended 31.03.2017:**

Summary of Assets and Liabilities **(in ₹):**

	2016	2017		2016	2017
Share Capital	5,00,000	5,00,000	Fixed Assets	8,50,000	10,00,000
Surplus balance	5,25,000	6,50,000	Non-Current	1,00,000	1,50,000
L.T. Loan	5,00,000	5,30,000	Investments	3,40,000	3,50,000
Creditors	1,75,000	2,00,000	Stock	3,80,000	3,45,000
			Debtors	30,000	35,000
	17,00,000	18,80,000	Cash & Bank	17,00,000	18,80,000

Summary Income Statement for the year ended 31.03.2017 (in ₹)

Sales	20,90,000
Less: Cost of Sales	13,60,000
Gross Profit	7,30,000
Less: Operating Expenses	
(Office Expenses ₹ 2,30,000 & Depreciation ₹ 1,10,000)	3,40,000
	3,90,000
Add: Non operating Incomes (dividend received)	25,000
Less: Interest paid	(70,000)
	3,45,000
Less: Income Tax	1,30,000
Profit after Tax	2,15,000
Add: Opening balance	5,25,000
	7,40,000
Less: Dividend	90,000
Closing Balance	6,50,000

Answer:

Cash Flow Statement for the year ended 31-03-2017

Operating Activities:		
Cash Operating Profit before working capital changes (EBDIT) [3,90,000+1,10,000]	5,00,000	
Increase in Stock	(10,000)	
Decrease in Receivables	35,000	
Increase in Creditors	25,000	
	5,50,000	
Less. Tax paid	(1,30,000)	
		4,20,000
Investing Activities:		
Purchase of Fixed Assets [10,00,000-(8,50000-110,000)]	(2,60,000)	
Purchase of Investments	(50,000)	
Dividend received	25,000	
		(2,85,000)
Financing Activities:		
Loan taken	30,000	
Interest paid	(70,000)	
Dividend paid	(90,000)	
		(1,30,000)
		5,000
Opening Cash & Cash Equivalent		30,000
Closing Cash & Cash Equivalent		35,000

9. From the following financial information of Zed Ltd prepare a Cash Flow Statement for the year ended 31.03.2017.

	₹
EBIT	**2,00,000**
Depreciation and loss on asset charged	**45,000**
Interest on Debenture charged in Profit & Loss Statement	**44,000**
Purchase of Machinery	**42,000**
Investment in long-term project	**90,000**
Dividend paid	**18,000**
Purchase of furniture	**8,000**
Income tax paid	**20,000**

Sale of Machinery	**70,000**
Issue of Debentures	**40,000**

Position of current items as at 31-03-2016 and 31-03-2017 are as below (in ₹):

	31-03-2016	31-03-2017
Inventory	**70,000**	**1,54,000**
Trade receivables	**1,56,000**	**1,46,000**
Creditors	**1,12,000**	**53,000**
Outstanding Debenture Interest	**6,000**	**9,000**
Cash and cash equivalent	**30,000**	**33,000**

Answer:

Cash Flow Statement for the year ended 31-03-2017

Operating Activities:			
	EBIT	200000	
	Depreciation	45000	
	Cash Operating Profit before working capital changes	245000	
WC changes:	Increase in Stock	-84000	
	Decrease in Trade Receivables	10000	
	Decrease in Creditors	-59000	
	Operating Cash Flow before tax	112000	
	Tax Paid	-20000	92,000
Investing Activities:			
	Purchase of machinery	-42000	
	Investment in Long Term project	-90000	
	Purchase of furniture	-8000	
	Sale of machinery	70000	-70,000
Financing Activities:			
	Issue of Debenture	40000	
	Interest paid [44,000+6,000-9,000]	-41000	
	Dividend paid	-18000	-19,000
Net Cash Flow during the year			3,000
Add. Opening Cash & Cash Equivalent			30,000
Closing Cash & Cash Equivalent			33,000

Note: Outstanding interest should not be considered in adjusting working capital changes. Interest on Debenture is part of financing activity and hence, it should be considered in determining the actual amount of interest payment.

10. Following are the liabilities and assets of Flow Ltd as on 31-03-2016 and 31-03-2017:

	31-3-16 (₹)	31-3-17 (₹)
I. Equity and Liability:		
1. Shareholders' Fund:		
(a) Equity Share 10 each fully paid	3,00,000	5,00,000
9% Preference shares of 10 each fully paid	2,00,000	3,00,000
(b) Reserves and Surplus:		
Securities Premium Reserve	40,000	90,000
Revaluation Reserve (on Land)	-----	80,000
General Reserve	1,20,000	1,80,000
Profit and Loss balance	2,30,000	3,90,000
2. Non-current Liabilities:		
8% Debentures	2,00,000	----
3. Current Liabilities:		
Trade Payable	90,000	70,000
Provision for tax	60,000	90,000
Total	12,40,000	17,00,000
II. Assets:		
1. Non-current Assets:		
(a) Fixed Assets: Tangible		
Land	5,00,000	5,80,000
Other Fixed Assets	3,50,000	4,80,000
(b) Non-current Investment	70,000	1,10,000
2. Current Assets:		
Inventory	90,000	70,000
Trade Receivables	1,40,000	3,30,000
Cash & Cash equivalents	90,000	1,30,000
Total	12,40,000	17,00,000

Following further particulars for the year 2016-17 are also given:

I. Interim Dividend on equity shares ₹ 50,000 and Preference dividend ₹ 18,000 were paid during the year. Dividend distribution tax paid during the year ₹ 10,000.

II. Debentures were redeemed at 10% premium, premium on redemption charged to Profit & Loss for the year. Debenture interest ₹ 12,000 were also paid during the year.

III. The company sold one fixed asset for ₹ 24,000 (W.D.V. ₹ 35,000). Fixed assets of ₹ 2,00,000 were acquired by issue of 8,000 equity shares at 25% premium and balance by issue of preference shares at par. Other equity shares were issued for cash during the year at a premium.

IV. Interest on Investment received ₹ 8,000. Investments having book value ₹ 20,000 were taken over by a creditor against ₹ 20,000 due to him.

V. Income tax paid during the year ₹ 68,000.

You are required to prepare the Cash Flow Statement of Flow Ltd for the year ended 31-03-2017

Answer:

Workings:

Equity Share Capital A/c

Particulars	Amount (₹)	Particulars	Amount (₹)
		Balance	300,000
		FA	80,000
Balance	500,000	Bank**	120,000
	500,000		500,000

Security Premium A/c

Particulars	Amount (₹)	Particulars	Amount (₹)
		Balance	40,000
		FA	20,000
Balance	90,000	Bank**	30,000
	90,000		90,000

Provision for Tax A/c

Particulars	Amount (₹)	Particulars	Amount (₹)
Bank	68,000	Balance	60,000
Balance	90,000	Adj P/L **	98,000
	158,000		158,000

Investment A/c

Particulars	Amount (₹)	Particulars	Amount (₹)
Balance	70,000	Creditors	20,000
Bank**	60,000	Balance	110,000
	130,000		130,000

Other Fixed Asset A/c

Particulars	Amount (₹)	Particulars	Amount (₹)
Balance	350,000	Bank	24,000
Equity Share Capital	80,000	Loss	11,000
Sec. Premium	20,000		
Pref. Shares	100,000	Depreciation**	35,000
		Balance	480,000
	550,000		550,000

Adjusted P/L A/c

Particulars	Amount (₹)	Particulars	Amount (₹)
Equity Div	50,000	Balance	230,000
Pref. Div	18,000	Interest	8,000
DDT	10,000		
Deb red premium	20,000		
Deb Interest	12,000	FFO**	466,000
Loss on FA	11,000		
Gen Res	60,000		
Depreciation	35,000		
Provision for tax	98,000		
Balance	390,000		
	704,000		704,000

Cash Flow Statement for the year ended 31-03-2017

OPERATING ACTIVITIES		
Operating profit before working capital changes	466,000	
Decrease in Inventory	20,000	
Increase in Trade Receivable	-190,000	
Change in Trade Payable affecting cash (decrease-20,000 & Investment taken 20,000)	0	
	296,000	
less. Tax paid	-68,000	228,000
INVESTING ACTIVITIES		
Sale of Fixed Assets	24,000	
Interest on Investments	8,000	
Purchase of Investment	-60,000	-28,000
FINANCING ACTIVITIES		
Issue of Equity shares including premium	150,000	
Redemption of Debenture including premium	-220,000	
Debenture Interest paid	-12,000	
Payment of Equity dividend	-50,000	
Payment of preference dividend	-18,000	
Payment of dividend distribution tax	-10,000	-160,000
Net Cash Flow during the year		40,000
add. Opening Cash & Cash Equivalent		90,000
Closing Cash & Cash Equivalent		130,000

11. The Accountant of Calcutta Ltd has collected the following information for the preparation of Cash Flow Statement for the year 2016-17:

(figures are ₹ in lakhs)

Net profit (PAT)	**24,994**	**Proceed from sale of assets (loss ₹ 40 lakhs charged against profit)**	**145**
Dividend paid	**7,295**		
Provision for Income Tax	**5,000**	**Purchase of fixed assets**	**18,410**
Income Tax paid	**4,248**	**Depreciation charged**	**20,000**
Dividend Distribution tax paid	**1,240**	**Proceeds from long term borrowings**	**46,555**
Interest received on investment	**2,506**	**Book value of investment sold**	**27,765**
Interest expenses	**10,000**	**Profit on sale of investment credited to Profit & Loss A/c**	**100**
Interest paid during the year	**10,520**	**Redemption of Debenture**	**34,740**
Opening cash & bank balance	**5,703**	**Calls in arrear received**	**14**
Closing cash & bank balance	**7,688**	**Increase in Working Capital (excluding Cash & bank)**	**56,075**

You are required to prepare the Cash Flow Statement for the year 2016-17.

Answer:

CASH FLOW STATEMENT FOR THE YEAR 2016-17

OPERATING ACTIVITY:			**INVESTING ACTIVITY:**		
PAT	24,994		Interest received on Inv	2,506	
add.			Purchase of FA	-18,410	
Prov for tax	5,000		Sale of assets	145	
Interest	10,000		Sale of Investment	27,865	12,106
Loss on sale of asset	40				
Depreciation	20,000		**FINANCING ACTIVITY:**		
	60,034		Redemption of Debenture	-34,740	
less.			Dividend paid	-7,295	
Interest on Investment	2,506		DDT paid	-1,240	
Profit on sale of investment	100		Interest paid	-10,520	
	57,428		Long term borrowing	46,555	
Adjustment for WC changes	-56,075		Calls in arrear received	14	-7,226
Cash from operation before tax	1,353		**Net Cash Flow during the year**		1,985
Tax paid	4,248		**add. Opening Cash & Cash equivalent**		5,703
		-2,895	**Closing Cash & Cash Equivalent**		7,688

***** A comprehensive problem (for better understanding of different non-cash adjustments)**

12. From the following Balance Sheets, Income Statement and other notes and information you are required to prepare a Cash Flow Statement of FCFS Ltd for the year ended 31-03-2017:

Balance Sheet of FCFS Ltd

	31-03-16 ('000 ₹)	31-03-17 ('000 ₹)
Equity and Liability :		
Shareholders' Fund		
a. Share Capital	1,00,000	2,00,000
b. Reserves and Surplus	65,000	1,44,000
Non-current Liabilities		
a. 10% Debentures	50,000	30,000
Current Liabilities		
a. Trade Payables	50,000	61,000
b. Other current liabilities (including outstanding debenture interest of 600 and 400 respectively)	10,000	14,000
c. Short-term Provisions	32,000	58,000
TOTAL	3,07,000	5,07,000
Assets :		
Non-current Assets		
Fixed Assets		
a. Tangible	1,05,000	1,90,000
b. Intangible	8,000	5,000
c. Non-current Investments	32,000	41,000
Current Assets		
a. Current Investments	10,000	14,000
b. Inventories	30,000	72,000
c. Trade Receivables	80,000	1,04,000
d. Cash & Cash Equivalents	36,000	73,000
e. Other current Assets	6,000	8,000
TOTAL	3,07,000	5,07,000

Statement of Profit and Loss for the year 2016-17

Revenue from Operations	5,76,000
Other Income	15,000
	5,91,000
Expenses	
Purchase of stock in trade	3,61,000
Change in Inventories	(42,000)
Employee benefit expenses	48,000
Finance Cost	4,000
Depreciation and Amortisation	30,000
Other Expenses	44,000
	4,45,000
Profit before tax	1,46,000
Tax provision	25,000
Profit after tax	1,21,000

Few relevant points:

Income statement include the following:

- Profit on sale of machinery (BV 50,000) 7,000
- Loss on sale of furniture (BV 10,000) 3,000
- Non-current investment sold for 13,000 and current investment for 3,000. Respective profits were 3,000 and 400.
- Depreciation charged on machinery 19,000
- Income from investment: 2,500 on non-current and 200 on current.

Notes to Accounts revealed the following:

Reserves and Surplus		31-03-17
Securities Premium	10,000	
Addition on public issue	8,000	18,000
General Reserve	30,000	
Addition during the year	12,000	42,000
Profit & Loss	25,000	
Profit after tax	1,21,000	
Trans to reserve	(12,000)	
Dividend paid	(20,000)	
Proposed Dividend	(30,000)	84,000
		1,44,000
Tangible Assets:	31-03-16	31-03-17
Machinery	80,000	1,20,000
Furniture	25,000	70,000
	1,05,000	1,90,000
Short term Provisions:		
Provision for tax	20,000	28,000
Proposed Dividend	12,000	30,000
	32,000	58,000

Information on some of the balance sheet items:

- Shares were issued as below:

  30,000 against machinery at par

  25,000 to acquire stock at par

  Balance for cash at a premium
- A machine (BV 9,000) was converted into stock in trade
- Debenture holders took investment 9,000 (at BV) in part satisfaction of their claim.

Answer:

Cash Flow Statement of FCFS Ltd for the year ended 31-03-2017

OPERATING ACTIVITIES			
	PBT	146000	
add	Depreciation & Amortisation	30000	
	Finance Cost	4000	
	Loss on sale of furniture	3000	
		183000	
less	Profit on sale of machinery	-7000	
	Profit on sale of investments	-3400	
	Income from Investments	-2700	
	Operating Profit before working capital changes	169900	
	Increase in Inventory [(72000-25000-9000)-30000]*	-8000	
	Increase in Trade receivables	-24000	
	Increase in other current assets	-2000	
	Increase in Trade Payables	11000	
	Increase in other current liabilities excl interest**	4200	
		151100	
	Tax paid	-17000	134100
INVESTING ACTIVITIES			
	Sale of Machinery	57000	
	Sale of Furniture	7000	
	Sale of Non-Current Investments	13000	
	Sale of Current Investments	3000	
	Income from Investments	2700	
	Purchase of machinery in cash	-88000	
	Purchase of Furniture in cash	-63000	
	Purchase of non-current investments	-28000	
	Purchase of current investments	-6600	-102900
FINANCING ACTIVITIES			
	Issue of shares in cash incl. premium	53000	
	Redemption of debenture in cash (20000-9000)	-11000	
	Interest paid [4000+600-400]	-4200	
	Proposed Dividend paid	-12000	
	Interim Dividend paid	-20000	5800
	Net Cash Flow during the year		37000
	Opening Cash & Cash equivalent		36000
	Closing Cash & Cash equivalent		73000

* Increase in Inventory after adjustment for non cash acquisition.

** Outstanding debenture interest, being financing activity, should not be considered in adjusting working capital changes.

Workings for different Assets and Investments

	Machinery	Furniture	NC Invst.	C Invest.		Machinery	Furniture	NC Invst.	C Invest.
Op. Bal	80000	25000	32000	10000	Bank	57000	7000	13000	3000
Pr on sale	7000		3000	400	Loss on sale		3000		
					Stock	9000			
Eq. Shs	30000				Debenture			9000	
Purchase	**88000**	**63000**	**28000**	**6600**	Depreciation	19000	8000		
(bal fig)					Cl Bal	120000	70000	41000	14000
	205000	88000	63000	17000		205000	88000	63000	17000

13. Balance Sheets of Expansion Ltd. are given below:

	31-03-16 (‘000 ₹)	31-03-17 (‘000 ₹)
Equity and Liability		
Shareholders’ Fund		
Share Capital (100 each)	**2,00,000**	**2,50,000**
Reserves and Surplus:		
General Reserve	**50,000**	**60,000**
Securities Premium	**-**	**10,000**
Profit & Loss Statement	**30,500**	**30,600**
Non-current Liabilities		
Bank Loan	**70,000**	**-**
Current Liabilities		
Trade Payables	**1,50,000**	**1,35,200**
Short-term Provisions (Provision for tax)	**30,000**	**35,000**
TOTAL	**5,30,500**	**5,20,800**
Assets		
Non-current Assets		
Fixed Assets		
Tangible		
Land & Building	**2,00,000**	**1,90,000**
Machinery	**1,50,000**	**1,69,000**
Intangible (Goodwill)	**-**	**5,000**

Current Assets		
Inventories	**1,00,000**	**84,000**
Trade Receivables	**80,000**	**64,200**
Cash & Cash Equivalents	**500**	**8,600**
TOTAL	**5,30,500**	**5,20,800**

Additional information:

During the year ended 31.12.2017 :

(a) Dividend of ₹ 23,000 was paid.

(b) Business of another company consisting of stock ₹25,000 and Machinery ₹25,000 were purchased by the issue of ₹ 50,000 Equity Shares at 120 and payment in cash of ₹ 5000.

(c) There was a further purchase of machinery for ₹ 8,000; Depreciation charged on machinery – ₹12,000.

(d) Loss on sale of machinery was ₹ 200 which was written off to Profit & Loss Statement.

(e) Income tax provided during the year was ₹ 33,000.

(f) ₹ 75,000 paid against Bank Loan in full settlement.

You are required to prepare the Cash Flow Statement for the year ended 31-03-2017.

Answer:

Notes:

(i) Consider the transaction (item b) relating Business Purchase. Here, cash and non-cash payments were made for Current and Non-current items. Let us show it by preparing the following account –

Business Purchase A/c

To Equity Share Capital	50,000	By Machinery	25,000
To Securities Premium	10,000	By Goodwill (bal. fig.)	15,000
To Cash	5,000	By Stock	25,000
	65,000		65,000

It can be observed that for Machinery and Goodwill (both non-current items, having value 40,000), Equity Shares were issued at a premium, and in addition, 20,000 shares including premium were issued against Stock. Thus, of the stock acquired, cash acquisition is 5,000, and this 5,000 affects cash flow.

So, while calculating decrease in inventory, we proceed as below:

Closing Inventory	84,000
Less. Non-cash acquisition	20,000
Closing inventory from cash acquisition	64,000
Opening Inventory	1,00,000
So, Decrease in Inventory	36,000

(ii) **Machinery A/C**

To Balance b/f	1,50,000	By Loss on sale of Machinery	200
To Business Purchase	25,000	By Bank(sale value)-bal.fig.	1,800
To Bank	8,000	By Depreciation	12,000
		By Balance c/f	1,69,000
	1,83,000		1,83,000

Cash Flow Statement of FCFS Ltd for the year ended 31-03-2017

OPERATING ACTIVITIES		
Increase in P/L balance	100	
Transfer to Reserve	10,000	
Interim Dividend	23,000	
Provision for Taxation	33,000	
Interest on Bank Loan	5,000	
Depreciation on Building	10,000	
Depreciation on Machinery	12,000	
Amortisation of Goodwill	10,000	
Loss on sale of machinery	200	
Operating profit before working capital changes	103,300	
Decrease in Trade Payable	-14,800	
Decrease in Inventory [100000-(84000-20000)]	36,000	
Decrease in Trade Receivable	15,800	
Operating cash flow before tax	140,300	
Payment of Tax [30000+33000-35000]	-28,000	112,300
INVESTING ACTIVITIES		
Sale of Machinery	1,800	
Purchase of machinery in cash	-8,000	-6,200
FINANCING ACTIVITIES		
Repayment of Bank Loan	-70,000	
Payment of Interest	-5,000	
Payment of Interim Dividend	-23,000	-98,000
Net Cash Flow during the year		8,100
Opening Cash & Cash Equivalent		500
Closing Cash & Cash Equivalent		8,600

Note: Operating Profit before working capital changes may also be ascertained by preparing the Adjusted Profit & Loss A/C.

Study Note – 4

ACCOUNTS OF BANKING, ELECTRICITY AND INSURANCE COMPANY

Learning Objective:

- *To be able to know the definitions, salient features and other terms related to banking companies. To understand the details of unclaimed deposits and liquidity requirements. To be able to prepare and present final accounts of banking companies.*
- *To be able to know the definitions and other terms related to electricity companies. To Understand the basic provisions of Electricity Act,2003 and its applicability. To be able to prepare the final accounts of Electricity Company.*
- *To understand the meaning and types of insurances, their principles and legal provisions. To be able to understand the differences between life and non-life insurance and other related terms of an Insurance. To be able to prepare final accounts of companies.*

1. Choose the correct alternative.

(i) Rate of provisioning for advances doubtful for more than 1 year but less than 3 years is

A. 25%

B. 40%

C. 60%

D. 100%

(ii) Balance of Interest Accrued on Security Deposit A/C of an electricity company should be shown

A. Under Current Liability

B. Under Non-current Liability

C. Under Current Asset

D. Under Non-current Asset

(iii) Which of the following is not a mandatory financial statement of a General Insurance Company as per IRDA regulations?

A. Revenue Account

B. Profit and Loss Account

C. Balance Sheet

D. Cash Flow Statement

(iv) A Banking Company needs to transfer a minimum of _______ of its profit to reserve fund.

A. 10%

B. 15%

C. 20%

D. 25%

(v) In case of an electricity company, depreciation on assets is calculated based on the rates notified by

A. Companies Act 2013

B. State Electricity Commission

C. Central Electricity Regulatory Commission

D. Income Tax Act 1961

(vi) Which of the following Acts has not been replaced by The Electricity Act,2003

A. The Indian Electricity Act, 1910,

B. The Electricity (Supply) Act, 1948 and

C. The Electricity Regulatory Commissions Act, 1998

D. Companies Act 1956

Answer:

(i) B

(ii) B

(iii) D

(iv) D

(v) C

(vi) D

2. State true or False.

(i) No banking company shall directly or indirectly deal in the buying, selling or bartering of goods, except in connection with the realization of security given to or held by it.

(ii) A banking company may grant loans or advances on the security of its own shares.

(iii) Maximum number of members in Central Electricity Authority is 13(thirteen).

(iv) The Straight Line Method by application of a fixed rate over the fair life of the asset is not allowed by CERC.

(v) Bonus is the share of profit which is payable by the insurance company to the policyholders.

(vi) In case of Double Insurance the same risk and the same subject matter is insured with more than one insurer.

(vii) Before paying any dividend, a banking company has to write off completely all of its capitalized expenses including preliminary expenses, share selling commission etc.

(viii) As per the Electricity Act 2003, 12% of the power supplied by suppliers and distributors has to be generated using renewable and non-conventional sources of energy.

(ix) All contracts of insurance are contracts of uberrimae fidei.

Answer:

(i) True

(ii) False

(iii) False

(iv) True

(v) True

(vi) True

(vii) True

(viii) False

(ix) True.

3. Match the following items in Column 'A' with items shown in Column 'B

Column 'A'		Column 'B'	
1.	Rate of provision on secured sub-standard advances	A.	Double Insurance
2.	Insurers transfer a part of the risk	B.	14%
3.	Same risk and object is insured with more than one insurer.	C.	15%
4.	Rate of return on equity as per Regulation 21 in case of Electricity Companies.	D.	Re-insurance

Answer:

1. (C)
2. (D)
3. (A)
4. (B)

4. **Write a Short Note: Treatment of Service Line cum Development Charges**

Answer:

Following different accounting and reporting practices are noticed in published Financial Statements of some Electricity Companies:

Accounting Practice 1: SLD is accounted for as a liability and subsequently proportionate amount is transferred to Income Statement during the expected life of the Asset.

Accounting Practice 2: SLD is accounted for as Reserve as the amount is not refundable and disclosed under the head Reserves and Surplus without transferring any proportionate amount to Income Statement during the expected life of the Asset.

Accounting Practice 3: SLD is accounted for as **Capital Reserve** as the amount is not refundable and subsequently proportionate amount is transferred to Income Statement during the expected life of the Asset to match against depreciation on total cost of such asset.

Accounting Practice 4: SLD is accounted for as reduction in the cost of Non-Current Asset and depreciation is provided on such reduced cost.

5. **Write a Short Note: Provisioning Arrangements for Non-Performing Assets**

Answer:

Rates of Provisioning for Non-Performing Assets and Restructured Advances

Category of Advances	Rate (%)
Standard Advances	
(a) Direct advances to agricultural and SME	0.25
(b) Advances to Commercial Real Estate (CRE) Sector	1.00
(c) All other loans	0.40
Sub-standard Advances	
Secured Exposures	15
Unsecured Exposures in respect of Infrastructure loan accounts where certain safeguards such as escrow accounts are available.	20
Unsecured other loans	25
Doubtful Advances – Unsecured Portion	100
Doubtful Advances – Secured Portion	
For Doubtful up to 1 year	25
For Doubtful > 1 year and up to 3 years	40
For Doubtful > 3 years	100

6. Write a Short Note: Valuation of Unlisted and other than actively traded Equity Securities and Derivative Instruments by Insurance Company.

Answer:

Unlisted equity securities and derivative instruments and listed equity securities and derivative instruments that are not regularly traded in active markets shall be measured at historical cost.

Provision shall be made for diminution in value of such investments. The provision so made shall be reversed in subsequent periods if estimates based on external evidence show an increase in the value of the investment over its carrying amount. The increased carrying amount of the investment due to the reversal of the provision shall not exceed the historical cost.

For the purposes of this regulation, a security shall be considered as being not actively traded, if its trading volume does not exceed ten thousand units in any trading session during the last twelve months.

7. From the following information, 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) Rs. 56000. Discount Received Rs. 204000.

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

Amount of Bill (₹)	Rate of Discount	Due Date (including grace days)
130000	13% p.a.	June 14, 2017
300000	15% p.a.	July 19, 2017
860000	12% p.a.	August 10, 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	130000	13%	3472
19.07.17	110	300000	15%	13562
10.08.17	132	860000	12%	37322
			Total	54356

Amount to be credited to P/L = 56000+204000-54356 = ₹ 2,05,644

Journal Entry:

Interest and Discount A/c …………….. Dr. 54,356

To Rebate on Bill Discounted A/c 54,356

8. **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:**

   (i) Date of Commercial Operation of COD = 1st April 2016

   (ii) Approved Opening Capital Cost as on 1st April 2016 = Rs. 20,00,000

   (iii) Return of equity to be computed @ 14% p.a.

   (iv) Additional Capital Expenditure (Allowed) is as follows:

Year	1	2	3	4
Amount (₹)	1,20,000	40,000	30,000	15,000

Answer:

Calculation for Return on Equity

Particulars	1st Year	2nd Year	3rd Year	4th Year
A. Opening Equity (30%)	600000	636000	648000	657000
B. Additional equity (30%)	36000	12000	9000	4500
C. Closing Equity (A+B)	636000	648000	657000	661500
D. Average Equity [(A+B)/2]	318000	642000	652500	659250
E. Return on Equity (14% of D)	44520	89880	91350	92295

9. **On 31st March, 2016 XYZ Bank Ltd. had a balance of ₹ 36 crores in Rebate on Bill Discounted Account. During the year ended 31st March, 2017, XYZ Bank Ltd. discounted bills of exchange of ₹16,000 crores charging interest at 18% p.a., the average period of discount being for 73 days. Of these, bills of exchange of ₹ 2400 crores were due for realization from the acceptor/customers after 31st March, 2017, the average period outstanding after 31st March, 2017 being 36.5 days.**

   XYZ Bank Ltd. asks you to pass journal entries and show the ledger accounts pertaining to:

   (i) Discounting of Bills of Exchange; and

   (ii) Rebate on bill Discounted.

Answer:

In the books of XYZ Bank Ltd

Journal (₹ in Crore)

Date	Particulars	L.F.	Debit (₹) Crore	Credit (₹) Crore
2017	Rebate on Bill Discounted A/c Dr. To, Discount on Bills A/c (Being the transfer of opening balance to Rebate on Bill Discounted Account]		36.00	36.00
	Bills Purchased and Discounted A/c Dr. To, Client A/c To, Discount on bills A/c (16000*18%*73/365) (Being the discounting of bills during the year)		16,000.00	15,424.00 576.00
	Discount on bills A/c Dr. To Rebate on Bills Discounted A/c (2400*18%*36.5/365) (Being the provision for unexpired discount as on 31.03.2012)		43.20	43.20
	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 Account)		568.80	568.80

Ledger of XYZ Bank Ltd.

Dr. **Rebate on Bill Discounted Account** *Cr.*

Date	Particulars	(₹ in Cr.)	Date	Particulars	(₹ in Cr.)
01.04.16	To Discount on bills A/c	36.00	01.04.16	By balance b/d	36.00
31.03.17	To balance c/d	43.20	31.03.17	By Discount on bill A/c (Rebate required)	43.20
		78.80			78.80

Dr. **Discount on Bill Account** *Cr.*

Date	Particulars	(₹ in Cr.)	Date	Particulars	(₹ in Cr.)
31.03.12	To Rebate on Bills Discount A/c	43.20	01.04.16	By Rebate on Bills Discounted A/c	36.00
	To Profit and Loss A/c (Transfer)	568.80	2016-17	By Bill Purchased and Discount A/c	576.00
		612.00			612.00

10. **From the following information of advances of Soft Bank Ltd. calculate the amount of provisions to be made in Profit and Loss Account for the year ended 31.3.2017:**

Asset classification	₹ in lakhs
Standard	3,000
Sub-standard	2,200
Doubtful:	
For one year	900
For two years	600
For three years	400
For more than three years	300
Loss assets	800

Answer:

Statement showing provisions on various performing and non-performing assets. ₹ in Lakhs

Asset Classification	Amount	Provision %	Amount of Provision
Standard	3,000	0.40	12
Sub-standard	2,200	15	330
Doubtful			
One year	900	25	225
2 yean	600	40	240
3 years	400	40	160
More than 3 years	300	100	300
Loss assets	800	100	800
			2,067

11. **From the particulars given below, ascertain the amount of provision to be made against advances of PBI, Kolkata.** **(₹ in Lakhs)**

Particulars	Amount (₹)
Total amount of Loons & Advances Advance fully secured Advance overdue for 15 months	240 140 40
Advance overdue for more than 2.5 year but less than 3 years (Secured by mortgage of land & building valued ₹10 lakhs)	20 _
Unsecured Advance not recoverable	40

Answer:

Statement showing provisions to be made (₹ in Lakhs)

Type of Advance	Amount (₹)	Percentage of Provisions (%)	Amount (₹)
Standard Asset	140	0.40%	56,000
Sub-Standard Asset	40	15%	6,00,000
Doubtful Asset	20	(Unsecured provision + 40% of secured provision)	14,00,000*
Loss Asset	40	100%	40,00,000
			60,56,000

Unsecured Provision (20,00,000 - 10,00,000) i.e. 10,00.000 + 40% of 10,00.000 = 1400000

12. Calculate depreciation as per 2009 regulations from the following information of on Electricity generation project

(i) Date of commercial operation i.e. 1.9.2010.

(ii) The details of actual expenditure incurred up to the date of commercial operation i.e. 1.9.2010 and projected expenditure to be incurred from the date of commercial operation up to 31.3.2014 for the assets under Transmission system The details of apportioned approved cost as on the date of commercial operation and projected expenditure to be incurred for the above mentioned assets is summarized below:

[₹ in lakh]

Apportioned approved cost	Actual Cost Incurred as on the dale of commercial operation	Proposed Expenditure from the date of commercial operation to 31.3.2011	Proposed Expenditure for 2011-12	Total Expenditure completion cost	
840000	**800000**	**200000**	**40000**	**1040000**	
Average Rate of Depreciation Calculated as per rates Specified in Appendix-III		**5.3**	**5.2**	**5.2**	**5.2**

Additional capital expenditure of ₹ 40000 lakhs has been considered out of 200000 lakh for the year 2010-11 and no further additional capital expenditure has been considered as capital cost has been restricted to apportioned approved cost in the absence of revised capital expenditure.

Answer:

Computation of Depreciation

Particulars	**2010-11**	**2011-12**	**2012-13**	**2013-14**
A. Opening Gross Block	8,00,000	8,40,000	8,40,000	8,40,000
B. Additional Capital exp.	40,000	0.00	0.00	0.00
C. Closing Gross Block JA+B]	8,40 ,000	8,40,000	8,40,000	8,40,000
D. Average Gross Block [(A+Q/2]	8,20,000	8,40,000	8,40,000	8,40,000
E. Weighted Average Rate of Depreciation	5.3	5.2	5.2	5.2
F. Period	7 months	12 months	12 months	12 months
G. Depreciation [D * E * F/12)	25,352	43,680	43,680	43,680

13. The Revenue Account of a life insurance company shows the life assurance fund on 31st March, 2017 at ₹50,00,000 before taking into account the following items:

(i) Claims covered under re-insurance ₹9,000.

(ii) Bonus utilized in reduction of life insurance premium ₹4,000.

(iii) Interest accrued on securities ₹ 7,000.

(iv) Outstanding premium ₹ 4,000.

(v) Claims intimated but not admitted ₹ 20,000.

What is the life assurance fund after taking into account the above omissions?

Answer:

Statement showing Life Assurance Fund

Particulars	**Amount (₹)**	**Amount (₹)**	**Amount (₹)**
Balance of Fund as on 31st March, 2013			50,00,000
Add:			
Interest on securities		7,000	
Premium outstanding		4,000	
			11,000
			50,11,000
Less:			
Claims outstanding	20,000		
Less: Covered under re-insurance	9,000		
		11,000	
Bonus in reduction of premium		4,000	
			15,000
Balance of Life Assurance Fund			49,96000

Study Note – 5

ACCOUNTING STANDARDS

Learning Objective:

- *To understand the legal provision required for and accounting treatment under AS 11- Accounting for the Changes in Foreign Exchange Rates, AS 12 - Accounting for Government Grants, AS 15 - Employee Benefits, AS 16 - Borrowing Costs, AS 17 - Segment Reporting, AS 18 - Accounting Standard Related Party Disclosure and AS 19 - Accounting for Leases*
- *To have a detail understanding of different alternative situations based on numerical problems.*

Fill in the blanks:

1. Foreign currency is a currency other than the _________ _________ of the entity.
2. Government grants in the form of non-monetary assets is recorded at _________ _________ if it is given free of cost.
3. Short-term employee benefits are employee benefits (other than termination benefits) that are expected to be settled wholly before _________ after the end of the annual reporting period in which the employees render the related service.
4. Where retirement benefit scheme is amended in a manner which results in additional benefits being provided to retired employees, the cost of the additional benefits should be taken as _________ as per AS-5.
5. When the carrying amount of the qualifying asset exceeds its recoverable amount or net realisable value, _________ is written down.
6. Borrowing costs are _________ as part of cost of qualifying asset when it is probable that they will result in future economic benefits and cost can be measured reliably.
7. A reporting entity is exempt from the disclosure requirements in relation to related party transactions and outstanding balances, including commitments, with a _________ that has control or joint control of, or significant influence over, the reporting entity.
8. _________ is the period over which an asset is expected to be economically usable by one or more users.
9. Any assistance by government in the form of transfers of resources to an entity in return for past or future compliance with certain conditions relating to the operating activities of the entity is known as _________ .
10. _________ is essentially any party that controls or can significantly influence the management or operating policies of the company during the reporting period.
11. A _________ is a business segment or a geographical segment identified for which segment information is required to be disclosed by this Statement.
12. A lease is classified as a _________ if it transfers substantially all the risks and rewards incidental to ownership.
13. A lease is classified as an _________ if it does not transfer substantially all the risks and rewards incidental to ownership.

14. The _________ is the non-cancellable period for which the lessee has contracted to lease the asset together with any further terms for which the lessee has the option to continue to lease the asset, with or without further payment, when at the inception of the lease it is reasonably certain that the lessee will exercise the option.

Answer:

1. functional currency
2. nominal valu
3. twelve months
4. Prior Period and Extraordinary Items
5. the carrying amount
6. capitalized
7. government
8. Economic life
9. Government Grant
10. A related party
11. reportable segmen
12. finance lease
13. operating lease
14. lease term

True and False:

1. **There is no option to recognize the exchange differences arising on translation of any long-term monetary items from foreign currency to functional currency and it is permitted.**
2. **Every part of an entity is necessarily an operating segment or part of an operating segment.**
3. **A lease is an agreement whereby the *lessee* conveys to the *lessor* in return for a payment or series of payments the right to use an asset for an agreed period of time.**
4. **Under Defined Contribution Plans (DCP), Amount paid is usually determined with reference to employee's earnings and/or years of service**

Answer:

1. **False**

   There is **an option** to recognize the exchange differences arising on translation of any long-term monetary items from foreign currency to functional currency and it is permitted.

2. **False:**

   Not every part of an entity is necessarily an operating segment or part of an operating segment.

3. **False**

   A lease is an agreement whereby the **lessor** conveys to the **lessee** in return for a payment or series of payments the right to use an asset for an agreed period of time.

4. **False**

   Under Defined Benefit Plans (DBP) Amount paid is usually determined with reference to employee's earnings and/or years of service (if the basis of contribution are determined, it will be treated as defined contribution scheme)

Answer the following questions:

1. What does it mean by the word exchange difference?

Answer:

Exchange difference is the difference resulting from translating a given number of units of one currency into another currency at different exchange rates.

2.

	Exchange Rate ($1)
Goods sold on 03.02.2018 of US $1,00,000	**₹ 64.17**
Exchange rate on 31.3.2018	**₹ 63.58**
Date of actual payment 5.04.18	**₹ 63.75**

Calculate the loss/gain for the financial years 2017-18 and 2018-19.

Answer:

As per AS-11, all foreign currency transactions should be recorded by applying the exchange rate at the date of transaction. Therefore, goods sold on 03.02.2018 and corresponding debtor would be recorded at ₹ 64.17

= 1,00,000 × 64.17 = 64,70,000

As per AS-11, at the balance sheet date all monetary items should be reported using the closing rate.

Therefore, the debtors of US $1,00,000 outstanding on 31.3.18 will be reported as:

1,00,000 × 63.58 = 63,58,000.

Exchange loss ₹1,12,000 = (64,70,000– 63,58,000) should be debited in profit and loss account for 2017-18.

As per AS-11, exchange difference on settlement on monetary items should be transferred to profit and loss account as gain or loss thereof:

1,00,000 × 63.75 = 63,75,000 - 63,58,000 = ₹17,000 should be credited to profit or loss for the year 2018-19.

3. Discuss the reporting practices in financial statement when there is any exchange difference on the reporting date

Answer:

(a) Monetary items like foreign currency balance, receivables, payables, loans at closing rate (in case of restriction or remittance other than temporary or when the closing rate is unrealistic, it is reported at the rate likely to be realized).

(b) Non-monetary items like fixed assets, which are recorded at historical cost, should be made at the rate on the date of transaction.

(c) Non-monetary items other than fixed assets are carried at fair value or net realizable value on the date which they are determined i.e. B/S date (inventories, investments in equity-shares).

4. State the disclosure requirement for an enterprise under AS – 11.

Answer:

An enterprise should disclose the followings under AS 11:

(a) The amount of exchange difference included in the net profit or loss for the period.

(b) The amount of exchange difference adjusted in the carrying amount of fixed assets during the accounting period.

(c) The amount of exchange difference in respect of forward contracts to be recognized in the profit/ loss for one or more subsequent accounting period.

(d) Foreign currency risk management policy.

5. Define government assistance and government grants?

Answer:

Government assistance is action by government designed to provide an economic benefit specific to an entity or range of entities qualifying under certain criteria. Government assistance for the purpose of this Standard does not include benefits provided only indirectly through action affecting general trading conditions, such as the provision of infrastructure in development areas or the imposition of trading constraints on competitors.

Government grants are assistance by government in the form of transfers of resources to an entity in return for past or future compliance with certain conditions relating to the operating activities of the entity.

6. A Ltd. purchased machinery from B Ltd. on 01.07.2017. The price was ₹1064 lakhs after charging 12% GST and giving a trade discount of 5% on the Quoted price. Transport cost was ₹50000 and installation charges came to 2% on the quoted price.

A loan of ₹700 lakhs was taken from the bank on which interest at 15% p.a. was to be paid. Expenditure incurred on materials ₹30,000, wages ₹10,000 and overhead ₹ 5,000 to ready for use of Machinery on 1.04.2018. However, it was actually put to use only on 1.07.2018.

Find out the cost of the machine and suggest the accounting treatment for the expenses incurred in the interval between the dates 1.04.2018 and 01.07.2018. The entire loan amount remain unpaid on 01.07.2018.

Answer:

As per para 6, AS 16, borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalised as part of the cost of that asset. Other borrowing costs should be recognised as all expense in the period in which they are incurred.

Cost of the Machine	₹	
Quoted Price = $\frac{100}{112}\times\frac{100}{95}\times 1064 = 1000$		
Price of the Machinery	1064	
Add: Transportation cost	0.50	
Add: Installation Charges @ 2% on ₹1,000 lakhs	20.00	
Add: Expenditure incurred till the machine was ready for use or sale	₹	
materials	0.3	
wages	0.1	
overhead	0.05	
Add: Cost of borrowing @ 15% on ₹700 lakhs (from 01.07.2017 to 1.04.2018)	78.75	99.7
Cost of the machine		1163.7

As per para 19 and para 20, of AS 16, capitalisations of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete.

Similarly, an asset is normally ready for its intended use or sale when its physical construction or production is complete even though routine administrative work might still continue. Hence, capitalisation of borrowing cost @ 15% on ₹700 lakhs for 3 months amounting to ₹26.25 lakhs should be treated as an expense and, as such, should be adjusted against Profit and Loss Statement.

7. What is qualifying asset as per AS 16?

Answer:

A qualifying asset is an asset that necessarily takes substantial period of time to get ready for its intended use or sale.

Examples of qualifying assets:

- Any tangible fixed assets, which are in construction process or acquired tangible fixed assets, which are not ready for use or resale. Such as plants and machinery.
- Any intangible assets, which are in development phase or acquired but not ready for use or resale, such as patent.
- Investment property.
- Inventories that require a substantial period (i.e. generally more than one accounting period) to bring them to a saleable condition.

8. Write short note on geographical segment

Answer:

A **geographical segment** is a distinguishable component of an enterprise that is engaged in providing products or services within a particular economic environment and that is subject to risks and returns that are different from those of components operating in other economic environments. Factors that should be considered in identifying geographical segments include:

(a) similarity of economic and political conditions;

(b) relationships between operations in different geographical areas;

(c) proximity of operations;

(d) special risks associated with operations in a particular area;

(e) exchange control regulations; and

(f) the underlying currency risks.

9. State the threshold criteria for identifying a segment as reportable segments

Answer:

A business segment or geographical segment should be identified as a reportable segment if:

(a) its revenue from sales to external customers and from transactions with other segments is 10 per cent or more of the total revenue, external and internal, of all segments; or

(b) its segment result, whether profit or loss, is 10 per cent or more of -

 (i) the combined result of all segments in profit, or

 (ii) the combined result of all segments in loss, whichever is greater in absolute amount; or

(c) its segment assets are 10 per cent or more of the total assets of all segments.

A business segment or a geographical segment which is not a reportable segment, may be designated as a reportable segment despite its size at the discretion of the management of the enterprise. If that segment is not designated as a reportable segment, it should be included as an unallocated reconciling item.

If total external revenue attributable to reportable segments constitutes less than 75 per cent of the total enterprise revenue, additional segments should be identified as reportable segments, even if they do not meet the 10 per cent, until at least 75 per cent of total enterprise revenue is included in reportable segments.

10. An enterprise operates through eight segments, namely, A, B, C, D, E, F, G and H. The relevant information about these segments is given in the following table (₹ in lakh):

	A	B	C	D	E	F	G	H	Total (segment)
1. Segment Revenue									
(a) External Sales	**-**	**663**	**37**	**25**	**13**	**125**	**50**	**87**	**1000**
(b) Inter Segment Sales	**250**	**150**	**75**	**13**	**-**	**-**	**12**	**-**	**500**
2. Segment Results Profit/ (Loss)	**15**	**(270)**	**45**	**(15)**	**24**	**(15)**	**15**	**21**	
3. Segment Assets	**15**	**5**	**5**	**60**	**3**	**5**	**5**	**2**	**100**

Identify the reportable segments.

Answer:

Calculation for Reportable Segments.

Particulars	A	B	C	D	E	F	G	H	Total
1. Segment Revenue									
(a) External Sales	-	663	37	25	13	125	50	87	1000
(b) Inter Segment Sales	250	150	75	13	-	-	12	-	500
Total	250	813	112	38	13	125	62	87	1500
% of segment revenue to the revenue of all segment revenue	**16.7**	**54.2**	7.5	2.5	0.8	8.3	4.1	5.8	
2. Segment Results Profit/ (Loss)	15	(270)	45	(15)	24	(15)	15	21	
% of segment results Profit/Loss to the total Profit/(Loss), whichever is greater in absolute amount	5	**90**	**15**	5	8	5	5	7	
3. Segment Assets	15	5	5	60	3	5	5	2	100
% of segment assets to total segment assets	**15**	5	5	**60**	3	5	5	2	

So, the reportable segments are A, B, C and D

Now, total external sales of A, B, C and D = 725

Whereas, 75% of total external sales = 1000×75% = 750, shortfall of 25

Hence the Company selects segment F with highest external sales.

So the reportable segments are A, B, C, D and F and "an unallocated reconciling item"

11. Write a short note on: Related Party

Answer:

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 per following relationships are considered as related:

- 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.
- 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.

12. X Ltd. sold machinery having WDV of ₹800 Lakhs to Y Ltd. for ₹900 Lakhs and the same machinery was leased back by B Ltd. to H Ltd. The Lease back is operating lease.

Comment if –

(a) Sale price of ₹900 lakhs is equal to fair value

(b) Fair value is ₹950 lakhs

(c) Fair value is ₹800 lakhs and sale price is ₹900 lakhs

(d) Fair value is ₹850 lakhs and sale price is ₹750 lakhs

(e) Fair value is ₹750 lakhs and sale price is ₹790 lakhs

(f) Fair value is ₹860 lakhs and sale price is ₹900 lakhs

Answer:

(a) X ltd. should immediately recognize the profit of ₹100 lakhs in its books.

(b) Profit ₹100 lakhs should be immediately recognized by X Ltd.

(c) Profit of ₹100 lakhs is to be amortized over the lease period.

(d) Loss of ₹50 lakhs to be immediately recognized by X Ltd. in its books provided loss is not compensated by future lease payment.

(e) Loss of ₹50 lakhs (800-750) to be immediately recognized by X Ltd. in its books and profit of ₹40 lakhs (790-750) should be amortized / deferred over lease period.

(f) Profit of ₹60 lakhs (860-800) to be immediately recognized in its books and balance profit of ₹40 lakhs (900-860) is to be amortized / deferred over lease period.

13. A purchased a machinery for ₹60,000 and leased out it to B for three years on leases basis, after the lease period, value of the computer was estimated to be ₹25,000. Lease amount payable at the beginning of each year is ₹35,000; ₹20,000; & ₹10, 000. Depreciation was charged @ 30% p.a. on W.D.V. You are required to pass the necessary journal entries in the books of A.

Answer:

Journals

In the books of A

Year	Particulars		Dr. (₹)	Cr. (₹)
1st Year	Machinery A/c	Dr.	60,000	
	To, Bank A/c			60,000
	Bank A/c	Dr.	35,000	
	To, Lease Rent A/c			35,000
	Depreciation A/c	Dr.	18,000	
	To, Machinery A/c			18,000
	Profit & Loss A/c	Dr.	18,000	
	To, Depreciation A/c			18,000
	Lease Rent A/c	Dr.	35,000	
	To, Profit & Loss A/c			35,000

2nd Year	Bank A/c To, Lease Rent A/c	Dr.	20,000	 20,000
	Depreciation A/c To, Machinery A/c	Dr.	15,600	 15,600
	Profit & Loss A/c To, Depreciation A/c Lease Rent A/c To, Profit & Loss A/c	Dr. Dr.	15,600 20,000	 15,600 20,000
3rd Year	Bank A/c To, Lease Rent A/c	Dr.	10,000	 10,000
	Depreciation A/c To, Machinery A/c	Dr.	10,920	 10,920
	Profit & Loss A/c To, Depreciation A/c Lease Rent A/c To, Profit & Loss A/c	Dr. Dr.	10,920 10,000	 10,920 10,000
	Bank A/c Loss on Sale A/c To, Machinery A/c	Dr. Dr.	25,000 480	 25,480

14. Write short notes on (i) Finance lease and (ii) Operating lease

Answer:

(i) Finance Lease – It is a lease, which transfers substantially all the risks and rewards incidental to ownership of an asset to the Lessee by the Lessor but not the legal ownership.

In following lease transactions are called Finance Lease.

- The lessee will get the ownership of leased asset at the end of the lease term.
- The lessee has an option to buy the leased asset at the end of term at price, which is lower than its expected fair value at the date on which option will be exercised.
- The lease term covers the major part of the life of asset.
- At the beginning of lease term, present value of minimum lease rental covers substantially the initial fair value of the leased asset.
- The asset given on lease to lessee is of specialized nature and can only be used by the lessee without major modification.

(ii) Operating Lease – It is a lease which does not transfer substantially all the risk and reward incidental to ownership.

15. On 20.4.2016, M Ltd obtained a loan from the bank for ₹ 75 lakhs to be utilised as:

Particulars	**₹ (in lakhs)**
Construction of a factory	**30**
Purchase of Machinery	**25**
Working Capital	**15**
Advance for purchase of Furniture	**5**

In March 2017, construction of factory was completed and machinery installed. Delivery of furniture was not received. Total interest charged by the bank for the year ending 31.3.2017 was ₹ 10 lakhs.

Show the treatment of interest under AS 16.

Answer:

As per AS 16, borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalised as part of the cost of that asset. The amount of borrowing costs eligible for capitalisation should be determined in accordance with this Standard. Other borrowing cost should be recognised as an expense in the periods in which they are incurred.

A qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale. As per AS 16, if an asset is ready for its intended use or sale at the time of acquisition, the same cannot be treated as a qualifying asset.

Treatment of Interest

Items	**Nature of Asset**	**Interest to be capitalized ₹(in lakhs)**	**Interest to be charged to P&L A/c ₹(in lakhs)**
Constructions of a factory	Qualifying Asset	(10×30/75) = ₹4	-
Purchase of a Machinery	Not a qualifying Asset	-	(10×25/75)= ₹3.33
Working Capital	Not a qualifying Asset	-	(10×15/75) = ₹2
Advance in purchase of Furniture	Not a qualifying Asset	-	(10×5/75) = ₹0.67
		4	**6**

16. Match the following items in Column 'A' with items shown in Column 'B'

	Column 'A'		**Column 'B'**
1	AS 16	A	Accounting for Leases
2	AS 19	B	Accounting for the Changes in Foreign Exchange Rates
3	AS 17	C	Related Party Disclosures
4	AS 11	D	Borrowing Costs
5	AS 18	E	Segment Reporting

Answer:

	Column 'A'		Column 'B'
1	AS 16	D	Borrowing Costs
2	AS 19	A	Accounting for Leases
3	AS 17	E	Segment Reporting
4	AS 11	B	Accounting for the Changes in Foreign Exchange Rates
5	AS 18	C	Related Party Disclosures

Study Note – 6

AUDITING CONCEPTS

Learning Objective: ***This chapter will help to understand objective and concepts of auditing and gain working knowledge and skills and techniques required to apply them in audit. Studying internal check helps to know how protect business from carelessness, inefficiency and fraud and also to ensure and produce adequate and reliable accounting information.***

NATURE, SCOPE AND SIGNIFICANCE OF AUDITING

1. State the Advantages of Statutory Audit.

Answer:

An audit which is undertaken under any specific statute or Act is called 'statutory audit'. The term 'statutory' signifies anything regulated by laws of the state. The advantages of statutory audit are listed below:

(a) Trustworthiness of published financial statements is increased.

(b) It is indicative of the fact that the management of the organisation has performed its statutory duties appropriately.

(c) It helps in judging whether corporate governance requirements are properly adhered to or not.

(d) It helps in assessing the efficacy of internal control system of an organisation.

(e) It results in quick detection and prevention of errors and fraud. As such, early action can be taken.

(f) It ensures timely assessment of tax.

(g) It facilitates obtaining financial assistance from banks and non-banking financial companies (NBFCs).

(h) It aids in settling insurance claims.

(i) It helps in determining the value of the business in the event of merger and acquisition (M&A).

(j) It aids in settling legal disputes with the stakeholders.

2. "Auditing is a social science."- Explain.

Answer:

The term "social science" refers to any scholastic discipline that focuses on the disciplined and systematic study of society, investigates problems of human society and renders direct or indirect services to the society. Social science covers a broad range of disciplines. Examples of social science are anthropology, sociology, economics, psychology and political science etc. All these subjects or branches of knowledge systematically study the society and its problems and attempt to devise various principles to overcome such problems. Likewise auditing also systematically studies the operations of a business or any other entity which is basically a part of the society. Auditor's comment on the accuracy and reliability of the financial statements of a business entity is of immense value to all stakeholders associated with that entity. Auditing has its social objects like protecting the interest of investors, shareholders, labourers and consumers, preventing capital erosion and to stop tax evasion in the national interest. These are likely to have a direct or indirect positive impact on societal wellbeing. Thus auditing can rightly be called social science.

Moreover, social science is 'dynamic' and evolves with the passage of time by accommodating the required changes. Auditing is also dynamic and modifies itself in response to the changes in law or regulations and stakeholders' expectations. Historical evidence indicates that accounting and auditing existed even in ancient Greece, Rome, Egypt and India. However, the scope of the audit was very limited in that period. In the eighteenth century, the industrial revolution in England led to the development of the corporate form of organisations. Management got separated from ownership and volume of transactions increased enormously. As a result auditing techniques also started evolving from this phase. Subsequently, the Companies Act made audit of companies mandatory and professional institutes started issuing rules and regulations for improving the quality of auditing around the globe. All these continuously changed the form, techniques, scope and objectives of the auditing profession. Thus the dynamic character of auditing can never be ignored.

Hence, there is no denying the fact that auditing should also be considered as a dynamic social science.

3. Explain the nature of auditing.

Answer:

The nature of auditing is summed up below:

(i) Auditing is a **systematic and scientific examination** of the books of accounts of a business.

(ii) Auditing is undertaken by an **independent** person or body of persons who are duly qualified for the job.

(iii) Auditing is a **verification** of the results shown by the profit and loss account and the state of affairs as shown by the balance sheet.

(iv) Auditing is a **critical review** of the system of accounting and internal control.

(v) Auditing is done with the help of vouchers, documents, information and explanations received from the authorities.

(vi) The auditor has to satisfy himself with the **authenticity** of the financial statements and report that they exhibit a true and fair view of the state of affairs of the concern.

(vii) The auditor has to inspect, compare, check, review, scrutinise the vouchers supporting the transactions and examine correspondence, minute books of shareholders, directors, Memorandum of Association and Articles of Association, etc. in order to establish the correctness of the books of accounts.

4. Enumerate the scope of auditing.

Answer:

In the ancient period, the scope of auditing was really limited. But over the time the scope of auditing has extended considerably.

The scope of auditing of financial statements is determined by the auditor having regard to the terms of the engagement, the requirements of relevant legislation and the pronouncements of the Institute of Chartered Accountants of India (ICAI). Moreover, the auditor must also ensure that no relevant aspect of the organisation is left unchecked even if it is not specifically mentioned in the terms, regulations or pronouncements. Again, the terms of engagement cannot limit the scope of auditing in relation to matters which are prescribed by legislation or by the pronouncements of the ICAI.

According to SA-200 Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing, the scope of auditing should cover the following aspects:

(a) The auditor shall assess the reliability and sufficiency of the information contained in the underlying accounting records and shall undertake appropriate audit procedures for this purpose. Appropriate audit procedure may include either Compliance Procedures (i.e. the study of the accounting system and internal control) or Substantive Procedures (i.e. testing the authenticity, accuracy and completeness of information in accounting records).

(b) The auditor has to determine whether the relevant information is properly disclosed in the financial statements in conformity with the applicable generally accepted accounting principles and statutory requirements (i.e. requirements as per Accounting Standards and Companies Act).

(c) The auditor's work shall involve an exercise of judgement. He shall be principally concerned with items that either individually or as a group are material in relation to the affairs of an organisation.

Thus the duty of the auditor shall not be limited to mere verification of accounting entries based on the available vouchers and other documents, but he shall evaluate the authenticity of the transaction, appropriate recoding of the same in the books of accounts as well as compliance of the accounting and reporting process with prevalent statutes in this respect.

The scope of auditing, thus, depends on the following factors:

(i) The size of the organisation,

(ii) Legal status of the organisation (statutory or otherwis(e),

(iii) Purpose of audit,

(iv) Agreement between the auditor and owners (in case of non-statutory audit),

(v) Adequacy and effectiveness of the internal control system of the organisation,

(vi) Accounting system of the organisation,

(vii) Published guidelines and standards on auditing,

(viii) Relevant statutes prevalent in the country,

(ix) Legal decisions on different cases.

5. Explain the significance of auditing.

Answer:

The significance of auditing is listed below:

(i) Acceptability to the Government: Audited accounts are acceptable by government authorities like Income Tax Department, Land Revenue Department, etc.

(ii) Facilitating detection of error and fraud: Auditing helps in timely detection and prevention of errors and frauds.

(iii) Getting loans: For obtaining the loan from banks and financial institutions, previous years' audited accounts are of great help as the lenders can determine the solvency of the borrowers based on audited accounts.

(iv) Moral Check: Audit acts as a moral check on the employees of the client. This restricts them from committing defalcations.

(v) Helps in settling claims in partnership firms: In case of a partnership business, audited accounts facilitate settlement of claims on the retirement or death of a partner.

(vi) Settlement of Insurance Claim: In event of loss of property by fire or other incidents, audited accounts help in expediting the process of settlement of claims from the insurance company.

(vii) Aids in settling disputes: Audit often aids in amicable settlement of disputes between the management and labour unions on issues like payment of bonus and higher wages.

(viii) Prevention of wastage: Audit helps in detection of wastage which aids management to prevent the recurrence of the same in future.

(ix) Reviewing control systems: Audit appraises and reviews the existence and operations of different controls in the organisation and reveals weakness and inadequacy in them.

(x) Aids in case of insolvency and bankruptcy: Audited accounts form a basis for determining action in cases relating to insolvency and bankruptcy.

6. List the principles governing an audit.

Answer:

The basic principles governing an audit are stated below:

(i) Integrity, Objectivity and Independence: The auditor has to be straightforward, fair, impartial, honest and sincere in his approach to professional work.

(ii) Confidentiality: The auditor should uphold the privacy of the information and should not disclose any such information to a third party, including the employees of the entity, without the explicit authority of the management or client or unless there is a lawful or a professional responsibility to do so.

(iii) Professional Care, Skill and Competence: The auditor should exercise due professional care, competence and diligence expected of him while carrying out the audit work.

(iv) Responsibility of Work Performed by Others: The auditor should carefully direct, oversee and review the work delegated to staff. Likewise, the auditor may also use the work done by other auditors or experts.

(v) Documentation: The auditor should document matters, which are essential in providing evidence that the audit was carried out in accordance with the standards.

(vi) Planning: The auditor should plan his work in such a way as to enable him to conduct an audit in a timely and efficient manner. The audit plan should be based on the knowledge of the business of the entity. The plan should be continuously reviewed and modifications should be incorporated if required.

(vii) Audit Evidence: The auditor should get hold of enough suitable evidence to enable him to draw reasonable conclusions therefrom.

(viii) Accounting System and Internal Control: The auditor should have an understanding of the internal control and risk management framework established by the management. He has to judge the adequacy of such framework as well.

(ix) Audit Conclusions and Audit Report: The auditor should review and measure the conclusions drawn from the audit evidence obtained, as the basis for his findings contained in his report. Nevertheless, in case the auditor comes across any actual or suspected fraud, it would be more apt for him to bring the same instantaneously to the notice of the management.

7. Distinguish between error and fraud.

Answer:

The differences between error and fraud are presented below.

Point of Difference	Error	Fraud
1. Intention	It is unintentional.	It is intentional.
2. Impact	The impact of the error on the organisation is generally not serious.	The impact of fraud on the organisation is usually very serious. It can damage the goodwill of the organisation.
3. Involvement	Lower level employees are usually involved in an error.	Higher or lower level employees are involved in fraud.
4. Liability	It results in civil liability.	It leads to criminal liability.
5. Type	Errors are of two types: (1) Clerical Errors and (2) Errors of Principle.	Fraud may be of two types: (1) Misappropriation and (2) Manipulation or falsification of accounts.
6. Integrity	Error doesn't generally raise questions about the integrity of the concerned person.	In the case of fraud, the honesty and integrity of the concerned individual is always in doubt.

8. What do you mean by "Teeming and Lading"?

Answer:

It is a system of fraudulent manipulation of accounts. It is a method of misappropriation of cash by which the past defalcations are covered up by the current receipts. It is also known as 'lapping' or 'delayed accounting'. It is a method by which the cashier or the person who handles the cash of the organisation uses the money received from a person for his personal purpose for some time and when another payment comes to him he deposits that money against first money used, and does not show the new amount received, and this process will go on for some time. Such a process continues until the time the original amount misappropriated is replaced or until the cashier is caught. It can be detected with the help of auditors. The auditor has to carefully examine the internal check system regarding cash. If there is any deficiency in the internal check system, he must probe into the matter.

9. List the objectives of interim audit.

Answer:

The objectives of interim audit are as follows:

(a) To identify profit or loss of interim period,

(b) To distribute interim dividend,

(c) To obtain loan on the basis of interim account,

(d) To acquire information about the financial position of interim phase,

(e) To conduct investigation on behalf of owners, directors or government on special situations, and

(f) To determine the value of goodwill.

10. Distinguish between accounting and auditing.

Answer:

The difference between accounting and auditing is as follows :

Points of Difference	Accounting	Auditing
1. Scope	Accountancy is mainly concerned with the preparation of financial statements.	Auditing is a systematic and independent examination of data, statements, records, operations and performance (financial and otherwis(e) of an enterprise for a stated purpose.
2. Status	An accountant is an employee of the organisation.	An auditor (other than the internal auditor) is an independent outsider.
3. Service tenure	An accountant is a permanent employee of the organisation.	An auditor can be changed from year to year.
4. Formal qualification	A formal qualification is not essential for an accountant.	A formal qualification is a must for a company auditor.
5. Knowledge in other areas	An accountant is not expected to have knowledge in auditing or in other areas.	Apart from thorough knowledge in accounting, an auditor should have knowledge in other disciplines like law, management, economics etc.
6. Report submission	An accountant is not required to submit any report.	An auditor has to submit a report to his appointing authority expressing his opinion on the truthfulness and fairness of the financial statements.
7. Remuneration	As an employee of the business, an accountant draws his monthly salary regularly.	An auditor is paid a remuneration agreed upon between him and his client.
8. Nature of work	The work of an accountant is constructive in nature.	The work of auditor is analytical in nature.

11. Distinguish between audit and investigation.

Answer:

There exist substantial differences between audit and investigation. These differences are enumerated below.

Points of Difference	Auditing	Investigation
1. Legal binding	Audit of annual financial statements is compulsory under the Companies Act, 2013.	Investigation is not compulsory in most cases under the Companies Act but voluntary depending upon necessity.
2. Time Horizon	Audit is conducted usually on annual basis.	Investigation may be conducted for several years at a time, say three years. In fact, the time horizon depends upon the requirement. There is no specific period.
3. Object	Audit is conducted to ascertain whether the financial statements show a true and fair view.	Investigation is conducted with a particular object in view, viz to know the financial position, earning capacity, prove fraud, invest capital, etc.
4. Report submission	Audit report is addressed to shareholders (or proprietors or partners).	Investigation report is addressed to the party on whose instruction investigation was conducted.
5. Person performing work	Audit is to be conducted by a chartered accountant.	Investigation may be undertaken even by a non-chartered accountant.
6. Parties for whom conducted	Audit is conducted on behalf of shareholders (or proprietor, or partners).	Investigation is usually conducted on behalf of outsiders like prospective buyers, investors, lenders, etc.
7. Checking Method	In case of audit test checks are applied.	Investigation is a thorough checking of the books of account for a particular or number of years.
8. Scope	The scope of auditing is general, which attempts to give an opinion on the financial statement of the company.	The scope of the investigation is limited as it attempts to answer only those questions that are asked in the engagement letter.
9. Nature of Evidence	Audit is usually concerned with prima-facie evidence.	Investigation is usually concerned with conclusive evidence.

12. List the objectives of auditing.

Answer:

The objectives of an audit can be grouped into two categories: (1) Primary Objectives and (2) Secondary Objectives.

Primary Objectives: The primary objective of an audit is to substantiate the accuracy and judge the reliability of the financial statements of a particular accounting period of the organisation and to express an opinion about the truthfulness and fairness of the financial statements. Rendering opinion on financial statements by the auditor is specifically included in SA 200.

Secondary Objectives: The following are the secondary objectives of audit:

(i) **Detection of errors:** Detecting errors may or may not be easy. It depends on the type of error. It is easy to locate those errors whose occurrences result in a mismatch in the total of the trial balance.

(ii) **Detection of fraud:** Fraud is difficult to detect because in most cases frauds are committed intelligently and top management is involved. However, an auditor can detect frauds if he applies reasonable skill and care in the discharge of his duties.

(iii) **Prevention of errors:** Appropriate measures can be suggested by the auditor to prevent the recurrence of errors committed earlier.

(iv) **Prevention of fraud:** An auditor can suggest ways for preventing the occurrence and recurrence of frauds..

13. List the social objectives of auditing.

Answer:

Auditing has certain social objectives which are enumerated below.

(i) **Protection to Shareholders**

Since the auditor is a representative of the shareholders it is his duty to make certain that the interests of the shareholders are protected. Shareholders are large in number but they are scattered and not united. Most of them have no idea about their rights and duties. As such, they are very much vulnerable at the hands of the management of the company if the management is unscrupulous. Hence protecting the interests of the shareholders is an important social object of an audit.

(ii) **Stopping Tax Evasion**

In order to protect the national interest, it is absolutely essential that tax evasion should be stopped. Evasion of tax is a moral, social, and legal crime which adversely affects the developmental agenda of a nation by decreasing the revenue of the government. The object of an audit should be to stop tax evasion. Propriety audit, environment audit etc. are helpful in stopping tax evasion.

(iii) **Stopping Capital Erosion**

Capital erosion results from the payment of dividend out of inflated profit or payment of dividend out of unrealised profit. Payment of dividend out of inflated profit or out of unrealised profit signifies payment of dividend out of capital which leads to capital erosion. This is very serious in the sense that it will lead to capital reduction or wind up of the business. One of the important social objects of an audit is to stop capital erosion by introducing various types of audit like management audit, propriety audit, cost audit, operation audit etc.

(iv) **Ensuring Fair Return to Investors**

An important social object of an audit is to ensure a fair return to the investors. The ability of an organisation to give a fair return to its investors depends on the solvency and profitability position of the organisation.

(v) **Reasonable Price for Consumers**

It is an important social object of an audit to make sure that the consumers get the commodities at a fair and reasonable price. Ensuring supply of articles to the consumers implies that they are protected against the possible exploitation of the business.

(vi) **Fair Wages for Labourers**

An important social object of an audit is to ensure fair wages for labourers. It is essential to verify whether wages for labourers have been cut or reduced in the plea of labour cost control.

(vii) **Complying with Policies Regarding "Corporate Social Responsibility"**

The Companies Act 2013 has put emphasis on matters relating to"Corporate Social Responsibility". As per Section 135 of the Companies Act 2013, every company having net worth of rupees five hundred crore or more, or turnover of rupees one thousand crore or more or a net profit of rupees five crore or more during any financial year shall constitute a Corporate Social Responsibility Committee of the Board consisting of three or more directors, out of which at least one director shall be an independent director. The Board of every company shall ensure that the company spends, in every financial year, at least two per cent. of the average net profits of the company made during the three immediately preceding financial years, in pursuance of its Corporate Social Responsibility Policy.

14. Explain the inherent limitations of an audit.

Answer:

Generally following are the inherent limitations of an audit:

1. **Non-detection of Errors and Frauds**

   It may not be possible for the auditor to detect certain errors and frauds which are committed very cleverly.

2. **Problem of Dependence**

   In verifying or valuing certain items, an auditor has to depend on the explanation, clarification and information provided by the responsible officers of the organisation. He may or may not get correct or complete information. As such, if such explanation and information prove to be untrue, then the audit report is affected adversely as well.

3. **Dependence on the Opinions of Others**

   In dealing with certain items, an auditor has to rely on the opinions of experts like solicitors, engineers, architects etc. since an auditor can not be an expert in all the fields.

4. **Inherent Limitations of the Financial Statements**

   Limitations of audit mainly stem from limitations of financial statements. It is true that financial statements may not disclose the true picture even after audit due to inflationary trends. Further, certain non-monetary facts cannot be measured.

5. **No Assurance**

   There is no assurance on the part of the auditor about future profitability and prospects of the organisation.

6. **Detailed Checking Not Possible**

   In most cases, it is not possible for the auditor to check each and every transaction due to time and cost constraints. He has to rely on test checking.

7. **Exercise of Judgement**

   The nature, timing and extent of audit procedures is a matter of professional judgement of the auditor which varies from auditor to auditor. The same audit work may be done by two auditors in different ways because of the difference in personal judgement.

8. **Influence of Management on the Auditor**

   There are also instances that the auditor is influenced by management.

9. **Post-mortem Activity**

   Critics argue that it is not useful because it starts only after the events have taken place.

15. Discuss the concept of materiality.

Answer:

The concept of "materiality" implies that trivial matters are to be disregarded, and all important matters are to be disclosed. Materiality is the threshold or cut-off point above which missing or incorrect information in financial statements is considered to have an impact on the decision-making of users. As per SA 320 (Revise(d) "Materiality in Planning and Performing an Audit", misstatements, including omissions, are considered to be material if they, individually or in aggregate, could reasonably be expected to influence the economic decisions of the users taken on the basis of the financial statements. Judgements about materiality are made in the light of surrounding circumstances. What is material in one circumstance may be quite immaterial in another circumstance. Further, the judgements about materiality are also affected by the size or nature of a misstatement or a combination of both. Both the amount (quantity) and nature (quality) of misstatements are significant in deciding what is material.

16. Explain the relevance of materiality.

Answer:

According to AICPA, the auditor's determination of materiality is a matter of professional judgement. It is affected by the auditor's perception of the financial information needs of users of the financial statements. The concept of materiality is applied by the auditor both in planning and performing the audit. In planning the audit, the auditor makes judgments about the size of misstatements that will be considered material. But the auditor considers not only the size but also the nature of uncorrected misstatements, and the particular circumstances of their occurrence when evaluating their effect on the financial statements. The materiality constitutes an indispensable element in the decisional process of the financial audit.

The report of the auditor whereby he expresses his opinion about the reliability and correctness of financial statements depends very much on the degree of materiality. If the auditor has not noticed any material misstatements or deficiencies he submits an unmodified report. Otherwise, the report is a modified one. The modified report may take the form of a qualified report if material misstatements or deficiencies are observed but the same is not pervasive. On the other hand, if misstatements or deficiencies are significant the auditor has to submit an adverse report or a report with a disclaimer of opinion.

17. List the points to be considered carefully in determining materiality.

Answer:

Materiality is a relative term. What may be material in one circumstance may be immaterial in another. The consideration of materiality is the matter of professional judgement and experience of the auditor. There are no hard and fast rules that can be followed in all situations to determine materiality.

The following points have to be considered carefully in determining whether an item is material or not:

(i) **Nature of transaction:**

The nature of the transaction is an important factor. For example, if a transaction of a small amount is occurring unusually, it may be material, but if it is a routine transaction, it may be immaterial.

(ii) **Size or amount of transaction**

The size or amount involved is another significant criterion. For instance, Rs. 1000 may be material to a small concern whereas it may be immaterial to a large concern.

(iii) **Judging an item individually and in aggregate**

In judging materiality, an item should be considered separately as well as in aggregate. For example, an item may be immaterial separately, but it may be material when it is aggregated with many immaterial items. When this occurs, the effect becomes material.

(iv) **Relative significance**

To judge the materiality of an item, its relative significance may be considered. If an item belongs to a group it should be considered in relation to that group and not in isolation. For instance, a particular item of a current asset or current liability may be viewed on the basis of total current assets or total current liabilities.

(v) **Comparison with previous year's figures**

The materiality of an item can be considered by comparing it with the corresponding figure in the previous year. For example, if the amount of an item of the current year is very low or high while comparing it with the corresponding figure in the previous year then it may become material when compared to the corresponding figure of the previous year.

(vi) **Impact of prior period items**

In prior periods, misstatements may have been considered immaterial and may have been ignored accordingly. Such misstatements may affect the financial information of the current period.

(vii) **Precise calculation vs estimation**

Even a small error is material if such error results from the amount of an item which has been determined precisely and objectively. But if the amount of an item is subject to estimation, a minor difference from the estimate may be viewed as immaterial.

(viii) **Deviation from the statutory requirement**

Deviation from regulatory requirement is often treated as material even if the amount of deviation is minor.

18. Explain the concept of "True and fair."

Answer:

The Companies Act 1913 used the term "true and correct". It was subsequently replaced by the term "true and fair" in the Companies Act 1956. The term "fair" is a subjective term and it requires an exercise of judgement on the part of the auditor. There exist a huge debate and controversy over the use of the term"true and fair".

The term "true and fair" is an opinion and not a guarantee. It is the principle which is widely used in auditing and financial accounting. "True and fair view" in auditing means that the financial statements are free from material misstatements and faithfully represent the financial performance and position of the entity. The expression of true and fair view is, however, not strictly defined in the accounting literature, in the Companies Act or in a legal notion. As such, its interpretation leaves much room for flexibility. In general terms, "true" denotes that financial statements are factually correct and have been prepared according to the applicable reporting framework such as the IFRS and they do not contain any material misstatements that may mislead the users. On the other hand, "fair" implies that the financial statements present the information faithfully without any element of bias and they reflect the economic substance of transactions rather than just their legal form.

Preparation of true and fair financial statements has been expressly recognised as one of the responsibilities of the directors of companies in the corporate law of several countries such as in the Companies Act 2006 in the UK. Company law of certain jurisdictions requires the auditors to expressly state in their audit report whether in their opinion the financial statements present a true and fair view of the financial performance and position of the entity.

According to Stettler Howard, fairness is a pervasive concept which extends to every phase of the financial statement.

19. List the "guiding factors" of "True and fair."

Answer:

The guiding factors of "true and fair view" are as follows:

(i) Material information has been properly disclosed.

(ii) In preparing the financial statements of an entity, generally accepted accounting principles have been strictly adhered to.

(iii) Financial statements of the entity have been prepared in accordance with regulatory requirements.

(iv) Disclosure of exceptional and non-recurring items have been properly made.

(v) Due care has been taken in dealing with the events occurring after the balance sheet date but prior to the submission of the audit report.

(vi) The information contained in the financial statements are ambiguous.

(vii) Financial statements are drawn up in such a manner that there are no overstatements or understatements. At the same time, there is no window dressing or a secret reserve.

20. Distinguish between "Statutory Audit" and "Private / Voluntary / Non-statutory Audit".

Answer:

The following are the differences between "Statutory Audit" and "Private / Voluntary / Non-statutory Audit":

Points of Difference	Statutory Audit	Private / Voluntary / Non-statutory Audit
1. Legal compulsion	It is compulsory under statute or law.	It is not mandatory. Rather it is optional.
2. Nature	It must cover all the aspects as stated in the concerned statute.	It may be a complete audit or partial audit as per the decision of the appointing authority.
3. Qualification	A statutory auditor must possess the requisite qualification as per the concerned statute.	No specific qualification is prescribed for non-statutory auditor.

4. Example	Audit of companies, banks, cooperative societies, trusts etc. are examples of statutory audit.	Audit of a sole proprietorship, partnership firms, clubs, associations etc. are examples of non-statutory audit.
5. Appointment	In the case of company form of business, the auditor is appointed by the shareholders (in most cases), or by the board of directors, or by the Central Government.	In the case of sole proprietorship business, the auditor is appointed by the sole proprietor. In the case of partnership firms, the auditor is appointed by the partners.
6. Remuneration	Remuneration of a statutory auditor is fixed according to the provisions of the concerned statute.	Remuneration of a non-statutory auditor is fixed on the basis of agreements entered into between the auditor and his appointing authority.
7. Rights and duties	Rights and duties of a statutory auditor are governed according to the provisions of the concerned statute.	Rights and duties of a non-statutory auditor are determined on the basis of agreements entered into between the auditor and his appointing authority.
8. Liability	Liabilities of a statutory auditor are two-fold: ((a) Liabilities as per the concerned statute and ((b) Liabilities under the common law of the country.	A non-statutory auditor can be held liable only under the common law of the country.
9. Approach	The approach is compliance-oriented.	The approach is proprietary-oriented.
10. Scope	The scope is determined by the Statute.	The scope is determined by the management.

21. State the circumstances which necessitate continuous audit.

Answer:

Continuous Audit is applicable in the following cases:

(i) where final accounts have to be prepared immediately after the close of the financial year,

(ii) where the transactions are many in number,

(iii) where the systems of internal check and internal control in operation are not reasonable,

(iv) where the statements of accounts are to be presented to the management at regular intervals,

(v) where sales effected are very large,

(vi) where it is necessary to examine the transactions of an organisation in detail,

(vii) where an interim dividend is to be declared.

22. List the objectives of "Balance Sheet Audit".

Answer:

The objectives balance sheet audit are listed below:

1. To make sure that all assets owned by the organisation are included in the balance sheet at the accurate value,

2. To ensure that all liabilities are incorporated at the proper values.
3. To make certain that the assets shown in the balance sheet are in fact owned by the organisation.
4. To make sure that established accounting principles are followed to prepare the balance sheet.
5. To substantiate that all items are properly recognised into capital items and revenue items and treated accordingly.
6. To ensure that the requirements of relevant Statutes are suitably complied with.

23. What do you mean by "Partial Audit"?

Answer:

An audit which is conducted considering the particular area of accounting which the owner thinks essential is known as a partial audit. Here, an audit of the whole account is not conducted. By and large, business transactions are related to cash, debtor, creditor, stock etc. A business may conduct an audit of any of these transactions. Under partial audit, an auditor should conduct an audit of such transactions that are specifically stated in the agreement. The method of conducting a partial audit is akin to other audit but an auditor should sign the report clearing stating that the audit is 'partial audit'. If it is stated, an auditor will be accountable for the loss which is caused due to using the report as the complete audit.

24. List the objectives, advantages and limitations of "Partial Audit".

Answer:

Objectives of Partial Audit

A partial audit has the following objectives:

1. To make out whether the capital is fully mobilised or not,
2. To make clear the doubts where the owner has a suspicion,
3. To carry out the final audit in less time and at less cost.

Advantages of Partial Audit

The partial audit has the following advantages:

1. It is less expensive because the audit is conducted in the suspected area.
2. Partial audit helps in detecting the frauds and errors quickly.
3. The partial audit provides suggestions which increase the efficiency of staff.

Disadvantages of Partial Audit

The partial audit has the following disadvantages:

1. It is not a legal audit.
2. It is usually carried out only for control purpose.

25. Identify the correct answer:

(i) Various types of quality audits are

(a) Product

(b) Process

(c) Management (system)

(d) Registration (certification)

(e) All of above

(ii) When the auditor is an employee of the organization being audited (audite(e), the audit is classified as a........ Quality audit.

(a) Internal

(b) External

(c) Compliance

(d) Both A & B

(iii) The most comprehensive type of audit is the .... system audit, which examines suitability and effectiveness of the system as a whole.

(a) Quantity

(b) Quality

(c) Preliminary

(d) Sequential

(iv) Each of the three parties involved in an audit .... plays a role that contributes to its success.

(a) the client, the auditor, and the auditeer

(b) the client, the auditor, and the audite

(c) the client, the moderator, and the auditee

(d) the client, the auditor, and the auditee

(v) ------------------is a method of misappropriation of cash by which the past defalcations are covered up by the current receipts.

(a) Fraud

(b) Error

(c) Lapping

(d) Forensic Audit

(vi) An audit which is conducted considering the particular area of accounting which the owner thinks essential is known as -------.

(a) Complete Audit

(b) Partial Audit

(c) Balance Sheet Audit

(d) Cost Audit

(vii) The Companies Act 1913 used the term "True and -----------".

(a) Fair

(b) True

(c) False

(d) Correct

(viii) -----------is conducted with a particular object in view, viz to know financial position, earning capacity, prove fraud, invest capital, etc.

(a) Auditing

(b) Accounting

(c) Investigation

(d) Sampling

(ix) Misappropriation of goods is a ----------------.

(a) Fraud

(b) Clerical error

(c) Error of principle

(d) Compensating error

(x) ------------------ is a relative term.

(a) Audit

(b) Disclosure

(c) Materiality

(d) Accounting

Answer:

(i) (e)

(ii) (a)

(iii) (b)

(iv) (d)

(v) (c)

(vi) (b)

(vii) (d)

(viii) (c)

(ix) (a)

(x) (c)

26. Fill in the blanks:

(i) Audit is derived from ________________.

(ii) Auditing is the examination of __________ of business.

(iii) Auditing is done with the principles set in _____________________.

(iv) An in depth examination to detect a suspected fraud is termed as _______________.

(v) An audit in which auditor reviews the performance of an entity is termed as ______________.

(vi) An audit in which the auditor reviews the adherence of policy made by the management is ________________.

(vii) __________________ audit is conducted at the end of the accounting year.

(viii) _________________ audit is conducted between two annual audits.

(ix) An audit which is conducted considering the particular area of accounting which the owner thinks essential is known as a ------------.

(x) In the case of ----------, the honesty and integrity of the concerned individual is always in doubt.

(xi) Investigation is usually concerned with ------------- evidence.

(xii) The auditor's determination of materiality is a matter of --------- judgement.

(xiii) In the case of ---------------, the honesty and integrity of the concerned individual is always in doubt.

(xiv) ------- level employees are usually involved in an error.

(xv) The concept of ------------- implies that trivial matters are to be disregarded, and all important matters are to be disclosed.

(xvi) The term "true and fair" is an opinion and not a -----------------.

(xvii) According to Stettler Howard, ------------- is a pervasive concept which extends to every phase of financial statement.

Answer:

(i) Audit

(ii) Books of Account

(iii) Standards on Auditing

(iv) Investigation

(v) Operational Audit

(vi) Internal Audit

(vii) Annual Audit

(viii) Interim Audit

(ix) Partial Audit

(x) Fraud

(xi) Conclusive

(xii) Professional

(xiii) fraud

(xiv) Lower

(xv) materiality

(xvi) guarantee

(xvii) fairness

27. Match the following:

	Column A		Column B
1	**Primary objective of business**	**A**	**Basic principles governing an audit**
2	**SA 200**	**B**	**Comptroller & Auditor General of India**
3	**Annual Audit**	**C**	**Whether financial statement presents true and fair view**
4	**The authority for Government Audit**	**D**	**Final Audit**

Answer:

	Column A		**Column B**
1	Primary objective of business	C	Whether financial statement presents true and fair view
2	SA 200	A	Basic principles governing an audit
3	Annual Audit	D	Final Audit
4	The authority for Government Audit	B	Comptroller & Auditor General of India

28. State whether the following statements are true or false:

(i) An auditor is not insurer.

(ii) The auditor examines in depth the implementation of the quality system.

(iii) The concept of true or fair is a fundamental concept in auditing.

(iv) For the benefit of the organisation, quality auditing should only report non-conformances and corrective actions, but should not highlight areas of good practice.

(v) Auditor has right to disclose the client information to a third party.

(vi) There is no difference between Statutory and external audit.

(vii) An investigation is done with the generally accepted auditing procedure.

(viii) The time required and costs involved in an external audit are much higher as compared to internal audits.

(ix) The primary objective of the audit is for detecting frauds and error in the books of accounts and financial records of the clients business.

(x) Partial audit is not a legal audit.

(xi) Statutory audit is compliance-oriented.

(xii) Materiality is an absolute term.

(xiii) The term "true and fair" is an opinion and not a guarantee.

(xiv) Audited accounts are acceptable by government authorities.

(xv) For obtaining loan from banks and financial institutions, previous years' audited accounts are of great help.

(xvi) Lower level employees are usually involved in an error.

(xvii) In the case of error, the honesty and integrity of the concerned individual is always in doubt.

(xviii) Teeming and Lading is also known as lapping.

(xix) Investigation is compulsory.

(xx) Capital erosion results from payment of dividend out of inflated profit or payment of dividend out of unrealised profit.

(xxi) What is material in one circumstance must be immaterial in another.

(xxii) Investigation is usually concerned with conclusive evidence.

Answer:

Question No	Answer	Question No	Answer
(i)	T	(xii)	F
(ii)	F	(xiii)	T
(iii)	F	(xiv)	T
(iv)	F	(xv)	T
(v)	F	(xvi)	T
(vi)	F	(xvii)	F
(vii)	F	(xviii)	T
(viii)	T	(xix)	F

(ix)	F	(xx)	T
(x)	T	(xxi)	F
(xi)	T	(xxii)	T

29. Match the following:

	Column A		**Column B**
1	**External and Internal Audit**	**A**	**Statutory Audit**
2	**Tax Audit**	**B**	**Audit conducted between two annual audits**
3	**Audit against provision of funds**	**C**	**To ensure that the expenditure is made according to limit.**
4	**Interim Audit**	**D**	**Functional classification of Audit**

Answer:

	Column A		**Column B**
1	External and Internal Audit	D	Functional classification of Audit
2	Tax Audit	A	Statutory Audit
3	Audit against provision of funds	C	To ensure that the expenditure is made according to limit.
4	Interim Audit	B	Audit conducted between two annual audits

AUDIT ENGAGEMENT, AUDIT PROGRAM, AUDIT WORKING PAPERS, AUDIT NOTE BOOK, AUDIT EVIDENCE AND AUDIT REPORT

30. List the contents of audit engagement letter.

Answer:

As per SA-210, 'Agreeing the Terms of Audit Engagements', the audit engagement letter should contain the following:

(i) The objective and scope of the audit of financial statements.

(ii) The responsibilities of the auditor.

(iii) The responsibilities of the management with regard to:

- (a) selection of accounting policies
- (b) consistent application of the accounting policies selected
- (c) preparation of financial statements on a going concern basis
- (d) maintenance of adequate accounting records and internal control

(e) arrangement ensuring the involvement of internal auditor and other personnel

(f) written representation by the management

(iv) Unrestricted access to all records, documentation and other information required in an audit.

(v) The possibility of frauds remaining undetected because of the test nature of the audit.

(vi) The fact that the audit process may be subject to a peer review under the Chartered Accountants Act, 1949.

(vii) Identification of the applicable financial reporting framework for the preparation of the financial statements.

Reference to the expected form and content of any reports to be issued by the auditor and a statement that there may be circumstances where a report may differ from its expected form and content.

31. List the activities to be included in audit planning.

Answer:

According to SA-300, 'Planning an Audit of Financial Statements', a planning exercise should include, among all other things, the following activities:

(i) To acquire sufficient information regarding the accounting system followed by the client and associated policies adopted by it.

(ii) To acquire information on the existing internal control system of the organisation in order to decide the degree of reliance to be placed on it.

(iii) Determining the nature, scope and timing of various audit procedures to be followed.

(iv) The analytical procedures to be applied as a risk assessment procedure.

(v) To obtain a general understanding of the legal and regulatory framework applicable to the entity and how the entity is complying with it.

(vi) To determine the materiality.

(vii) To determine the resources to be deployed in specific audit areas such as the use of experienced team members for high-risk areas or to involve experts on complex matters.

(viii) To determine the amount of resources to be allocated to specific audit areas such as the number of team members to be assigned to observe inventory count at material locations.

(ix) To decide the timing of deploying resources such as whether at the interim stage or at key cut-off dates.

(x) To decide how the resources are to be managed, directed and supervised.

32. What do you mean by "Audit Programme"? List the steps in preparing audit programme.

Answer:

Before commencing the actual audit work, every auditor generally prepares a detailed programme of work. This is popularly known as Audit Programme.

According to W.B. Meigs, an audit programme is a detailed plan of auditing work to be performed, specifying the procedure to be followed in verification of each item in the financial statements and giving the estimated time required.

Thus, audit programme may be defined as a carefully drawn detailed plan of audit work clearly specifying the responsibilities of the audit staff and time allotted to perform the same after incorporating precautionary arrangements against potential errors, frauds and omissions, in order to perform the functions of auditing in an efficient and effective manner.

The general **steps** in preparing an audit programme are to:

(a) decide the extent of examination to be done.

(b) allocate the duties among the audit staff considering their qualification and experience.

(c) specify the time for completion of the allotted responsibilities.

(d) decide the audit techniques to be followed by them.

33. List the objectives of audit programme.

Answer:

The objectives of the audit programme are to:

(a) allocate the audit work among the staff on the basis of their qualification and experience.

(b) ensure that no important matter is left out.

(c) arrange the functions to be performed in order of their importance.

(d) ensure that the audit work is completed within time.

(e) keep written evidence of each work to be done and the progress thereof.

34. List the features of audit programme.

Answer:

A well-thought-out audit programme must have the following features or qualities:

(a) Materiality: An audit programme should include all material items.

(b) Flexibility: An audit programme must be flexible to add, change or cancel any part of it without affecting the overall plan.

(c) Pervasiveness: An audit programme must be so designed as to include all functions however small they can be.

(d) Objective Oriented: An audit programme must consider all the audit objectives.

(e) Logical: An audit programme should be prepared with functions logically selected and arranged.

35. List the matters to be considered before preparing an audit programme.

Answer:

The effectiveness of an audit programme largely depends on its completeness which again requires consideration of a number of important issues. These are as follows:

(a) **Understanding the Nature and Scope of Audit Work:** The auditor should prepare the audit programme after deciding the nature and scope of audit work based on legal provisions in case of statutory audit and terms of engagement agreement in case of non-statutory audit.

(b) **Developing an Idea about the Nature of the Organisation:** Since nature of the organisation, commercial or non-commercial, largely determines the scope of an audit, the auditor must pay due consideration to this while preparing the audit programme.

(c) **Management Process:** In preparing an audit programme, the auditor should also consider the management process and identify those in charge of governance in order to decide whom to communicate in need of important information so that unnecessary delay in getting the same is avoided.

(d) **Verification of Important Documents:** The auditor needs to verify all the important documents relating to the formation, policy and management of the organisation as they significantly affect the treatment of an item in the accounts. Verifying them beforehand helps the auditor to decide the extent and manner of examination based on which the programmes are generally scheduled.

(e) **Forming an Idea about the Accounting Methods:** Since accounting methods and policies adopted differ from organisation to organisation, a prior understanding of the same will help the auditor to clearly specify the scope of the audit work and design the audit programme accordingly.

(f) **Checking of Last Year's Final Accounts and Auditor's Report:** In case of an existing organisation, the auditor should collect and go through last year's final accounts and auditor's report thereon. Such a practice may help the auditor a lot in designing a flawless audit programme for the current year. However, this will not be applicable to a new organisation.

(g) **Evaluation of Internal Control and Internal Check System:** Since the existence of a sound internal check and internal control system minimises the possibility of misstatements and frauds, an understanding of the same can largely help the auditor to design an effective work schedule to reduce the time to complete the audit work.

36. State the advantages of an audit programme.

Answer:

A predetermined audit programme offers a number of advantages as follows:

(a) **Detail Plan of Work:** Audit programme incorporates every single matter howsoever insignificant. As a result, nothing remains unchecked and thus, audit risk reduces significantly.

(b) **Effective Co-ordination of All Aspects of Audit Work:** A well-planned audit programme ensures a proper balance between different aspects of audit work. As a result, audit staff does not end up with spending more time on examining petty items and conducts detail examinations of items of material importance.

(c) **Balance Distribution of Work:** Audit programme distributes different functions to the audit staff based on their experience and qualifications. This reduces any possibility of grievance on the part of the staff.

(d) **Assessing Progress of Work:** Since an audit programme describes in detail the work to be performed by each staff along with the time allotted, the auditor can very easily determine the progress of work during the audit.

(e) **Better Control Over Work:** Since an audit programme provides the details of the work, any deviations can be quickly identified. This enhances auditor's control over the entire audit work.

(f) **Measurement of Incomplete Work:** Through the audit programme, an auditor can determine the incomplete portion of any work at a given point of time. As a result, it becomes easier for him to reallocate any work in case the person concerned is absent or has left the job.

(g) Timely Completion of Work: Since every single function is allotted a specified time, the entire audit work is also completed within the time limit set for the job.

(h) Fixing Responsibility for Each Work Done: The audit programme fixes the responsibilities of each person of the audit team. Each staff needs to put his signature against the audit procedure performed by him on a daily basis. As a result, negligence on the part of any staff can be easily detected.

(i) Documentary Evidence of Actual Work Done: Since the audit programme systematically records the progress of work done and the means of doing them, the auditor can use the same as documentary evidence to defend any allegation of professional negligence in the court of law.

(j) Helps in Preparing Future Audit Programmes: On the basis of the audit programme of the previous year, the auditor can prepare the audit programme of the current year after incorporating suitable modifications.

37. List the shortcomings of an audit programme. Also state the measures to be taken to overcome those shortcomings.

Answer:

The shortcomings of a predetermined audit programme are as follows:

(i) Monotony and Rigidity: Since the audit programme allocates the job among the audit staff clearly specifying their respective responsibilities and duties, they need not do anything beyond the programme. As a result, the work becomes mechanical and the staff loses their interest. Hence, the effectiveness of the audit may get reduced.

(ii) Unrealistic: Many times audit programme places unrealistic targets as regards to the completion of a given job. As a result, the staff need to hurry and the quality of the audit is compromised.

(iii) Loss of Initiative: Following a fixed audit programme, the efficient audit staff often get dull and lose initiative. This significantly affects their morale.

(iv) Unsuitability for Small Organisation: Though for a large organisation, audit programmes are quite useful, it is not so for the small organisation. For them, it only increases the burden of the auditor.

The following **steps may be taken to remove the shortcomings** of a fixed audit programme.

(i) Educating the Audit Staff: The audit staff should be clearly informed about the purpose of the audit programme. They should be told that they may go beyond the programme if the situation so demands. If possible, their opinion should also be considered while preparing the audit programme.

(ii) Initiating Changes Based on Circumstances: Instead of following the same programme year after year, the auditor may initiate appropriate changes based on circumstances. This will remove the monotony of the audit staff engaged in the audit work.

(iii) Rotating the Audit Staff: Instead of allocating the same job to the same person repetitively, the auditor may rotate the duty of the staff. This will increase their drive and initiative.

(iv) Reviewing the work of the Audit Staff: The performance of the audit staff should be regularly reviewed through surprise check. This will keep them ever alert and more dedicated to their duty.

38. What is "audit file"? Classify it.

Answer:

The file which is used by the auditor to preserve all the important documents relevant for the audit of an organisation is known as an audit file. It basically acts as the archive of all the important statements, notes, etc. generated during the conduct of the audit of the organisation.

According to SA-230, 'Audit Documentation', audit files are defined as one or more folders or other storage media, in physical or electronic form, containing the records that comprise of audit documentation for a specific engagement.

Audit files are generally of two types—Permanent Audit File and Temporary Audit File.

A. Permanent Audit File

Permanent audit file contains all the documents which are of continuing importance for the audit of succeeding years.

B. Temporary Audit File

Temporary audit file contains documents relevant for the audit of the current year only.

39. List the papers to be preserved in permanent audit file.

Answer:

The audit papers that are preserved in a permanent audit file include:

(i) Name, address and contact information of the client.

(ii) Documents describing the legal and organisational structure of the client's business. These include a memorandum of association and an article of association in case of a company, partnership deed in case of a firm, etc.

(iii) Extracts or certified copies of important legal documents, long-term agreements with third parties, etc.

(iv) Copies of various important instructions issued by the management.

(v) Certified copies of the resolutions of shareholders' meetings and board meetings that are of continuing importance.

(vi) Certified copies of audited accounts of the previous year.

(vii) Statements regarding the accounting procedures and internal control system. For example, internal control checklist, flow chart, list of different books of accounts, important forms, etc.

(viii) Analysis of significant ratios and trends.

(ix) Record of communication with the previous auditor.

(x) Significant audit observations of earlier years.

40. List the papers to be preserved in temporary audit file.

Answer:

The audit papers that are kept in a temporary audit file include:

(i) Documents describing important changes incorporated in the audit programme considering the changes in the internal control system, accounting policies and procedures.

(ii) Current year's audit memorandum, audit plan and audit programme.

(iii) Audit evidence procured during the course of the current audit.

(iv) Internal control questionnaire and flow charts and notes on the system of internal control.

(v) Various analytical statements prepared during the course of the current audit. For example, the ageing schedule of customers, comparative statements, etc.

(vi) Different accounting schedules such as the schedule of debtors and creditors, schedule of contingent liabilities.

(vii) Copies of the communication with the previous auditor, experts and others.

(viii) Certified copies of the resolutions of shareholders' meeting and board meetings held during the year.

(ix) Copies of queries raised during the audit and answers obtained.

(x) Copies of communication with the client regarding weakness in the internal control system, wrong accounting policies followed, rectifications suggested, etc.

(xi) Letter of representation or confirmation received from the client.

41. What is "Audit Note Book"? List its contents.

Answer:

In the course of conducting an audit of an organisation, the audit staff may come across various misstatements, frauds or any other issues which need further clarification from the management or investigation and in-depth observation later on. In order to avoid any chance of such issues being unanswered, the audit staff generally records the same in a separate notebook and raises the issue in future. Such a record is known as Audit Note Book.

Generally, the following issues are recorded in an audit notebook:

(i) Extracts of various important legal documents of client's business such as Memorandum of Association, Article of Association, minutes of the board and shareholders' meetings, terms and conditions of important contracts, relevant details of the partnership agreement in case of a partnership business, etc.

(ii) Any technical or other feature which is of material importance.

(iii) Meaning of all technical terms used in the business (in case they are not common).

(iv) Nature and types of the product and the production process.

(v) Name of all important documents as well as information regarding their source.

(vi) Details of missing vouchers (like description, serial number and name of the relevant books of accounts) whose duplicates must be obtained.

(vii) Description of all errors and frauds discovered during the course of an audit.

(viii) Description of all items that need to be investigated further.

(ix) Description of all items that have been investigated, but no explanation has been obtained.

(x) Details of all important letters.

(xi) The casting of all important accounts.

(xii) Important accounting policies followed by the client such as methods of valuation of the closing stock, the policy of making provisions, etc.

(xiii) Any qualification given by the audit staff regarding any item of material importance.

(xiv) Extracts of various important correspondence with bankers, creditors and debtors.

(xv) Description of items to be included in the audit report.

(xvi) Any inconsistency found in accounting methods.

(xvii) Progress report of the audit.

42. Explain the importance of "Audit Note Book".

Answer:

The importance of audit notebook is felt on the following grounds:

(i) Storing all Important Information in One Place: Audit notebook stores all important information about the organisation prior to and during the course of audit in a single place. As a result, the auditor can access them as and when required. This significantly improves efficiency and reduces time.

(ii) Documentary Evidence: The audit notebook can act as important documentary evidence as to the steps taken and necessary skill, judgment and care exercised by the auditor. This can be produced before the court while defending any charge of professional negligence on the part of the auditor. In London and General Bank (1895) case law, such a role of audit notebook was recognised by the honourable judge.

(iii) Evaluation of the Audit Staff: By evaluating the sufficiency and relevance of notes contained in the audit notebook, an auditor can easily judge the efficiency and knowledge of the audit staff.

(iv) Help to Settle all Audit Queries: Audit notebook compiles all the queries that need an explanation from the management or accounting staff. The queries are then placed before the concerned parties at a time. Hence, it minimises the chance of anything being left out, while at the same time ensures that the normal workflow is not hampered due to audit.

(v) Help in Preparation of Audit Report: Since audit notebook contains all the important findings of the audit work including the inadequacies or queries remained unresolved, it assists the auditor a lot in finalising the audit report.

(vi) Help in Future Audit: The audit notebook of any period contains various useful information about the organisation and its system of accounting. Based on such information, the auditor can easily determine the areas which should deserve special attention while performing the audit next year.

43. What is meant by "Audit Working Papers"? Give examples.

Answer:

In course of an audit of an organisation, an auditor adopts various methods and procedures to accumulate and thereafter analyse audit evidence and other important documents to reach some meaningful conclusion regarding his engagement. Audit working papers include all such records kept by an auditor in relation to the evidence accumulated, methods and procedures adopted and conclusions reached during the course of the audit.

As per SA-230, 'Audit Documentation', audit working papers (also called audit documentation) refer to the record of audit procedures performed, relevant audit evidence obtained and conclusions the auditor reached.

Such records can be kept either in physical form or in an electronic form.

As per SA-230, examples of audit working paper/documentation include:

(i) Audit Programmes

(ii) Analyses

(iii) Issues memoranda

(iv) Summaries of significant matters

(v) Letters of confirmation and representation

(vi) Checklists

(vii) Correspondence (including e-mail) concerning significant matters.

44. State the purposes of "Audit Working Papers".

Answer:

According to SA-230, 'Audit Documentation', audit working papers or audit documentation serves a number of purposes as follows:

(i) Providing evidence of auditor's basis for a conclusion about the achievement of the overall objectives of the auditor.

(ii) Providing evidence that the audit was planned and performed in accordance with Standards of Audit (SAs) and applicable legal and regulatory requirements.

(iii) Assisting the engagement team to plan and perform the audit.

(iv) Assisting members of the engagement team responsible for the supervision to direct and supervise the audit work, and to discharge their review responsibilities in accordance with SA-220, 'Quality Control for an Audit of Financial Statements'.

(v) Enabling the engagement team to be accountable for its work.

(vi) Retaining a record of matters of continuing significance to future audits.

(vii) Enabling the conduct of quality control reviews and inspections in accordance with SQC 1.

(viii) Enabling the conduct of external inspections in accordance with applicable legal, regulatory or other requirements.

45. List the contents of "Audit Working Papers".

Answer:

As per SA-230, 'Audit Documentation', an auditor should follow the guidelines mentioned below to decide on the form, content and extent of audit documentation (or working papers).

(i) The auditor shall prepare audit working papers on a timely basis. They should be prepared while performing the task itself rather than after the audit work is performed.

(ii) The auditor shall prepare audit working papers that is sufficient to enable an experienced auditor, having no previous connection with the audit, to understand:

((a) the nature, timing and extent of audit procedures performed to comply with the SAs and applicable legal and regulatory requirements;

((b) the results of the audit procedures performed and the audit evidence obtained; and

((c) significant matters arising during the audit, the conclusion reached thereon and significant professional judgments made in reaching those conclusions.

(iii) In documenting the nature, timing and extent of audit procedures performed, the auditor shall record:

((a) the identifying characteristics of the specific items or matters tested;

((b) who performed the audit work and the date such work was performed; and

((c) who reviewed the audit work performed and the date and extent of such review.

(iv) The auditor shall document discussions of significant matters with management, those charged with governance and others, including the nature of the significant matters discussed and when and with whom the discussions took place.

(v) If the auditor identified information that is inconsistent with the auditor's final conclusion regarding a significant matter, the auditor shall document how the auditor addressed the inconsistency.

(vi) If in exceptional circumstances, the auditor judges it necessary to depart from a relevant requirement in an SA, the auditor shall document how the alternative audit procedures performed achieved the aim of that requirement, and the reasons for the departure.

46. "Audit working papers are confidential."- Explain.

Answer:

Audit working papers are highly confidential. They contain important information about the organisational structure, management procedures, accounting policies, etc. of the client organisation. This information may be of high value for the competitors and once leaked may be misused also. Thus, whosoever is in possession of the working papers should be responsible for their safe custody. These should never be made available to any third party except with the permission of the client or unless the law demands.

47. Critically discuss the ownership and custody of audit working papers.

Answer:

While recognising the need for preserving and maintaining the confidentiality of audit working papers, an important and relevant question that arises is who is the owner and custodian of the audit working papers. Significant differences of opinion exist in this respect. One view has been that the audit working papers should be the property of the client. This is because such papers are prepared based on the client's books of accounts and other documents provided by him and contains confidential information about his business. Thus, their ownership must lie with the client as otherwise the confidentiality may be compromised. The other view, however, contends that audit working papers contain information procured and evaluated by the auditor in properly discharging his duties. Therefore, the auditor can easily defend himself against any future allegation of negligence based on the working papers. Hence, it is the auditor who should be the sole owner and custodian of the working papers.

In this respect decisions of a few notable case laws can be mentioned here. In *Leicestershire County Council* vs. *Michael Faraday and Partners Ltd*. (1941), it was held that if the auditor acts as an agent of the client such as to resolve any income tax dispute, etc., he cannot claim any right over the working papers. Similar to this decision, in *Sockockinsy* vs. *Bright Graham and Co.* (1938), it was held that an auditor is an independent evaluator and not an agent of the client and accordingly all working papers prepared by the auditor in the course of the audit should belong to the auditor only. In *Chantrey Martin and Co*. vs. *Martin* (1953), the court recognised the difference between an auditor's role as an independent professional and that as an accountant or expert, being an agent of the client. It was held that when the auditor acts as an independent professional, he himself will be the owner of all working papers.

Currently, the above controversy has been resolved by professional bodies through different regulatory pronouncements. In India, as per SA-230, 'Audit Documentation', audit working papers are the property of auditor and not of the client. On request, the auditor can handover the same to the client if he wants. But the client cannot compel him to do so. However, since the working papers contain confidential information about the business of the client, it will be a duty of the auditor to maintain a high degree of confidentiality regarding the same and preserve them for a period of time sufficient to meet the needs of his practice and satisfy any future legal requirements.

48. What is audit evidence? What are its sources?

Answer:

As per SA-500, 'Audit Evidence', the term 'audit evidence' includes information used by the auditor in arriving at the conclusions on which the auditor's opinion is based. Audit evidence includes both information contained in the accounting records underlying the financial statements and other information. In short, substantive evidence collected by an auditor from various sources to base his opinion on the financial statements of the organisation is called audit evidence.

Depending upon the source, audit evidence may be of two types—internal evidence and external evidence. These are discussed below:

A. Internal Evidence

These are evidence collected from within the organisation. For example, sales invoices, counterfoils of cash memos, goods received notes, credit notes and debit notes, etc.

B. External Evidence

These are evidence collected from outside sources. For example, quotations, confirmation from debtors and creditors, etc.

49. Explain the need for audit evidence.

Answer:

Audit evidence is an important element of the audit process. In order to form his unbiased opinion on the reliability and fairness of the financial performance and financial state of affairs, an auditor needs to objectively examine the financial statements based on sufficient and appropriate evidence. Opinion based on casual and subjective evaluation may leave material misstatements or frauds undetected and as a result, the auditor may be held guilty of professional negligence.

The auditor, therefore, should always try to obtain sufficient and appropriate audit evidence and analyse them thoroughly before arriving at an opinion. Only by doing so, the auditor can keep the audit risk to a substantially low level.

In SA-200, it is recognised that reasonable assurance is obtained when the auditor has obtained sufficient appropriate audit evidence to reduce audit risk to an acceptably low level. Here, sufficiency refers to the quantity and appropriateness refers to the quality of audit evidence.

50. Analyse the reliability of audit evidence.

Answer:

As per SA-500, the reliability of audit evidence depends on its source (whether internal or external) and nature (whether visual, documentary or oral). However, the following generalisations may be considered useful while assessing the reliability of audit evidence.

(i) Evidence obtained from independent and external sources is more reliable.

(ii) Internal evidence becomes more reliable when the related internal control over its preparation and maintenance is effective.

(iii) Evidence obtained directly by the auditor is more reliable than those obtained indirectly or by inference.

(iv) Evidence in documentary form is usually more reliable than oral representation.

(v) Audit evidence provided by original documents is more reliable than audit evidence provided by photocopies or facsimiles or documents that have been filmed or digitised.

In order to be certain about the reliability of audit evidence in relation to a particular matter, an auditor should try to obtain evidence from various sources. This is because evidence obtained from alternative sources and in different forms, if found consistent, substantially increases the reliability. Thus, in case there appears any inconsistency, the auditor must obtain additional evidence by conducting other audit procedures. Even he should submit a disclaimer in case sufficient and reliable audit evidence is not available.

51. Explain the term “Compliance Procedure” in relation to audit evidence.

Answer:

Compliance procedure is the audit procedure designed to evaluate the operating effectiveness of controls in preventing or detecting and correcting material misstatements at the assertion level. Compliance procedures include tests of the following assertions:

(i) The internal control exists.

(ii) The control system is operating effectively.

(iii) The control has operated throughout the period under audit.

52. Explain the term “Substantive Procedure” in relation to audit evidence.

Answer:

The substantive procedure is the audit procedure designed to detect material misstatements by either test of details, i.e. vouching and verification or by analytical procedures, i.e. analysis of significant ratios and trends.

Substantive procedures provide assurance in respect of the following assertions:

(i) The asset or liability exists on a given date.

(ii) The entity is the rightful owner of the asset and the liability is a valid obligation of the entity.

(iii) There is no unrecorded assets, liabilities and transactions.

(iv) Assets and liabilities have been recorded at an appropriate value.

(v) Transactions have taken place during the relevant accounting period.

(vi) Transactions have been recorded at an appropriate value.

(vii) Disclosures have been done in accordance with the recognised policies and relevant provisions of law.

53. Explain the methods of obtaining audit evidence.

Answer:

In specific, an auditor needs to apply the following procedures or methods for obtaining sufficient and appropriate audit evidence.

(i) Inspection: Inspection involves examining records or documents, whether internal or external, in paper form or otherwise or physical verification of a tangible asset. Inspection can provide reliable audit evidence depending on their nature and source and effectiveness of the internal control over their generation and processing. An example of inspection being used to obtain audit evidence is to physically examine the tangible asset for confirming its existence and inspecting the title deed or purchase invoice for confirming its ownership.

(ii) Observation: Observation consists of looking at a process or procedure being performed by others on a real-time basis. For example, the auditor may observe the inventory counting by the entity's personnel and obtain evidence that it is done correctly.

(iii) External Confirmation: External confirmation represents audit evidence obtained by the auditor as a direct written response from a third party, in paper form or by electronic or any other medium. For example, confirmation from the customer about the terms of the agreement.

(iv) Recalculation: Recalculation consists of checking the mathematical accuracy of the documents or records. This may be performed manually or electronically.

(v) Reperformance: Reperformance involves auditor's independent execution of procedures or controls that were originally performed as part of an entity's internal control.

(vi) Analytical Procedures: Analytical procedures involve evaluation of financial information by studying possible relationships among both financial and non-financial data and investigating identified fluctuations from previous years that are inconsistent. This is done by studying significant ratios and trends and inspecting abnormal fluctuation in the amount of an item.

(vii) Inquiry: Inquiry involves seeking information, both financial and non-financial, from knowledgeable persons within or outside the entity. Inquiries may range from formal written inquiries addressed to external parties to informal inquiries addressed to the client's staff.

In this context, it is worthy to mention that the procedures discussed above may be used as risk assessment procedure, compliance procedure or substantive procedure depending on the context in which they are applied by the auditor.

54. What is "Audit Report"?

Answer:

In the words of Lancaster, "A report is a statement of collected and considered facts, so drawn up as to give clear and concise information to persons who are not already in possession of the full facts of the subject matter of the report."

An audit report is a document written in a standard format through which the auditor expresses his opinion regarding the reliability and correctness of an entity's financial statements. The preparation of an audit report is the last work of audit. An auditor presents weaknesses, strengths and details of an organisation through the audit report.

55. List the features of a good audit report.

Answer:

The features of a good audit report are listed below:

1) **Simplicity**

A good audit report should be simple so that it can be easily understood by all. A good report is written in a simple language avoiding vague and unclear words. The message of a good report should be self-explanatory.

2) **Clarity**

The report should be clear and unambiguous. Clarity depends on the proper arrangement of facts. The auditor should make his purpose clear, define his sources, state his findings and finally make necessary recommendations.

3) **Brevity**

It should be concise, accurate and specific. It means that a good report is one that transmits maximum information with minimum words. It avoids unnecessary detail and includes everything which is relevant and required to present proper information.

4) **Firmness**

It should clearly indicate the scope of work to be done. Further, the report should firmly state whether the financial statements of the entity reflect the "true and fair" view of the state of affairs of the business.

5) **Objectivity**

It should be based on objective evidence.

6) **Consistency**

Consistency in presenting accounting information should be there in a good audit report according to GAAP or IFRS.

7) **Disclosure**

It should disclose all the facts and the truth.

8) **Impartiality**

It should be unbiased. If recommendations are made at the end of a report, they have to be impartial and objective.

9) **Information-based**

Relevant and accurate information should be included in the report. If not so, it will involve unnecessary expenditure and the reports will be a waste. Since decisions are taken on the basis of information contained in the report, any inaccurate information or statistics will lead to wrong decision.

10) **Timeliness**

A report should be prepared and presented within the stipulated time. If the report is presented in time, necessary actions may be taken.

56. State the importance of an audit report.

Answer:

The audit report issued by the auditor is considered as an important informational tool for many parties. Auditor's reports are important to users of financial statements because they inform users of the auditor's opinion as to whether or not the statements are fairly stated or whether no conclusion can be made with regard to the fairness of their presentation. An audit report is of immense use to the following parties or events:

1) **Shareholders**: Audit report helps shareholders or members in understanding how the company is progressing and the money they have invested is properly utilised or not.
2) **Prospective Investors**: Potential investors assess the risk of the company before making any investments. Audit report proves handy in such a situation.
3) **Suppliers**: Creditors are interested in knowing the ability of the company in paying back their dues in time. Audit report serves their purpose.
4) **Financial and Lending Institutions:** Banks and lending institutions judge the creditworthiness, liquidity position and profitability of the company from the audit report.
5) **Merger**: Whenever potential merger partners need to evaluate a company, they prefer to have statements that have passed a rigorous examination by the auditors.
6) **Insurance Claim**: In the event of loss of property by fire or other incidents, audit report helps in expediting the process of settlement of claims from the insurance company.
7) **Prevention of Wastage**: Audit report identifies the wastage which aids management to prevent the recurrence of the same in future.
8) **Insolvency**: Audit report forms a basis for determining action in cases related to insolvency and bankruptcy.
9) **Decision-making**: The auditor's report is considered as a trusted informational frame for many financial decisions.

57. Fill in the blanks:

(i) An Audit report reflects the work done by the ____________________.

(ii) Audit programme act as a __________ of audit procedures to be performed.

(iii) The reliability of audit evidence depends on its source, _________ or ___________.

(iv) An audit report is the _____________ product of every audit.

(v) Audit report reflects the real position of the _________________of the company.

(vi) Audit working papers are the records of the ___________ and execution of the audit engagement.

(vii) An audit note book acts as an _______________ tool available as a defence with the auditors in the event of any charges is brought against him.

(viii) SA 500 releates to audit ------------------.

(ix) SA 230 relates to audit --------------------.

(x) Confirmation from debtors is an example of -------------- evidence.

(xi) The auditor can use the audit programme as a documentary --------- to defend any allegation of professional negligence in the court of law.

(xii) An audit file basically acts as the ------- of all the important statements, notes, etc. generated during the conduct of audit of the organisation.

(xiii) ------------ audit file contains all the documents which are of continuing importance for the audit of succeeding years.

(xiv) Audit working papers refer to the record of audit procedures performed, relevant audit evidences obtained and ---------- the auditor reached.

(xv) In India, as per SA-------, audit working papers are the property of auditor and not of the client.

(xvi) 'Audit evidence' includes ----------- used by the auditor in arriving at the conclusions on which the auditor's opinion is based.

(xvii) Goods received notes, credit notes and debit notes, etc are examples of ------------- audit evidence.

(xviii) Evidence obtained directly by the auditor is ------ reliable than those obtained indirectly or by inference.

(xix) In SA-200, it is recognised that reasonable assurance is obtained when the auditor has obtained sufficient ------------ audit evidence to reduce audit risk to an acceptably low level.

(xx) --------- procedure is the audit procedure designed to evaluate the operating effectiveness of controls in preventing or detecting and correcting material misstatements at the assertion level.

Answer:

Question No.	Answer	Question No.	Answer
(i)	auditor	(xi)	evidence
(ii)	check list	(xii)	archive
(iii)	internal or external	(xiii)	Permanent
(iv)	final	(xiv)	conclusions
(v)	financial status	(xv)	230
(vi)	planning	(xvi)	information
(vii)	check list	(xvii)	internal
(viii)	evidence	(xviii)	more
(ix)	documentation	(xix)	appropriate
(x)	external	(xx)	Compliance

58. Identify the correct answer:

(i) CAATS stands for

(a) Cornwall Air Ambulance Trust

(b) Children Air Ambulance Trust

(c) Center for alternatives to Animal Testing

(d) Computer Assisted Auditing Technique

(ii) Chartered Accountants have to retain the working papers for-

a. 2 yrs

b. 3 yrs.

c. 5 yrs.

d. 7 yrs.

(iii) SA 210 stands for-

a. Quality control for an audit of financial Statements

b. Agreeing the terms of Audit engagements.

c. Audit Documentation

d. Responsibility of Joint Auditor

(iv) SA 230 stands for-

a. Quality control for an audit of financial Statements

b. Agreeing the terms of Audit engagements.

c. Audit Documentation

d. Responsibility of Joint Auditor

(v) SA 530 stands for-

a. Quality control for an audit of financial Statements

b. Agreeing the terms of Audit engagements.

c. Audit Documentation

d. Audit Sampling

(vi) SA 300 stands for

a. Audit Planning'

b. Audit Sampling

c. Audit Documentation

d. None of these

(vii) Permanent Audit file contains

a. Copies of management letters

b. Audit Programme

c. Analysis of transaction and balances

d. Analysis of significant ratios and trends

(viii) Current Audit file contains

a. AOA and MOA of the company

b. Analysis of significant ratios and trends

c. Notes regarding significant accounting policies

d. Audit programme.

(ix) Objective of an Audit is to formulate an overall opinion on

a. Cost Statement

b. Financial Statement

c. Books of Accounts

d. None of these

Answer:

Question No.	Answer
(i)	d
(ii)	d
(iii)	b
(iv)	c
(v)	d
(vi)	a
(vii)	d
(viii)	d
(ix)	b

59. State whether the following statements are true or false:

(i) An Audit report is the end product of the auditing.

(ii) An audit engagement is the initial stage of a audit during which the auditor notifies the client that he has accepted the audit work.

(iii) An audit programme is a detailed plan of the auditing.

(iv) An Audit note book is a bound book in which a large variety of matters observed during the course of audit are recorded.

(v) An Audit note book does not contain details about the name of key management personnel.

(vi) As per ICAI (C.A) auditor need to retain the working papers for a period of 5 yrs.

(vii) An audit work reflects the work done by the management.

(viii) An audit report should have a proper title.

(ix) In an audit report the Membership number of the Chartered Accountants is irrelevant.

(x) Reporting in Audit report should comply with the requirements as made by statues.

(xi) An audit programme must be flexible to add, change or cancel any part of it without affecting the overall plan.

(xii) Temporary audit file contains documents relevant for the audit of the current year only.

(xiii) The audit note book can act as important documentary evidence.

(xiv) Audit working papers should be made available to any third party.

(xv) Quotations, confirmation from debtors and creditors, etc are examples of internal audit evidence.

(xvi) Audit evidence obtained from independent and external sources are more reliable.

(xvii) Evidence in documentary form is usually more reliable than oral representation.

(xviii) A good audit report should be based on subjective evidence.

Answer:

Question No.	Answer	Question No.	Answer
(i)	T	(x)	T
(ii)	T	(xi)	T
(iii)	T	(xii)	T
(iv)	T	(xiii)	T
(v)	F	(xiv)	F
(vi)	F	(xv)	F
(vii)	F	(xvi)	T
(viii)	T	(xvii)	T
(ix)	F	(xviii)	F

60. Match the following:

	Column A		Column B
1	**External Confirmation**	A	**Final product of every audit.**
2	**Audit programme**	B	**Records of the planning and execution of the audit engagement.**
3	**Audit working papers**	C	**Method of obtaining audit evidence**
4	**Audit report**	D	**Check list of audit procedures to be performed.**

Answer:

	Column A		Column B
1	External Confirmation	C	Method of obtaining audit evidence
2	Audit programme	D	Check list of audit procedures to be performed.
3	Audit working papers	B	Records of the planning and execution of the audit engagement.
4	Audit report	A	Final product of every audit.

61. Match the following:

	Column A		Column B
1	**SA 210**	A	**Agreeing the terms of Audit engagements.**
2	**SA 230**	B	**Audit Planning**
3	**SA 300**	C	**Audit Sampling**
4	**SA 530**	D	**Audit Documentation**

Answer:

	Column A		Column B
1	SA 210	A	Agreeing the terms of Audit engagements.
2	SA 230	D	Audit Documentation
3	SA 300	B	Audit Planning
4	SA 530	C	Audit Sampling

62. Match the following:

	Column A		Column B
1	**Temporary audit file**	A	**objective evidence**
2	**External audit evidence**	B	**documents relevant for the audit of the current year only**
3	**Audit report**	C	**property of auditor and not of the client**
4	**Audit working papers**	D	**confirmation from debtors and creditors**

Answer:

	Column A		Column B
1	Temporary audit file	B	documents relevant for the audit of the current year only
2	External audit evidence	D	confirmation from debtors and creditors
3	Audit report	A	objective evidence
4	Audit working papers	C	property of auditor and not of the client

INTERNAL CHECK, INTERNAL CONTROL, INTERNAL AUDIT - INDUSTRY SPECIFIC

63. Explain the concept of internal check.

Answer:

Spicer and Pegler have defined internal check as "an arrangement of staff duties whereby one person is allowed to carry through and to record every aspect of a transaction so that without collusion between two or more persons, fraud is prevented and at the same time the possibilities of error are reduced to a minimum."

Thus internal check may be defined as a system of allocation of duties among the staff of the entity in a way that it eliminates the chances of any duplicity of work and at the same time ensures that the work of one is interlinked with that of another, so that the work done by the previous employee is automatically checked by the next one.

64. List the objectives of internal check.

Answer:

Following are the objectives of an internal check system:

(i) **Elimination of Frauds and Errors:** The main objective of an internal check is to eliminate or at least minimise the frauds and errors that may be committed by the staffs of an organisation.

(ii) **Ensuring Detection of Errors and Frauds at an Early Stage:** Internal check attempts to detect errors and frauds promptly which helps to minimise their effects in the long run.

(iii) **Increasing Reliability of Financial Data:** Another objective of internal check system is to increase the reliability of financial data of an organisation by ensuring the timely recording of all transactions pertaining to the organisation in a particular period.

(iv) **Ensuring Smooth Flow of Work:** Division of work done while implementing internal check ensures a smooth flow of work.

(v) **Ensuring Careful and Continuous Work by Staff:** Internal check exercise moral pressure over the staffs so that they work carefully to minimise the chances of errors and frauds.

(vi) **Prompt Preparation of Final Accounts:** Internal check ensures prompt recording of transactions in an orderly manner. This helps in finalising the accounts promptly.

(vii) **Improving Overall Efficiency:** Another important objective of internal check is to improve overall functional efficiency of the organisation.

65. List the essential features of an internal check system.

Answer:

Certain qualities are needed to make an internal check system more effective and efficient.

These are known as the essential characteristics of an internal check system. These are as follows:

(i) **Division of Work:** Before applying internal check, it is necessary to divide the entire task among the staff in such a way that the work of one staff can be checked automatically by another. For example, when the staff takes the responsibility of purchase, then another staff should make its payment.

(ii) **Provision of Check:** The organisation should set up such a provision that a work done by any staff can be checked by another staff. For example, an officer may check the work done by the staff by reallocating the duties.

(iii) **Use of Devices:** In this modern world, various devices can be used to perform some functions automatically. For example, the organisation may use time keeping machine to determine the time spent by a worker on a job. Use of machines may help to make internal check easier.

(iv) **Compulsory Leave:** Every member of the staff should be encouraged to go on leave at least once a year. So that his portion of work done is verified by another.

(v) **Self-balancing System:** An organisation may also use a self-balancing system of maintaining ledger where errors are detected and rectified easily.

(vi) **Job Rotation:** An organisation needs to transfer the staff from one job to another so that the work of previous staff can be checked by the later.

(vii) **Specialisation:** The organisation must also arrange for a specialised training programme to make the staff well equipped with the knowledge to perform a task efficiently.

(viii) **Control over Employees:** Generally, chances of frauds are high in case there is direct contact between staff and the consumer or public. So, a manager can keep eyes in those works so that the internal check system can be made more effective.

66. State the advantages of an internal check system.

Answer:

The advantages of an internal control system are listed below:

(a) **Less chance of Error and Fraud:** Right, responsibility and duties of each staff are clearly defined under the internal system. So, they perform work wholeheartedly which reduces the chances of errors and frauds.

(b) **Smooth Flow of Work:** Internal check system is based on the principle of division of labour. Accordingly when the work is distributed among the employees based on their skill the entire work process gets completed within reasonable time and at the minimum cost.

(c) **Moral Pressure on Employees:** Work of every staff is checked automatically. So, the staff remain honest.

(d) **Prompt Finalisation of Accounts:** Every book of accounts remains correct, every staff is checked automatically. So accounts can be finalised in less time, cost and labour.

67. List the disadvantages / drawbacks of an internal check system.

Answer:

Though the internal check system is useful in many respects, even then it has some disadvantages as follows:

(i) Dependence on Other: Under the internal check system a staff depends on other staff from whom the workflows. Therefore to ensure timely conduct of the entire work one may have to hurry and thus commit an error.

(ii) Conflict among Staff Members: Under the internal check system, once the work performed by one staff is checked by another staff and any error or fraud is detected, there arises a conflict between the staff members.

(iii) Planned Frauds: Planned frauds with the involvement of many staff may not get detected by internal check.

(iv) Carelessness: Employees may also develop a sense of carelessness in the way that everyone thinks that his mistake will be detected by the net staff.

(v) Not Suitable for Small Concern: Small organisations cannot use internal check system as it needs the engagement of more manpower and accordingly involves high incidence of cost.

(vi) Audit Risk: In organisations with an effective internal check, the auditor may be tempted to adopt test checking instead of routine checking. This, at times, sufficiently increases the audit risk.

68. How does an auditor evaluate the effectiveness of an internal control system?

Answer:

The auditor should evaluate the internal check system before relying on it. For this purpose, he should consider the following aspects and determine the effectiveness of the existing internal check system

(i) no single person is allowed to execute a transaction in total. The division of work should be such that the work of one is automatically checked by another.

(ii) duties of every clerk in the organisation have been reshuffled from time to time so that no single staff remains attached with a particular job forever.

(iii) every staff of the organisation have taken an annual holiday at their will or have been compelled to do so.

(iv) each and every receipt and despatch of goods is properly recorded.

(v) every transaction takes place under the supervision of competent authority.

(vi) modern machineries for maintaining accounting records have been fully utilised.

(vii) The self-balancing system is in vogue.

(viii) notice has been sent out to every debtor and creditor to obtain their confirmation regarding their account balances and the same has been verified by the competent authority.

69. To what extent can a statutory auditor rely on an internal check system?

Answer:

In an organisation, an auditor is appointed to authenticate the books of accounts and final financial statements based on all available evidence. He is also to express an unbiased opinion on the exhibition of true and fair view of the financial performance and financial state of affairs through the income statement and the balance sheet respectively. Thus keeping in mind such an objective the auditor needs to decide the extent of examination that he should conduct to arrive at any conclusion. The auditor, in this context, can resort to either detailed checking or test checking. Detailed checking refers to the examination of books of accounts in detail. Test checking, on the other hand, is the technique of checking some transactions selected as the sample from the group of transactions and drawing a conclusion on that basis, taking sample transactions selected to be the representative of the remaining transactions. Detailed checking is time-consuming as well as laborious whereas test checking relieves the auditor from such pain. Thus, in actual practice, often the auditor is found reporting to test checking, provided the internal check system is satisfactory.

Reliance on an effective internal check system and thereby streamlining the audit process enables the auditor to devote more time in examining the critical areas of accounting including valuation of the closing stock, valuation of assets and liabilities, determining the reasonableness of provisions etc.

However such reliance simultaneously increases the risk of the auditor. This is because even a sound internal check system can not guarantee the non-existence of any error or fraud in the accounts. Thus when the auditor applies test checking instead of a detailed checking, there is every possibility that any such error or fraud remains undetected. In such a situation the auditor cannot escape his responsibility on the ground that he relied upon the existing internal check system of the organisation, rather he will be held liable for negligence in his duty. This was also held in the famous Case Law of Mc. Bride Ltd vs. Rooke and Thomas, Canada (1941). In this case, the honourable judge concluded that an auditor cannot be relieved from his liability for non-detection of material errors and frauds simply on the ground that he depended on the internal check system.

Thus the auditor should always keep in mind that resorting to test checking by relying on internal check system of the organisation no way reduces the liability of the statutory auditor. If any error or fraud is detected afterwards he will be held liable for being negligent in his duty. Therefore if an auditor relies on internal check system and tries to make his work short and simple, he must do so at his own risk.

70. What is internal control? Explain its scope.

Answer:

The internal control system provides a measure for the management to obtain information, protection and control which are essentially crucial for the running of a business organisation successfully. In other words, internal control is the process, effected by an entity's Board, management, and other personnel, designed to provide reasonable assurance regarding the achievement of the objectives in the following categories:

(i) Reliability of financial reporting,

(ii) Effectiveness and efficiency of operations, and

(iii) Compliance with applicable laws and regulations.

The scope of the internal control system is vast. It comprises both administrative control as well as accounting control.

A. Administrative Control

Administrative control refers to the control system that ensures adherence to management's policies, rules, regulations and thereby maintains operational efficiency. Administrative control is associated with the decision-making process which is concerned with management's authorisation of transactions. In other words, it relates to the management function that is directly linked with achieving the organisational objective. Administrative control relates to the production process, quality control, operational efficiency, statistical analysis, pricing strategies, marketing strategies, human resource management, performance analysis, etc.

B. Accounting Control

Accounting control, also known as financial control, refers to the control system which ensures recording of transactions in the books of accounts adhering to the established accounting policies and principles. It also refers to confirming the fact that transactions recorded in the books of accounts are genuine, they pertain to the organisation and are properly authorised. To ensure the reliability of accounting data and ensuring adoption of generally accepted accounting principles (GAAP) and now the very recent International Financial Reporting Standard (IFRS) are the prime objectives of accounting control. Accounting control relates to maintaining proper books of accounts, recording transactions timely, checking arithmetical accuracy of books of accounts, rotation of duties of staffs, etc. Accounting control is again divided into two sub-sections namely ((a) Internal Check and ((b) Internal Audit.

71. List the objectives of internal control.

Answer:

In an organisation, internal control is the holistic and minutely planned control system whose prime objective is to conduct the activities of the organisation in an orderly manner. However, within this prime objective, the specific objectives are as follows:

A. Authorisation

An important objective of internal control is to ensure that all transactions are approved by the responsible personnel in accordance with specific or general authority.

B. Completeness

Another objective of internal control is to ensure that the books of accounts are completed in all respect and no valid transaction has been omitted from the accounting records.

C. Accuracy

An important objective of internal control is to ensure that all valid transactions are accurately recorded, consistent with the originating transaction data and information is recorded in a timely manner.

D. Validity

Internal control should also ensure that all recorded transactions fairly represent the economic events that actually occurred, are lawful in nature and have been executed in accordance with management's general authorisation.

E. Physical Safeguards and Security

It must ensure that access to physical assets and information systems are controlled and properly restricted to authorised personnel.

F. Error Handling

Internal control should ensure that errors detected at any stage of processing receive prompt corrective action and are reported to the appropriate level of management.

G. Segregation of Duties

Another objective of internal control is to ensure that duties are assigned to individuals in a manner that ensures that no one individual can control both the recording function and the procedures related to the processing of the same transaction.

In this respect SA-315 on Risk Assessment and Internal Control advocates the following objectives of internal control:

(i) To ensure that transactions are executed as per management's authorisation

(ii) To ensure that transactions are recorded in a proper way to facilitate preparation of financial information for maintaining the record of assets.

(iii) To ensure that assets are protected from unauthorised use, sale, etc.

(iv) To ensure that assets are verified at frequent intervals.

72. List the limitations of internal control system.

Answer:

No matter how well internal controls are designed, they can only provide a reasonable assurance that objectives have been achieved. Some limitations are inherent in all internal control systems. These are as follows:

(i) **Judgment:** The effectiveness of controls will be limited by decisions made with human judgment under pressure to conduct business based on the information at hand.

(ii) **Breakdowns:** Even well designed internal controls can break down. Employees sometimes misunderstand instructions or simply make mistakes. Errors may also result from new technology and the complexity of computerised information systems.

(iii) **Management Override:** High-level personnel may be able to override prescribed policies and procedures for personal gain or advantage. However, this should not be confused with management intervention, which represents management actions to depart from prescribed policies and procedures for legitimate purposes.

(iv) **Collusion:** Control systems may become ineffective due to employee collusion. Individuals acting collectively can alter financial data or other management information in a manner that cannot be identified by control systems.

(v) **Costly System:** The total system of internal control often turns up to be very costly. If the losses incurred on account of errors and frauds exceed the benefits of the internal control system, then it becomes redundant for the organisation.

(vi) **Control Over Common Business Activities:** Internal control system is concerned with common business activities only. It is difficult to follow a particular system for specific business activities.

73. What is meant by "internal control questionnaire"?

Answer:

Internal control questionnaire (ICQ) is a comprehensive and well-structured series of questions concerning internal control. It is prepared by the auditor for collecting information about the existence, operation and efficiency of internal control in an organisation. It is the most widely used technique of evaluation of internal control. Before embarking on audit, the auditor frames the questionnaire covering important areas of operation, namely, purchase sales, stock keeping, wage payment, etc. Each question in the questionnaire is set with the aim of assessing the strength of internal control at every stage of operation.

The questions range from the system of authorisation, the flow of transaction, documents used in the flow, recording of transactions, division of labour aiming at the internal check, handling of assets, reporting of transactions to the management and review of operations. Generally, questions are so set that a 'Yes' answer indicates a satisfactory position and 'No' answer suggests a deficiency in the control system. In case of 'No', answer provision is also made for further explanation or details. In case of the question not relevant to the business, 'not applicable' reply is given.

The questionnaire is sent by the auditor to the client with the request to get it filled up by some responsible officer(s). After going through the answers, if some inconsistencies or incongruities are noticed, the auditor should discuss the matters with the concern officers. The auditor then reports the deficiency to the management and suggests for improvement in the internal control system.

74. List the advantages and limitations of internal control questionnaire.

Answer:

Internal Control Questionnaire offers the following advantages:

(i) An internal control system can be assessed easily through the preparation of the questionnaire.

(ii) Weak areas in respect of internal control can be identified easily and improvements can be suggested accordingly.

(iii) It facilitates the preparation of an audit programme. Based on the questionnaire he can decide whether to go for a detailed checking or can depend on test checking.

(iv) It may act as evidence that audit work has been done with due care.

Internal Control Questionnaire suffers from the following limitations:

(a) It may not cover all the aspects of internal control, and in that case, there is a chance that internal control system assessment may not reveal the actual picture.

(b) Sometimes it may be difficult sometimes to give all answers in 'yes' or 'no' form.

75. What is "Internal Audit"?

Answer:

Internal audit is a dynamic profession involved in helping organisations achieve their objectives. It is concerned with evaluating and improving the effectiveness of risk management, control and governance processes in an organisation. According to **Taylor and Perry**, "Internal audit is a review of operations and records, sometimes continuously undertaken within a business by specially assigned staff." **The Institute of Internal Auditors, USA** (Standards for the Professional Practice of Internal Auditin(g) has defined internal audit as, "Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organisation's operations. As per the **committee of Internal Audit, formed by The Institute of Chartered Accountants of India**, internal audit is, "An independent management function, which involves a continuous and critical appraisal of the functioning of an entity with a view to suggesting improvements thereto and add value to and strengthen overall governance mechanism of the entity, including the entity's risk management and internal control system."

Thus, internal audit is a continuous appraisal of the various operational activities of the organisation, apart from checking the books of accounts, by an employee of the organisation, preferably other than employees of accounts department, with an objective to report about the effectiveness of operations of the organisation.

76. List the objectives of internal audit.

Answer:

As per SA-610, the broad objectives of internal audit are as follows:

(i) Review of the accounting system and related internal control

(ii) Examination of financial and operating system

(iii) Examination of effectiveness and efficiency of financial control

(iv) Examination and verification of assets.

In specific the objectives of internal Audit include the following:

(i) Determine the accuracy and propriety of financial transactions.

(ii) Evaluate financial and operational procedures for adequacy of internal controls and provide advice and guidance on control aspects of new policies, processes systems.

(iii) Verify the existence of assets and ensure that proper safeguards are maintained to protect them from loss.

(iv) Appraise whether liabilities shown in the financial statement are genuine and have resulted from legitimate activities undertaken by the organisation.

(v) To conduct a special investigation as per the instruction given by the management.

(vi) Determine the level of compliance with the policies and procedures, and government laws and regulations.

(vii) Evaluate the accuracy, effectiveness, and efficiency of the information processing systems.

(viii) Coordinate audit efforts with, and provide assistance to, the Audit Committee and external auditors.

(ix) Determine the effectiveness and efficiency in accomplishing the mission and identify operational opportunities for cost savings and revenue enhancements.

77. List the advantages and limitations of internal audit.

Answer:

Internal audit offers a number of advantages, such as -

(i) Assistance to Management: Internal audit assists management to execute various plans.

(ii) Detection and Prevention of Errors and Frauds: Through the internal audit, frauds and errors can be detected easily. Moreover, the auditor can offer suggestive measures to prevent recurrence of these errors and frauds subsequently.

(iii) Reduction in Wastage: Internal audit ensures reduction of wastage through identification of areas of weaknesses and deficiencies.

(iv) Safeguarding Assets: Internal audit ensures whether proper measures have been taken to safeguard the assets. Internal auditor ensures that proper security has been provided for the assets.

(v) Increasing Efficiency: Internal audit helps in increasing the effectiveness of the internal control system of the organisation and thereby helps in increasing the efficiency of the organisation.

Internal audit suffers from some limitations like:

(i) **Costly Affair:** Internal audit is an expensive matter.

(ii) **Undue Influence:** Internal auditor is the staff of the organisation. He may be influenced by other staffs of the organisation in course of his work.

(iii) **Unsuitable for Small Organisation:** It is a costly affair. It is indeed difficult for small organisations to carry out an internal audit.

(iv) **Less Qualified Person may be Appointed as the Internal Auditor:** Since no such prescribed qualification is required for appointment of an internal auditor, it may happen that a less qualified person gets appointed as an internal auditor.

(v) **High Chances of Distortion:** Internal audit report is prepared by the internal auditor who is basically a staff of the organisation. So, there is a chance that he may not always report the actual fact in order to save his colleagues in the organisation.

78. Distinguish between internal control and internal check.

Answer:

The differences between internal control and internal check are listed below:

Points of Difference	**Internal Control**	**Internal Check**
Nature	Internal control system is the whole system of control.	Internal check is only a part of internal control.
Flexibility	It deals with overall control of the organisation with flexibility.	It is comparatively less flexible.
The scope of work	It exercises control over all the areas of a function.	It is concerned with the work allocation only.
Importance	It is concerned with operational efficiency, productivity and profitability of the organisation.	It is mainly concerned with record keeping and accounting reports.
Function	Implementation of internal control is the responsibility of the management staff.	Internal check can be carried out by the ordinary staff.
Internal	Internal control system includes internal check, internal audit and administrative control.	It has no internal element.

79. Distinguish between internal check and internal audit.

Answer:

The differences between internal check and internal audit are listed below:

Points of Difference	Internal Check	Internal Audit
Nature	It runs automatically and concurrently with the execution of the transaction.	It is not an automatic process and works after the transaction takes place.
Staff	To run this system no separate set of staff is required.	To carry out internal audit a separate department is formed.
Objective	Prevention and early detection of errors and frauds is the objective of internal check.	To check the operational efficiency is the main objective of the internal audit.
Function	One employee's work is automatically checked by the work of another employee.	It is a continuous review of records independently.
Importance	It is concerned with carrying out work efficiently and effectively.	It is concerned with appraisal and ascertainment of the reliability of records.
Activity	It prevents the occurrence of errors and frauds.	It creates moral pressure on staff not to commit errors and frauds.

80. Distinguish between internal control and internal audit.

Answer:

The differences between internal control and internal audit are listed below:

Points of Difference	Internal Control	Internal Audit
Nature	It runs automatically and concurrently with the execution of the transaction.	It is not an automatic process and works after the transaction takes place.
Presence	Internal control system presents in all departments.	A separate department is formed to execute internal audit.
Scope	Scope of the internal control system is very wide.	Internal audit is an important part of the internal control system.
Responsibility	Implementation of internal control is the responsibility of the management staff.	Internal audit is executed by the internal auditor.

81. Discuss the legal requirement of internal audit.

Answer:

As per Section 138 of the Companies Act, 2013 read with Rule 13 of Companies (Accounts) Rules, 2014, certain classes of companies are required to appoint Internal Auditors who shall either be a Chartered Accountant, Cost Accountant or such other professional as may be decided by the Board to conduct internal audit of the functions and activities of the company. The following class of companies shall be required to appoint an internal auditor or a firm of internal auditors, namely (a) "Every listed company" and (b) Private and unlisted public companies meeting "any" of the following criteria:

Criteria	Unlisted Public	Private
Paid up share capital	Fifty crore rupees or more during	No share capital criteria.
Turnover	Two hundred crore rupees or more during the preceding financial year.	Two hundred crore rupees or more during the preceding financial year.
Outstanding deposits	Twenty five crore rupees or more at any point of time during the preceding financial year.	No deposit criteria.
Outstanding loans or borrowings from banks or public financial institutions	Exceeding one hundred crore rupees or more at any point of time during the preceding financial year.	Exceeding one hundred crore rupees or more at any point of time during the preceding financial year.

82. To what extent can an external auditor rely upon the work of internal auditor?

Answer:

SA-610 (earlier AAS-7), issued by ICAI states that external auditor can use the work of internal auditor after evaluation of internal audit functions.

Accordingly, the following factors should be considered while determining the extent to which external auditor can rely on the work of internal auditor:

(i) whether internal audit is undertaken by an outside agency or by a separate audit department within the entity.

(ii) the scope of the internal audit, management action and the internal audit report.

(iii) experience and qualification of internal audit.

(iv) the technical compliance by the internal auditor.

(v) the authority vested on internal auditor and level of management to whom he is accountable.

(vi) whether professional care has been taken by the internal auditor in conducting audit work.

The above statements suggest the following features:

- The role of the internal auditor is determined by the management and differs from the external auditor.
- External auditor should evaluate internal audit function to the extent it is relevant for determining nature, timing and extent of his compliance and substantive procedures.
- The responsibility of the external auditor cannot be reduced due to reliance on the work of the internal auditor.

Thus to conclude it can be said that the external auditor can rely on the work of the internal auditor, but if any misstatements remain undetected, the external auditor will be held liable for negligence in his duty.

83. State whether the following statements are true or false:

(i) Internal Audit is an independent appraisal activity.

(ii) Internal Check and Internal Audit are one and the same.

(iii) **Internal auditor has a big role to play in preventing fraud.**

(iv) **Internal Auditing is a function distinct from authorisation and recording.**

(v) **Internal auditor of a company cannot be its Cost Auditor.**

(vi) **Internal control questionnaire (ICQ) is prepared by the employer.**

(vii) **The responsibility of the external auditor cannot be reduced due to reliance on the work of the internal auditor.**

(viii) **To carry out internal audit no separate department is required to be formed.**

(ix) **Even a sound internal check system cannot guarantee the non-existence of any error or fraud in the accounts.**

(x) **Resorting to test checking by relying on internal check system of the organisation no way reduces the liability of the statutory auditor.**

(xi) **Internal audit is a dynamic profession involved in helping organisations achieving their objectives.**

(xii) **Internal check is not a part of internal control.**

(xiii) **To carry out internal audit a separate department is formed.**

Answer:

Question No.	Answer	Question No.	Answer
(i)	T	(viii)	F
(ii)	F	(ix)	T
(iii)	T	(x)	T
(iv)	T	(xi)	T
(v)	T	(xii)	F
(vi)	F	(xiii)	T
(vii)	T		

84. Define "Vouching". State its importance.

Answer:

In the words of **Ronald A. Irish**, "Vouching is a technical term, which refers to the inspection of documentary evidence supporting and substantiating a transaction". According to **J. Lancaster**, "Vouching is a device used to prove that various transactions for the period are fairly, truly and sincerely reflected in the books of accounts". Thus, in straightforward words, vouching means examination of accuracy, authority and authenticity of transactions that appear in the books of original entry with the help of supporting documents of these transactions.

Importance

In the words of De Paula, "Vouching is the essence of auditing." The success or failure of auditing depends on vouching. Audit work is impossible without vouching. It is, therefore, no exaggeration to say that "the vouching is the soul of auditing." The importance of vouching is as given below:

(i) **Detection of Errors at Initial Stage:** By checking the entries, with original evidence, the errors can be located at an early stage.

(ii) Detection of Frauds: Frauds may be committed by presenting duplicate vouchers. All the frauds, however small, can be detected with the help of vouching. So, all the evidential documents and records are to be checked carefully and in detail by an auditor which is the scope of vouching.

(iii) Keeps the Auditor Alert: If the auditor notices any error or fraud, he becomes more alert and careful. He resorts to auditing in depth. In the case of Armitage vs Brewer and Knott, 1982, it was held that audit is dependent on vouching and if the auditor shows carelessness in vouching, he will be held liable for it.

(iv) Reliable Examination: In vouching, the entries in original books of accounts are verified to ensure that the transactions are genuine. These entries are authenticated and complied with normally accepted principles of accounting. The entries in the books of original entries are the foundation on which the correctness of the entire accounting record is based. Thus, vouching tests the very base of the accounting process.

(v) Ensures Correctness of the Books of Accounts: Vouchers are links between transactions and entries. It ensures correctness of entries in books of accounts.

(vi) Finds out the Unrecorded Transactions: Since each and every transaction is checked and ratified on the basis of the document, vouching helps to find out the unrecorded or missing transactions.

(vii) Authorisation of Transactions: If transactions are not authorised, such transactions can be fictitious transactions. Fictitious transactions can be found with the help of vouching.

85. List the objectives of vouching.

Answer:

Some of the major objectives of vouching are summarised below:

(i) To ensure that all the transactions are properly recorded in the books of accounts,

(ii) To inspect the entries recorded in the books of accounts by documentary evidence,

(iii) To ensure that fraudulent transactions are not recorded in the books of accounts,

(iv) To make sure that all transactions are properly authenticated by appropriate authority,

(v) To find out whether all transactions are duly authorised,

(vi) To confirm that the necessary vouchers relating to entries recorded in books are with the client,

(vii) To ensure that the transactions are properly grouped into capital and revenue items, To ensure that the figures presented in the books of accounts are reliable, and

(viii) To ensure the accuracy in totalling, carrying forward and recording of an amount in the accounts.

86. State the features of vouching.

Answer:

The features of vouching are listed below:

(i) Vouching is an examination of the entries in books of accounts.

(ii) The examination is done with the help of vouchers like receipts, invoices, counterfoil or cheque books & pay-in-slips, pass-book, agreements, resolutions, minute book, correspondence, etc.

(iii) Vouching substantiates a transaction.

(iv) Vouching ensures the correctness of transactions recorded in the books.

(v) It is the essence of auditing.

87. What is voucher? Classify it. List its features.

Answer:

Voucher: Any document, which supports the entries in the books of accounts and establishes the arithmetical accuracy, is called a voucher. In other words, a voucher is documentary evidence, both internal and external, which is used to support the entries made in the books of accounts of a business.

Types / Classification

On the basis of originality, a voucher can be of two types:

(i) **Primary Vouchers**: Written evidence in original is said to be the primary voucher. For example, invoice for the purchase.

(ii) **Collateral Vouchers**: When the original voucher is not available, copies thereof are produced in support of subsidiary evidence. Such a voucher is usually known as a collateral voucher. For example, Photocopy of demand drafts, counterfoil of pay-in-slip. etc.

On the basis of sources of documents, vouchers can again be of two types:

(i) **Internal Vouchers**: Vouchers originating within the organisation are called internal vouchers. For example, sales invoices, material requisition slip, goods received notes etc.

(ii) **ExternalVouchers**: Vouchers originating from the outside sources are known as external vouchers. For example, bank statement, confirmation from customers and suppliers etc.

(iii) **Features**

In general, a valid voucher should have the following features:

(i) **Amount:** The amount written in the voucher must be same in words and in figures.

(ii) **Date:** Every voucher must have a date.

(iii) **Client's Name:** All vouchers must be in the name of the organisation or the client.

(iv) **Description of Transaction:** Every voucher must contain the description of one transaction only.

(v) **Signature:** Every voucher must be approved with signature by the competent authority.

(vi) **Clarity:** Voucher must be perfect. That is to say, hazy or incomplete writings must not be included in the voucher.

(vii) **Countersign in Case of Alteration:** If there is any alteration/correction, it must be countersigned by the competent authority.

(viii) **Serial Number:** A voucher must have a serial number.

88. List the duties of an auditor in case of missing vouchers.

Answer:

In the course of the audit, the auditor may find some vouchers missing. He must make a list of all the missing vouchers and should take the following steps in this regard:

(i) **Ask for Explanation:** If any voucher is missing, the concerned official should be asked to give a proper explanation.

(ii) **Non-availability of Vouchers**: Sometimes it is very difficult to collect some vouchers. For example, the vouchers of rickshaw-fare, taxi fare, retail purchase of some items, etc., in which case the auditor has to judge according to the circumstances.

(iii) **Materiality of Amount**: The auditor should verify whether the amount involved is material. If the amount of the voucher is very small, then the auditor may not go for further clarification.

(iv) **Nature of Lost Vouchers**: The auditor should examine the number and nature of transactions associated with the lost vouchers. If the number of transactions is very small, then the voucher may not be so necessary.

(v) **Causes of Loss of Vouchers**: If the transactions are important, and the supporting vouchers are lost, then he must know the causes of loss of vouchers.

(vi) **Verification of Stores**: In case of purchase of goods, if the voucher is not found, then he is to see whether the goods are stored, or issued to the production department, or re-sold, or included in the closing stock.

(vii) **Duplicate Vouchers**: In some special cases, the duplicate of the original voucher is to be procured.

(viii) **Statement of Lost Vouchers Signed by High Officials:** For all the lost vouchers, the auditor should make a statement of lost vouchers with the approval and signature of the higher authority.

(ix) **Declaration from Management**: The Auditor should also obtain a declaration from the management that transaction pertaining to missing voucher are real and are undertaken in the interest of the organisation.

(x) **Reposting of missing vouchers**: In case the number of missing vouchers are many and also of material in nature, he should mention the fact in his audit report. Even in extreme cases, he may have to submit a disclaimer of opinion.

89. How would you, as an auditor, vouch cash sales?

Answer:

Documents Required

(i) Cash memos (carbon copy)

(ii) Salesman's summary

(iii) Cashier's summary

(iv) Goods delivered summary

(v) Relevant accounting heads in ledger

(vi) Cash book

(vii) Daily cash sales statement

Procedures Followed/Duty of an Auditor

(i) The auditor should check the effectiveness and adequacy of the internal check system.

(ii) He has to examine the cash book with reference to daily cash sales summary and copies of cash memos.

(iii) He should examine whether the prices charged, discounts allowed and rates of tax charged, as shown by cash memos are correct and properly authorised.

(iv) He should compare the salesman's abstract with the carbon copies of cash memos.

(v) He has to examine whether the dates on cash memos and cash sales summary are identical.

(vi) The arithmetical accuracy of cash memos, cash sales summary and gate-keeper's goods delivered summary are to be examined.

(vii) He should ensure that no cancelled cash memo is torn out of the book.

90. How would you, as an auditor, vouch 'goods on sales or return'?

Answer:

Documents Required

(i) Customer's order for sending the goods

(ii) Invoice for returning goods

(iii) Memorandum columnar book

(iv) Sales book

(v) Ledger (Customer's A/(c)

(vi) Statements of customers giving details of inventories

Procedures Followed/Duty of an Auditor

(i) The auditor should verify whether the organisation maintains a separate memorandum record of goods sent out on sale or return basis.

(ii) The auditor has to ensure that goods sent are recorded along with the details of the customer.

(iii) He has to make sure that the sales account has been credited only after the goods have been sold and correspondingly customer's account has been debited.

(iv) The auditor should refer to this book to ensure that on the receipt of acceptance from the customer, proper entries have been made in the sales book and the customer's account.

(v) If acceptance has not been received, but the period of approval has expired, the goods at the end of the year should have been received back or the customer's account should be debited.

(vi) All goods sent on approval, in respect of which time limit has not expired should be included in stock.

(vii) The auditor should get a statement from the customer about the quantity and type of goods lying with him on an approval basis.

91. How would you, as an auditor, vouch 'commission received'?

Answer:

Documents Required

(i) Counterfoil of receipts/pay-in-slips

(ii) Cash book

(iii) Cash receipts

(iv) Agreement between the client and the third parties or account sales or bank advice

Procedures Followed/Duty of an Auditor

(i) The auditor should examine the agreement entered into between the client and the broker or agent or consignee.

(ii) He has to examine the receipts of commission in the cash book with counterfoils of the cash receipts.

(iii) The auditor has to ensure that money has been deposited into the bank by reference to counterfoils of pay-in-slips.

(iv) The auditor gas to make all the necessary calculations himself and also examine posting to the appropriate ledger accounts.

(v) He has to examine the counterfoils of receipt of commission with reference to the agreement between the client and the parties from whom it is receivable or a copy of account sales (in case of goods received on consignment) or bank advice (in case of commission received from abroa(d) and relevant documentary evidence in other cases.

92. How would you, as an auditor, vouch 'travelling expenses'?

Answer:

Documents Required

(i) Cash book

(ii) Standard form for claiming reimbursement

(iii) Ticket of the mode of transport used

(iv) Hotel bill

(v) Travelling Allowance Rules of the organisation

(vi) Approved tour programmes

(vii) Tour report, if any

Procedures Followed/Duty of an Auditor

(i) The auditor should check whether there is any approved rule for travelling expenses to be paid to the staff. If no rule exists, he should recommend that rules may be framed to control the expenses.

(ii) The voucher for travelling expenses should normally contain the following information:

(a) Name and designation of the person claiming the amount

(b) Particulars of the journey

(c) Amount of fare

(d) Amount of boarding or lodging expenses or daily allowance along with the dates and times of arrival and departure from each station

(e) Other expense claimed e.g. porterage, tips, conveyance, etc.

(iii) The auditor should examine the cash book for payments made for travelling expenses with reference to standard form for such reimbursement filled in by the claimant with his name and designation clearly indicated.

(iv) He should check the counterfoil of the air ticket if the journey was undertaken by air.

(v) He should ensure that the tour was sanctioned by proper authority.

(vi) Particulars of boarding and lodging expenses and in the case of halting allowance the rates thereof should be examined in terms of rules, if any, framed by the entity in this regard.

(vii) The evidence with regard to sundry expenses claimed is generally not attached to T.A. bills. So long as the amount appears to be reasonable, it is usually not questioned.

(viii) All vouchers for travelling expenses should be authorised.

(ix) In case of foreign travel expenses, the auditor should also examine the Reserve Bank of India's prescribed foreign exchange entitlement for such travel along with organisational rules in this regard.

(x) The travelling advance taken, if any, should be settled on the receipt of final bills.

(xi) Section 309 of the Companies Act, 2013 provides that the travelling expenses of the directors for attending board meeting are payable provided they have been allowed by the articles, or by a board's resolution or, if the articles so require, by a special resolution, passed by the company in the general meeting.

93. How would you, as an auditor, vouch 'remunearation paid to directors?

Answer:

Documents to be Checked

(i) Articles of Association

(ii) Resolutions of the general meeting

(iii) Minute book

(iv) Agreement with the directors

(v) Director's attendance register

(vi) Receipts issued by the directors

(vii) Bank statements

Procedures Followed/Duty of an Auditor

(i) The auditor should examine the Articles of Association and resolution adopted in the general meeting in order to ascertain the mode of payment of remuneration.

(ii) He should refer to a general meeting or board meeting resolution for the appointment and terms of appointment of the director as per Section 196 of the Companies Act, 2013.

(iii) He should check the agreement, terms and conditions of appointment of the directors.

(iv) He should examine Articles of Association and general meeting resolution to determine the manner of payment—monthly or at a specified percentage of the net profits of the company or partly by one way and partly by the other as per the provisions of Section 197(6) of the Companies Act, 2013.

(v) The auditor should verify directors' attendance in the board meetings and in the minute book if there is a provision of payment of remuneration to the directors for attending the meeting.

(vi) He should ensure compliance with the provisions of Sections 197, 198 and Schedule V to the Companies Act, 2013 regarding remuneration paid to the directors.

(vii) He should examine that the net profits and the commission payable to the directors have been computed in terms of Schedule III to the Companies Act, 2013.

(viii) He should ensure that a separate note has been given stating the computation of net profit under Section 198 of the Companies Act, 2013 with details of the commission payable as a percentage of profits to the directors including Managing Directors/Manager (if any).

(ix) He should also examine adherence to relevant sections of the Act, such as

  (a) Section 309(3) and (4) which deals with manner of payment of managerial remuneration,

  (b) Section 309 (2) which deals with the payment of sitting fees,

  (c) Section 198 which has prescribed overall limits to managerial remuneration.

94. What do you mean by 'verification'? List its objectives.

Answer:

According to **Spicer and Pegler**, "Verification of assets implies an enquiry into the value, ownership and title, existence and possession and the presence of any charge on the assets". So, verification of assets can be stated as a process of substantiation of assets recorded in the books of account, by means of physical inspection and examination of legal and official documents, and then forming an expert opinion as to the existence, ownership, possession, classification and valuation of assets of an entity.

Objectives of Verification

Verification of assets and liabilities is undertaken with the following objectives:

(i) **Existence:** To find out whether the assets that are shown in the balance sheet are in existence or not,

(ii) **Ownership:** To find out the ownership, possession and title of the assets,

(iii) **Correct Valuation:** To show the correct valuation of assets and liabilities,

(iv) **Valued on GAAP:** To see that assets and liabilities are valued on the basis of generally accepted principles and that valuation is consistent with that of the previous year,

(v) **True and Fair View:** To know whether the balance sheet exhibits a true and fair view of the state of affairs of the business,

(vi) **Check Fraud and Irregularity:** To check whether any fraud or irregularity are committed,

(vii) **Adequacy of Internal Control:** To find out whether there is an adequate internal control regarding acquisition, utilisation and disposal of assets,

(viii) **Arithmetic Accuracy:** To verify the arithmetic accuracy of the accounts,

(ix) **Proper Recording:** To ensure that the assets have been recorded properly,

(x) **Related to Business:** To verify that the assets and liabilities not connected with business are not shown in the balance sheet.

95. State the advantages of verification. Explain its steps.

Answer:

The main advantages of verification are:

(i) It avoids the manipulation of accounts.

(ii) It guards against improper use of assets.

(iii) It ensures proper recording and valuation of assets.

(iv) It exhibits a true and fair view of the state of affairs of the company.

Verification has the following steps:

(i) **Inspection**: It means a physical inspection of the assets of the company i.e. cash in the cash box, physical inventory, inspection of shares certificates, documents, etc.

(ii) **Observation:** The auditor may observe or witness the inspection of assets done by others.

(iii) **Confirmation:** It means obtaining written evidence from outside parties regarding the existence of assets.

96. Explain the importance of verification.

Answer:

The importance of the verifications can be summarised as follows:

(i) **To Know the Ownership:** Ownership of the assets should be verified by examining the title deeds. In case the title deeds are held by other persons such as solicitors or bankers, confirmation should be obtained directly by the auditor through a request signed by the client.

(ii) **To Show the Actual Financial Position:** Balance sheet is prepared to show the actual financial position of a business. So, to provide information about the real financial position, verification and valuation of assets are essential.

(iii) **To Know the Real Position of Profit and Loss:** Depreciation and other expenses on assets will be incorrect if the proper valuation of assets is not made. So, to calculate the actual amount of profit and loss, proper valuation of assets and liabilities is necessary.

(iv) **Possession:** The auditor should ascertain that the assets are in the possession of the client. If an asset is in possession of any other person, it should be seen that such possession has been duly authorised by the client.

(v) **Existence:** The physical verification of fixed assets is primarily the responsibility of the management and not the auditor. In order to verify the existence of assets, he should examine the records with reference to the documentary evidence and the internal controls.

(vi) **Valuation and Disclosure:** The auditor should satisfy himself that the assets have been valued and disclosed in the financial statements according to the generally accepted accounting principles and statutory requirements, if any.

(vii) **Adequate Disclosure of Encumbrances or Lien:** The duty of an auditor with regards to such disclosures is two folds—firstly, he should adopt audit procedures to ascertain whether an asset is subject to charge. Example of some such procedures are representations obtained from the management and confirmation obtained from the bank with regards to the purpose of holding securities. Secondly, if a charge exists, the auditor should ensure its proper disclosure in the financial statement.

97. List the general principles for verification of assets.

Answer:

Points requiring auditor's attention for verification are as under:

(i) **Cost:** The auditor should check the correctness of costs through normal vouching methods. He should ensure that adequate distinction has been made between revenue and capital nature of costs.

(ii) **Acquisition of Individual Asset:** The cost of the asset acquired should be verified with their purchase agreements or ownership rights and the receipts of the seller in respect of the price paid.

(iii) **Acquisition of Group of Assets:** Where a company or a partnership has taken over the assets of a going concern, the agreement of sale should be inspected and that amount paid for them ascertained.

(iv) **Sale of Assets:** When an asset is sold, its sale proceeds should be vouched with respect to the reference to the agreement, containing the terms and conditions of sale, counterfoil of the receipt issued to the purchaser or any other evidence which may be available. If the sale of a fixed asset has resulted in capital profit, it should be transferred to the capital reserve.

(v) **Valuation:** It must be ascertained that all assets are valued in accordance with the appropriate accounting policy. For the valuation made, the basis must be consistently applied, unless circumstances necessitated a change.

(vi) **Depreciation:** It is obligatory for a company to provide for depreciation out of the profits in accordance with the provisions under Sub-section (1) of Section 123 of the Companies Act, 2013 before any profits can be distributed as dividend. The law requires that depreciation should be provided in the manner as specified in Scheduled III to the Companies Act, 2013.

(vii) **Physical Verification of Fixed Asset:** The existence of fixed assets, where practicable, should be verified by physical inspection or by comparing the particulars of assets as entered in the schedule attached to the balance sheet, with the Asset Register.

(viii) **Existence:** Physical inspection should be done wherever possible. Where physical inspection is not possible, the possibility of obtaining indirect evidence has to be considered, e.g., machinery imported held in customs godown or materials sent to the subcontractor for job work or fabrication. In such circumstances, certificating of such parties should be obtained, and if considered necessary, even physical verification may be requested.

(ix) **Presentation in Accounts:** Material assets must be properly disclosed and correctly described in the accounts. It should be seen that the description given to them is clear and complete and is not misleading.

(x) **Inspection of Current Assets and Investments:** Wherever possible, all the securities and documents of title, cash, negotiable instruments etc. representing the assets should be inspected at the close of the last day of the accounting period.

(xi) **Charges on Asset:** It should be ascertained that no unauthorised charge has been created against an asset and all the charges are duly registered and disclosed. Where shares or securities are lodged with a bank to secure a loan or an overdraft, a certificate should be obtained from the bank showing the nature of the charges, if any.

(xii) **Assets with Third Parties:** Where assets, for example, government securities, share and debentures, stock sent on consignment, goods sent on sale or approval basis, etc. are in the custody of a third party other than a bank, these must be inspected.

(xiii) **Separate Disclosure:** Where depreciable assets are disposed of, discarded, demolished or destroyed, the net surplus or deficiency, if material, should be disclosed separately.

98. Distinguish between vouching and verification.

Answer:

The differences between vouching and verification are listed below:

Points of Distinction	Vouching	Verification
Meaning	Vouching means substantiating an entry in the books of account with the supporting vouchers like receipts, invoices, correspondence, contracts, etc.	Verification means examining with regard to the assets shown in the balance sheet that they exist, are in the name of the company, are properly valued and are free from any charge.
Frequency	Vouching is done at any time during the year.	Verification is done only after accounts are completed and balances are drawn.
Area of checking	In vouching, the auditor examines the bonafides of transactions and their correct recording in the books.	In verification, the auditor has to ensure that assets, as recorded in the balance sheet, do really exist on the date of the balance sheet.
Related area	Vouching is concerned with all issues of the income statement and with those balance sheet items undergoing change during the year.	Verification is concerned with all the items of the balance sheet.
Assurance about existence	Vouching cannot ensure the existence of assets. After the purchase of the assets, it may be sold, destroyed or even gifted away without being recorded in the books.	Verification ensures the existence of the assets through physical impelling of the place where the assets are located.

99. Fill in the blanks:

(i) Internal Check is a valuable part of the _______________ control.

(ii) Internal Audit is an independent ___________ activity.

(iii) The Internal Auditor is appointed by the ________________.

(iv) Accounting control is ---------- control.

(v) As per Section --------- of the Companies Act, 2013 read with Rule 13 of Companies (Accounts) Rules, 2014, certain classes of companies are required to appoint Internal Auditors.

(vi) Internal control questionnaire (ICQ) is prepared by the ------------.

(vii) Vouching is the -------------------- of auditing.

(viii) ---------------------- of assets implies an enquiry into the value, ownership and title, existence and possession and the presence of any charge on the assets.

(ix) The steps in the process of verification include inspection, observation and ----------.

(x) The auditor should examine that the net profits and the commission payable to the directors has been computed in terms of Schedule ----- to the Companies Act, 2013.

(xi) In internal check, the division of work should be such that the work of one is ------------------ checked by another.

(xii) Internal control comprises both --------------- control as well as accounting control.

(xiii) Internal control questionnaire (ICQ) is a comprehensive and well structured series of --------------- concerning internal control.

(xiv) Internal control questionnaire (ICQ) is the most widely used technique of evaluation of internal------------.

(xv) Internal auditing is an independent, objective assurance and consulting activity designed to add ------------ and improve an organisation's operations.

(xvi) The broad objectives of internal audit are laid down in SA----------.

(xvii) Internal audit is an important part of the internal ------------ system.

(xviii) External auditor can rely on the work of the internal auditor, but if any misstatements remain undetected, the external auditor will be held liable for --------------- in his duty.

(xix) The responsibility of the external auditor cannot be reduced due to reliance on the work of the ------------- auditor.

Answer:

Question No.	Answer	Question No.	Answer
(i)	internal	(xi)	automatically
(ii)	appraisal	(xii)	administrative
(iii)	management	(xiii)	questions
(iv)	financial	(xiv)	control
(v)	138	(xv)	value
(vi)	auditor	(xvi)	610
(vii)	essence	(xvii)	control
(viii)	Verification	(xviii)	negligence
(ix)	confirmation	(xix)	internal
(x)	III		

100. Identify the correct answer:

(i) The purpose of internal audit is to protect the

a. Assets

b. Audit staff.

c. Accountant

d. Management

(ii) The purpose of Internal audit is to detect the error in the

a. Accounting records

b. Employees records

c. Cash records

d. Bank records

(iii) The purpose of internal audit is to determine liabilities of

a. Employer

b. Employees

c. Accountant

d. External auditor

(iv) The assets protection is possible through

a. Internal Audit

b. Internal Control

c. Internal Check

d. None of the above

(v) The function of internal audit is meant for

a. Dearth of Staff

b. Dearth of time

c. Dearth of time and funds

d. Dearth of funds

(vi) Review of internal control system is very important for the auditor as the effectives of internal control system will determine the extent of checking to be done by the

a. Management

b. Auditor

c. Accountant

d. None of the above

(vii) Check list contains the instruction to be followed by the

a. Internal Auditor

b. External Auditor

c. Audit Assistants

d. Employee of the organisation

(viii) Internal Control Questionnaire contains the questions need to be followed by the

a. Employer of the organisation

b. Employee of the organsation

c. Auditor of the entity

d. Banker to the organsation

(ix) Accounting control

a. Administrative control

b. Internal audit

c. Internal check

d. Financial control

(x) ------------- allocation of duties among the staff in such a way that it eliminates the chances of any duplicity of work

a. Internal check

b. Internal control

c. Internal audit

d. Operational control

Answer:

(i) a

(ii) a

(iii) b

(iv) a

(v) a

(vi) b

(vii) c

(viii) b

(ix) d

(x) a

101. Match the following:

	Column A		Column B
1	Internal audit	A	Financial control
2	Accounting control	B	allocation of duties among the staff in such a way that it eliminates the chances of any duplicity of work
3	Administrative control	C	continuous appraisal of the various operational activities of the organisation
4	Internal check	D	ensures adherence to management's policies, rules, regulations

Answer:

	Column A		Column B
1	Internal audit	C	continuous appraisal of the various operational activities of the organisation
2	Accounting control	A	Financial control
3	Administrative control	D	ensures adherence to management's policies, rules, regulations
4	Internal check	B	allocation of duties among the staff in such a way that it eliminates the chances of any duplicity of work

102. Match the following:

	Column A		Column B
1	Vouching	A	An enquiry into the value, ownership and title, existence and possession and the presence of any charge on the assets
2	Verification	B	Concerned with evaluating and improving the effectiveness of risk management, control and governance processes
3	Internal Control	C	Concerned with operational efficiency, productivity and profitability of the organisation.
4	Internal Audit	D	examination of accuracy, authority and authenticity of transactions

Answer:

	Column A		**Column B**
1	Vouching	D	examination of accuracy, authority and authenticity of transactions
2	Verification	A	An enquiry into the value, ownership and title, existence and possession and the presence of any charge on the assets
3	Internal Control	C	Concerned with operational efficiency, productivity and profitability of the organisation.
4	Internal Audit	D	examination of accuracy, authority and authenticity of transactions

Study Note – 7

PROVISION RELATING TO AUDIT UNDER COMPANIES ACT

Learning Objective: *This chapter will help to understand the scope of auditing which is not only restricted to financial audit under the Companies Act, but has also been extended to cost accounting aspects, managerial policies, operational efficiencies and system applications. It also covers social implications of business organizations and environmental issues. Provisions of Auditing cover all these aspects and also describes the modern tools and techniques of auditing.*

1. Identify the correct alternative. [1 Mark Each]

(i) Dividend cannot be paid out of –

A. Current year's profit after providing depreciation

B. Undistributed profits for any previous financial year or years after providing for depreciation

C. Profit on revaluation of any fixed assets

D. Money provided by the Central Government or a State Government

(ii) A cost auditor submits his report to –

A. Government

B. Shareholders

C. Statutory Auditor

D. Board of Directors

(iii) An auditor should submit a Disclaimer of Opinion when –

A. He is satisfied with the truth and fairness of financial statements.

B. He has certain reservations as to the presentation of truth and fairness in financial statements.

C. Some material information is not available.

D. The effect of any disagreement with the management is not so material.

(iv) The first auditor of a Company is appointed by –

A. Board of Directors

B. Managing Director

C. Comptroller and Auditor General (CAG)

D. Shareholders

(v) An Audit Committee should have a minimum of ___________number of directors.

A. 4

B. 3

C. 5

D. 6

(vi) Unpaid dividend standing at the credit of Unpaid Dividend A/C should be transferred to Investor Education and Protection Fund after _____________years of its remaining unpaid.

A. Six

B. Eight

C. Seven

D. Five

(vii) Which of the following services cannot be rendered by an auditor as per Companies Act 2013?

A. Vouching

B. Verification of assets and liabilities

C. Issuing certificates on relevant matters

D. Providing investment advisory services

(viii) Casual Vacancy of a company auditor is filled by

A. Managing Director

B. Board of Directors

C. Central Govt.

D. Shareholders

(ix) A company auditor resigning from his post shall inform the same to the Registrar in

A. Form No. ADT -1

B. Form No.ADT - 2

C. Form No.ADT - 3

D. Form No.ADT - 4

(x) Which of the following conditions is not mandatory while utilizing past reserves for payment of dividend?

A. The rate of dividend shall not exceed the average of rates in the three immediately preceding years.

B. Total amount to be withdrawn shall not exceed one-tenth of the sum of its paid-up share capital and free reserves.

C. After withdrawn the balance of reserves shall not fall below 15% of its paid up share capital.

D. The company must obtain prior approval from the Central Govt. in this regard.

Answer:

(i) C
(ii) D
(iii) C
(iv) A
(v) B
(vi) C
(vii) D
(viii) B
(ix) C
(x) D

2. State true or False:

(i) The first auditor of a company is appointed by the shareholders of the company at the general meeting.

(ii) A company auditor can render actuarial services to his client.

(iii) Secretarial Audit is applicable to listed companies as well as certain non-listed public companies.

(iv) The first auditor of a Govt. Company is appointed by the shareholders of the company at the general meeting.

(v) The amount of dividend declared should be deposited in a scheduled bank in a separate account within fifteen days from the date of declaration of such dividend.

(vi) Each joint auditor shall be jointly and severally responsible in respect of undivided work.

(vii) For any default on the part of the company to deposit the unpaid dividend within the stipulated time, the company needs to pay interest @18% p.a.

(viii) As per Schedule II, the residual value of an asset should generally not exceed 10% of the original cost of the asset.

Answer:

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

3. Match the following items in Column 'A' with items shown in Column 'B

Column 'A'		Column 'B'	
1.	Audit of branch accounts	A.	Qualified Audit Report
2.	Unable to form an overall conclusion on Financial Statements	B.	Section 139(8)
3.	Audit Report with reservations	C.	Section 143(8)
4.	Filling up of casual vacancy	D.	Disclaimer of Opinion

Answer:

1. (C)
2. (D)
3. (A)
4. (B)

4. Match the following items in Column 'A' with items shown in Column 'B

Column 'A'		Column 'B'	
1.	Joint Audit	A.	Audit Report
2.	Confirmation of correctness and accuracy of a matter	B.	Section 142
3.	Emphasis of matter paragraph	C.	SA-299
4.	Remuneration of an auditor	D.	Audit Certificate

Answer:

1. (C)
2. (D)
3. (A)
4. (B)

5. Who can be appointed as a statutory auditor of a company as per the provisions of Companies Act 2013?

Answer:

As per Section 141 of Companies Act 2013, the following persons should be considered as qualified for this purpose.

(a) A person shall be eligible for appointment as an auditor of a company only if he is a chartered accountant [Section 141(1)].

(b) A firm can also be appointed by its firm name to be the auditor of a company if majority of partners practicing in India are qualified for appointment as company auditor [Section 141(1)].

(c) 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 [Section 141(2)].

Note: In this context the meaning of the term 'chartered accountant' shall be interpreted based on the provisions of The Chartered Accountants Act 1949.

6. State the disqualifications of a Company Auditor.

Answer:

As per Section 141(3) read with Rule10 of Company (Audit and Auditor) Rule 2014, the following persons shall not be eligible for appointment as an auditor of a company.

(*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, of face value not exceeding rupees one lakh;

(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 rupees five lakh;

(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, in excess of rupees one lakh;

(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) any person whose subsidiary or associate company or any other form of entity, is engaged as on the date of appointment in consulting and specialised services as provided in section 144.

Where a person appointed as an auditor of a company incurs any of the disqualifications mentioned in sub-section (3) after his appointment, he shall vacate his office as such auditor and such vacation shall be deemed to be a casual vacancy in the office of the auditor [Section 141(4)].

7. State the provisions of Companies Act 2013 relating to the appointment of the first auditor of a company.

Answer:

The provisions of Companies Act 2013 relating to the appointment of the first auditor of a company are discussed below:

I. In Case of a Company other than a Government Company [Section 139(6)]:

(a) The first auditor of a company, other than a Government company, shall be appointed by the Board of Directors within thirty days from the date of registration of the company.

(b) In the case of failure of the Board to appoint such auditor, it shall inform the members of the company, who shall within ninety days at an extraordinary general meeting appoint such auditor

(c) The auditor, so appointed, shall hold office till the conclusion of the first annual general meeting.

II. In Case of a Government Company [Section 139(7)]:

(a) In the case of a Government company or any other company owned or controlled, directly or indirectly, by the Central Government, or by any State Government, or Governments, or partly by the Central Government and partly by one or more State Governments, the first auditor shall be appointed by the Comptroller and Auditor-General of India within sixty days from the date of registration of the company.

(b) In case the Comptroller and Auditor-General of India does not appoint such auditor within the aforesaid period, the Board of Directors of the company shall appoint such auditor within the next thirty days.

(c) Further, in the case of failure of the Board to appoint such auditor within the next thirty days, it shall inform the members of the company who shall appoint such auditor within sixty days at an extraordinary general meeting.

(d) The auditor, so appointed, shall hold office till the conclusion of the first annual general meeting.

Note: For the aforesaid purpose 'Government Company' shall mean a company in which not less than 51% of the paid-up share capital is held by the Central Government or by any State Government, or Governments, or partly by the Central Government and partly by one or more State Governments, and includes a company which is a subsidiary company of such a Government Company.

8. How can a company fill up the casual vacancy of a statutory auditor?

Answer:

The provisions of Companies Act 2013 relating to filling up a casual vacancy of a company auditor are as follows:

I. In the case of a company other than a company whose accounts are subject to audit by an auditor appointed by the CAG i.e. for Non-government Companies:

(a) Any casual vacancy will be filled by the Board of Directors within thirty days.

(b) If such casual vacancy is as a result of the resignation of an auditor, such appointment shall also be approved by the company at a general meeting convened within three months of the recommendation of the Board.

(c) The auditor, so appointed, shall hold the office till the conclusion of the next annual general meeting.

II. In the case of a company whose accounts are subject to audit by an auditor appointed by the CAG i.e. for Government Companies:

(a) Any casual vacancy will be filled by the Comptroller and Auditor-General of India within thirty days.

(b) In case the Comptroller and Auditor-General of India does not fill the vacancy within the aforesaid period, the Board of Directors shall fill the vacancy within next thirty days.

Note: Though not defined clearly, 'casual vacancy' for the aforesaid purpose usually implies cessation of service of an existing auditor due to his death, resignation, disqualification etc.

9. State the provisions of Companies Act 2013 regarding the removal of a company auditor.

Answer:

A company auditor can be removed from his office in the following ways:

1. Removal of Auditor before the Expiry of His Term:

The auditor appointed under section 139 may be removed from his office before the expiry of his term subject to the fulfillment of the following conditions under Section 140(1) read with Rule 7 of CAAR 2014.

(a) An application to the Central Government for removal of the auditor shall be made in Form **ADT-2.** The applicationshall be accompanied with fees as provided for this purpose under the Companies (Registration Offices and Fees) Rules, 2014.

(b) The application shall be made to the Central Government within thirty days of the resolution passed by the Board.

(c) The company shall hold the general meeting within sixty days of receipt of approval of the Central Government for passing the special resolution for removal of the said auditor.

(d) The auditor concerned shall be given a reasonable opportunity of being heard.

2. Removal of the Auditor by Tribunal:

The provisions in relation to removal of an auditor as contained in Section 140(5) are as follows:

(a) The Tribunal either *suomotu*or on an application made to it by the Central Government or by any person concerned, may, by order, direct the company to change its auditors if it is satisfied that the auditor has, whether directly or indirectly, acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to, the company or its directors or officers.

(b) If the application is made by the Central Government and the Tribunal is satisfied that any change of the auditor is required, it shall within fifteen days of receipt of such application, make an order to removal the auditor from his office.

(c) The Central Government may appoint another auditor in his place.

(d) An auditor, whether individual or firm, against whom final order has been passed by the Tribunal under this section shall not be eligible to be appointed as an auditor of any company for a period of five years from the date of passing of the order and the auditor shall also be liable for action under section 447.

10. 'An auditor is an officer of the company' – Critically explain the statement.

Answer:

The above statement is debatable as there are arguments both in favour as well as against the statement.

- **Arguments in favour:**

  (a) There are a number of legal decisions where an auditor has been treated as an officer of the company. For example, in London vs. General Bank Ltd. (1895) it was held by Justice Lindley that it seems impossible to deny that for some purposes and to some extent, an auditor is an officer of a company. Similarly in Connell vs. The Himalaya Bank (1895) it was held that if an auditor is appointed at the General Meeting and is in receipt of remuneration from the company, he will be considered as the officer of the company.

  (b) As per Section 2(59) of the Companies Act 2013, an auditor will be treated as the officer of the company with respect to the following sections:

  (i) Section 299, Power to summon persons suspected of having property of company;

  (ii) Section 300, Power to order examination of promoters, directors, etc;

  (iii) Section 336: Offences by officers of companies in liquidation

  (iv) Section 337, Penalty for frauds by officers

  (v) Section 340, Power of Tribunal to assess damages against delinquent directors, etc;

  (vi) Section 342, Prosecution of delinquent officers and members of company;

  (vii) Section 463, Power of court to grant relief in certain cases.

- **Arguments Against:**

  (a) Except in a few cases, Companies Cat does not consider an auditor to be its officer.

  (b) In Findley vs. Waddell (1910) it was held that auditor appointed in a casual vacancy is not an officer of the company.

  (c) In The Western Counties Steam Bakeries and Milling Co. Ltd. (1897), it was held that every auditor who was appointed to audit the accounts may not be considered as the officer of the company.

Based on the above discussion it may be concluded that the real status of a company auditor is debatable. However, in a fair number of circumstances under Companies Act as well as other legal cases he is considered as an officer of the company.

11. State the statutory provisions in connection with the resignation by a company auditor.

Answer:

According to Section 140(2) of Companies Act, 2013, if a company auditor resigns from his post, he has to comply with the following steps:

(i) The auditor shall file a statement in the prescribed Form ADT-3 with the company and the Registrar, indicating the reasons and other facts with regard to his resignation within a period of thirty days from the date of resignation.

(ii) In case of Govt. Companies the auditor shall file such statement with the Comptroller and Auditor-General of India.

(iii) If the auditor does not comply with the above provision, he or it shall be punishable with fine which shall not be less than fifty thousand rupees but which may extend to five lakh rupees.

12. State the provisions of Companies Act 2013 in connection with the remuneration of a company auditor.

Answer:

As per Section 142 of Companies Act 2013, the provisions in connection with the remuneration of auditors are as under:

(i) The remuneration shall be fixed in its general meeting or in such manner as may be determined therein. However, the Board will fix remuneration of the first auditor appointed by it.

(ii) The above remuneration shall also include the expenses, if any, incurred by the auditor in connection with the audit of the company and any facility extended to him but does not include any remuneration paid to him for any other service rendered by him at the request of the company.

(iii) The above remuneration shall be shown under the head 'Other Expenses' in the Statement of Profit and Loss to be prepared as per Schedule III of Companies Act, 2013.

13. State the duties of a company auditor with respect to inclusion of certain items in his report as per Section 143(3) of the Companies Act 2013.

Answer:

As per Section 143(3), the company auditor, in his audit report, shall clearly state –

(i) Whether he has sought and obtained all the information and explanations which to the best of his knowledge and belief were necessary for the purpose of his audit and if not, the details thereof and the effect of such information on the financial statements.

(ii) Whether, in his opinion, proper books of account as required by law have been kept by the company and proper returns adequate for the purposes of his audit have been received from branches not visited by him.

(iii) Whether the report on the accounts of any branch office of the company audited by a person other than the company's auditor has been sent to him and the manner in which he has dealt with it in preparing his report.

(iv) Whether the company's balance sheet and profit and loss account dealt with in the report are in agreement with the books of account and returns.

(v) Whether, in his opinion, the financial statements comply with the accounting standards.

(vi) The observations or comments of the auditors on financial transactions or matters which have any adverse effect on the functioning of the company.

(vii) Whether any director is disqualified from being appointed as a director under sub-section (2) of section 164.

(viii) Any qualification, reservation or adverse remark relating to the maintenance of accounts and other matters connected therewith.

(ix) Whether the company has adequate internal financial controls system in place and the operating effectiveness of such controls.

14. Discuss the duties of a company auditor in relation to reporting of fraud.

Answer:

For the purpose of sub-section (12) of section 143, in case the auditor has sufficient reason to believe that an offence involving fraud, is being or has been committed against the company by officers or employees of the company, he shall report the matter to the Central Government immediately but not later than sixty days of his knowledge and after following the procedure indicated herein below.

(i) The auditor shall forward his report to the Board or the Audit Committee, as the case may be, immediately after he comes to knowledge of the fraud, seeking their reply or observations within forty-five days;

(ii) On receipt of such reply or observations the auditor shall forward his report and the reply or observations of the Board or the Audit Committee along with his comments (on such reply or observations of the Board or the Audit Committee) to the Central Government within fifteen days of receipt of such reply or observations;

(iii) In case the auditor fails to get any reply or observations from the Board or the Audit Committee within the stipulated period of forty-five days, he shall forward his report to the Central Government along with a note containing the details of his report that was earlier forwarded to the Board or the Audit Committee for which he failed to receive any reply or observations within the stipulated time.

The report shall be sent to the Secretary, Ministry of Corporate Affairs in a sealed cover by Registered Post with Acknowledgement Due or by Speed post followed by an e-mail in confirmation of the same.

The report shall be on the letter-head of the auditor containing postal address, e-mail address and contact number and be signed by the auditor with his seal and shall indicate his Membership Number.

The report shall be in the form of a statement as specified in Form ADT-4.

The provision of this rule shall also, mutatis mutandis, to a cost auditor and a secretarial auditor during the performance of his duties under section 148 and section 204 respectively.

15. State, in brief, the contents or elements of an Audit Report.

Answer:

As per **SA 700 "Forming an Opinion and Reporting on Financial Statements",** the basic elements of an audit report are as follows:

A. Title

In order to differentiate the audit report from other reports (such as the report of the Board of Directors), it is absolutely essential that the auditor's report has an appropriate title, i.e., "Auditor's Report".

B. Addressee

The Auditor's Report should be appropriately addressed as required by the circumstances of the engagement. Usually, the Auditor's Report is addressed to the appointing authority.

C. Auditor's Opinion:

The first section of the auditor's report shall include the opinion of the auditor and shall be named accordingly. This opinion section shall also -

(i) Identify the entity whose financial statements have been audited;

(ii) State that the financial statements have been audited;

(iii) Identify the title of each statement that comprises the financial statements;

(iv) Refer to the summary of significant accounting policies and other explanatory information; and

(v) Specify the date of, or period covered, by each statement comprising the financial statements.

D. Basis for Opinion:

Following the 'Opinion' section, the auditor's report shall include a separate section explaining the basis for holding such opinion.

E. Report in accordance with Going Concern Assumption:

Where applicable, the auditor shall report in accordance with SA 570 (Revised) on Going Concern.

F. Key Audit Matters:

In case of audit of complete set of general purpose financial statements of a listed entity, the auditor needs to communicate the key audit matters in accordance with SA 701. Key audit matters are defined as those matters that, in the auditor's professional judgement, were of most significance in the audit of the financial statements of the current period. As per the implementation guide, KAMs, in most of the cases, would relate to significant or complex matters disclosed in the financial statements. For instance, valuation of goodwill and other long-term assets, valuation of financial instruments etc.

G. Responsibilities for the Financial Statements

The report of an auditor should also include a section with heading 'Management's Responsibilities for the Financial Statements'.

According to SA 200, management, and where appropriate, those charged with governance should accept responsibility for the preparation of financial statements and also for the internal control currently in force in the organisation. An auditor's report must include reference to both responsibilities as it helps to explain the users the premise behind the audit conducted.

H. Auditor's Responsibilities for the Audit of Financial Statements

An audit report should also include a section with the heading 'Auditor's Responsibilities for the Audit of Financial Statements'. This portion of the audit report shall clearly state the risk involved in auditing and that the possibility of any misstatement being undetected cannot be ruled out

I. Other Reporting Responsibilities:

If the auditor addresses other reporting responsibilities in addition to the auditor's responsibilities under the SAs, a separate section having the subtitle "Report on Other Legal and Regulatory Requirements" has to be included to incorporate those other reporting responsibilities unless the same those are stated in the previous section.

H. Signature of the Auditor

The auditor has to sign the report in his personal name. When a firm is appointed as an auditor, the audit report has to be signed by the auditor in his personal name and in the name of the audit firm as well. The partner or proprietor signing the report has to mention the "Firm Registration Number" and the "Membership Number" assigned by the Institute of Chartered Accountants of India (ICAI).

I. Date of the Auditor's Report

The date on which the auditor signs the report expressing his opinion on the financial statements of an entity is the date of the auditor's report.

J. Place of Signature

The auditor's report shall name the place of the specific location where the report is signed.

16. What is a 'Disclaimer of Opinion'? When should an auditor submit a 'Disclaimer of Opinion'?

Answer:

A Disclaimer of Opinion Report is given when the Auditor is unable to form an overall opinion about thematters 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.

17. State the circumstances that may lead to submission of a report other than an Unqualified Report by an auditor?

Answer:

An Auditor may not be able to express an Unqualified Opinion when any of the following circumstances exist and in the auditor's judgement, the effect of the matter is or may be material to the Financial Statements. [SA 700]

i. **Limitation on Scope:** Limitation on scope of Auditor's work may be imposed by the clients or imposed by circumstances. It may lead to situations where the Auditor may have to issue a Qualified Opinion or a Disclaimer of Opinion.

ii. **Disagreement with management:** The Auditor may disagree with the Management as to - (a) the acceptability of the accounting policies selected, or the method of their application, (b) the adequacy of disclosure in the Financial Statements, or (c) the compliance of the Financial Statements with relevant regulations and statutory requirements. In such cases, he may have to give an Adverse Opinion or a Qualified Opinion.

iii. **Significant Uncertainty:** If there is a significant uncertainty affecting the Financial Statements (other than Going Concern problem), for example, litigation involving legal claims, etc. the result of which is dependent upon the resolution of the future events, the Auditor may have to quality his opinion or disclaim an opinion. However, where such significant uncertainty is not material, the Auditor may issue an Unqualified Opinion, by adding an "Emphasis of Matter" paragraph, without qualifying his opinion.

18. State the provisions of Companies Act relating to Secretarial Audit.

Answer:

Section 204 [read with Rule 9 of the Companies (Appointment and Remuneration of ManagerialPersonnel) Rules, 2014] of the Companies Act 2013 has introduced Secretarial Audit for thefollowing class of companies.

(i) Every listed company;

(ii) Every public company having a paid-up share capital of fifty crore rupees or more; or-

(iii) Every public company having a turnover of two hundred fifty crore rupees or more.

Accordingly the following provisions have been suggested in relation to Secretarial Audit inthese companies.

(1) The above companies shall annex with its Board's report made in terms of sub-section (3) ofsection 134, a secretarial audit report, given by a company secretary in practice, in the formatprescribed in Form MR-3 as per Rule 9 of the Companies (Appointment and Remuneration ofManagerial Personnel) Rules, 2014.

(2) It shall be the duty of the company to give all assistance and facilities to the companysecretary in practice, for auditing the secretarial and related records of the company.

(3) The Board of Directors, in their report made in terms of sub-section (3) of section 134,shall explain in full any qualification or observation or other remarks made by the companysecretary in practice in his report under sub-section (1).

(4) If a company or any officer of the company or the company secretary in practice, contravenes the provisions of this section, the company, every officer of the company or the companysecretary in practice, who is in default, shall be punishable with fine which shall not be lessthan one lakh rupees but which may extend to five lakh rupees.

19. State the provisions of Companies Act 2013 with respect to the audit of accounts related to a branch office.

Answer:

Section 143(8)of the Companies Act 2013, read with Rule 12 of CAAR 2014, specifies the provisions relating to the accounts of a branch office of a company as follows –

(a) Where a company has a branch office, the accounts of that office shall be audited either by the auditor appointed for the company (herein referred to as the company's auditor) under this Act or by any other person qualified for appointment as an auditor of the company under this Act and appointed as such under section 139.

(b) Where the branch office is situated in a country outside India, the accounts of the branch office shall be audited either by the company's auditor or by an accountant or by any other person duly qualified to act as an auditor of the accounts of the branch office in accordance with the laws of that country.

(c) The duties and powers of the company's auditor with reference to the audit of the branch and the branch auditor, if any, shall be as contained in sub-sections (1) to (4) of section 143. [Refer to 6.2.13]

(d) Similarly, if the branch auditor is appointed separately, the duties and powers of the branch auditor shall be as the same as applicable to company auditor under sub-sections (1) to (4) of section 143.

(e) The branch auditor shall prepare a report on the accounts of the branch examined by him and send it to the auditor of the company who shall deal with it in his report in such manner as he considers necessary.

(f) Provisions of sub-section (12) of section 143 regarding reporting of fraud by the auditor shall also extend to branch auditor to the extent it relates to the concerned branch.

20. Discuss the responsibility of a joint auditor. How far can a joint auditor rely upon the work done by other joint auditors?

Answer:

Responsibility of a joint auditor:

For the audit work divided among themselves, each joint auditor is responsible only for the work allocated to him. Accordingly, among other duties,

(a) Each joint auditor is required to scrutinize the audit report of the branch/divisions specifically allocated to him.

(b) Each joint auditor is required to obtain and evaluate information and explanations from the management of the divisions, zones or units specifically allocated to him.

However, they shall be jointly and severally responsible for the following:

(a) In respect of undivided work.

(b) In respect of decision taken jointly regarding the nature, timing or extent of audit procedures to be performed by any of the joint auditor. (However, they will be responsible only with respect to the appropriateness of the decision, proper execution of the audit procedures is the separate and specific responsibility of the joint auditor concerned.)

(c) In respect of matters which are brought to the notice of the joint auditors by any one of them and on which there is an agreement among them.

(d) In respect of compliance with disclosure requirement (i.e. Notes on accounts) of the relevant statute while examining the financial statements.

(e) For ensuring that the audit report complies with the requirements of the relevant statute.

Reliance on the Work of Other Joint Auditor:

It is not necessary for a joint auditor to review the work performed by other joint auditors or perform any tests in order to ascertain whether the work has actually been performed in accordance with the generally accepted audit procedures. However, each joint auditor is entitled to rely on the other joint auditors for bringing to his notice any departure from the generally accepted accounting principles or any material error noticed in the course of the audit.

21. What are the sources of dividend?

Answer:

According to Section 123(1), a company can declare or pay dividend for any financial year only -

(a) out of current year's profits after providing for depreciation; and/or

(b) out of the undistributed profits for any previous financial year or years after providing for depreciation; or

(c) out of money provided by the Central Government or a State Government for the payment of dividend by the company in pursuance of a guarantee given by that Government.

22. State the duties of an auditor regarding Unpaid Dividend.

Answer:

In connection with the payment of interim dividend, the auditor must consider the following points.

(a) The auditor should collect a statement or list containing every detail regarding the unpaid dividend such as the names of the shareholders, dividend payable to them, dividend warrant number, reason for the dividend remaining unpaid etc.

(b) The auditor shall conduct an enquiry to identify whether there was any fault on the part of the company and if so what action has been taken against the company.

(c) The auditor shall verify the statement provided by the management in this respect with other supporting documents like Dividend Register, Returned Warrants, bank statement etc and shall determine whether the dividend amount has been accurately calculated.

(d) The auditor shall also verify whether the unpaid dividend has been transferred to a separate account namely Unpaid Dividend Account within seven days from the expiry of 30 days allowed for declaration and payment of dividend.

(e) In case there is any default on the part of the company to deposit the unpaid dividend within the stipulated time as mentioned above, the company needs to pay interest @ 18% p.a. The auditor must verify whether there is any fault on the part of the company and if so whether they have deposited the interest and the penalty.

(f) The auditor shall also verify whether the company has published the details of unpaid dividend in its own website and also in other website(s) approved by the government for this purpose.

(g) In case the company has made any payment during the year from the Unpaid Dividend Account to any shareholder on his application for the same, the auditor must verify that the payment has been made to the right person and the amount so paid is determined properly.

(h) In case any amount of dividend is remaining unpaid for more than seven years, the auditor shall verify whether the same along with the interest accrued thereon has been transferred by the company to IEPF. He shall verify the same based on the statement submitted by the company to the IEPF and the receipt issued by the IEPF in this context.

(i) The auditor shall also verify whether all the shares in respect of which unpaid dividend has been transferred to IEPF, have also been transferred to such fund.

23. State the duties of an auditor regarding audit of issue of bonus shares.

Answer:

As per Section 63 of the Companies Act 2013, an auditor should -

(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 were issued in lieu of dividend.

24. Discuss the duties of an auditor in relation to the audit of debentures.

Answer:

The duties of an auditor in relation to the audit of debentures are discussed below:

(i) The auditor should verify that the prospectus had been duly filed with the registrar before the date of allotment of debentures.

(ii) He should check the amount collected in the cash book with the counterfoils of receipts issued to the applicants and also cross check the amount into the application and allotment book.

(iii) He should examine the debenture trust deed and note the conditions contained therein as to issue and repayment.

(iv) If the debentures are covered by a mortgage of a charge, it should be verified that the charge has been correctly recorded in the register of mortgage and charges and it has also been registered with the registrar of the companies.

(v) Compliance with SEBI guidelines should also be ensured.

(vi) Where debentures have been issued as fully paid up to vendors as a part of the purchase consideration, the contract in this regard should be checked.

25. What is the procedure of appointing a cost auditor in a company?

Answer:

The cost auditor is to be appointed by the Board of Directors (BOD) on the recommendation of the Audit Committee, where the company is required to have an Audit Committee. The cost auditor proposed to be appointed is required to give a letter of consent to the Board of Directors.

The company shall inform the cost auditor concerned of his or its appointment as such and file a notice of such appointment with the Central Government within a period of thirty days of the

Board meeting in which such appointment is made or within a period of one hundred and eighty days of the commencement of the financial year, whichever is earlier, through electronic mode, in form CRA-2 along with the fee as specified in Companies (Registration Offices and Fees) Rules,2014.

Any casual vacancy in the office of a cost auditor, whether due to resignation, death or removal, shall be filled by the Board of Directors (BOD) within thirty days of occurrence of such vacancy and the company shall inform the Central Government in Form CRA-2 within thirty days of such appointment of cost auditor.

26. Discuss the provisions relating to submission of cost audit report.

Answer:

Submission of Cost Audit Report by the Cost Auditor: 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.

27. Write a short note on the Audit of Municipalities and Panchayats.

The major objective of audit of Municipalities and Panchayats are enumerated below;

(i) To ensure on the fairness and correctness of contents in the Financial Statement

(ii) To report on adequacy of internal control

(iii) To ensure value of money is fully received on amount spent.

(iv) To detect the frauds and errors.

The following points are to be considered necessary for carrying on audit of Municipalities and Panchayats (Local Bodies);

(i) To ensure that the expediters incurred conform to the relevant provision of the law and is in accordance with the financial Rules and regulation formed by the compliant authority.

(ii) To encase that sanction is accorded by the competent authority either special or general.

(iii) To encase that there is provision of funds for expenditure and is authorized by competent Authority.

(iv) To ensure that where huge financial expenditure is made is run economically and is expected to contribute growth.

28. How will you conduct the audit of a hospital?

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 therefrom 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.

29. What are the rights of a company auditor as per Companies Act 2013.

Answer:

As per the Companies Act 2013, an auditor has the following rights:

(i) Right to Inspect Books of Accounts and Vouchers Every auditor of a company shall have the right of access at all times to the books of account and vouchers of the company kept at the registered office of the company or at any other place. In addition, auditor a holding company shall also have the right of access to the records of all its subsidiaries in relation to consolidation of its financial statements with that of its subsidiaries [Section 143(1)].

(ii) Right to Obtain Information and Explanations The auditor is also entitled to ask for such information and explanation as he may consider necessary for the performance of his duties as the auditor from the officers of the company [Section 143(1)].

(iii) Right to Inspect Branch Offices and Branch Accounts He is also entitled to inspect the accounts of any branch office [Section 143(8)].

(iv) Right to Receive the Report of Branch Audit from the Branch Auditor In case a separate auditor has been appointed to audit the branch accounts, the company auditor has the right to receive the branch audit report from the branch auditor. [Section 143(8)].

(v) Right to Receive Notices and Attend General Meetings The company auditor is also entitled to receive all notices of, and other communications relating to, any general meeting and to attend such meetings and being heard [Section 146].

(vi) Right to Sign the Audit Report and Other Documents The company auditor also has the right to sign the auditor's report or sign or certify any other document of the company in accordance with the provisions of Section 141(2) [Section 145].

(vii) Right to Have Audit Report Read at the AGM The company auditor has the right to have the report read before the company in the General Meeting and the same shall be open to inspection by any member of the company [Section 145].

(viii) Right to Attend the Meeting of the Audit Committee He also has a right to attend the meetings of the Audit Committee and to be heard in the meetings when the Committee considers the auditor's report. However he does not have the right to vote [Section 177(7)].

(ix) Right to be Indemnified The auditor of a company shall also have the right to be indemnified for any expenses incurred by him in defending himself in case the judgement in any law suit (whether civil or criminal) against the company goes in favour of the auditor.

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