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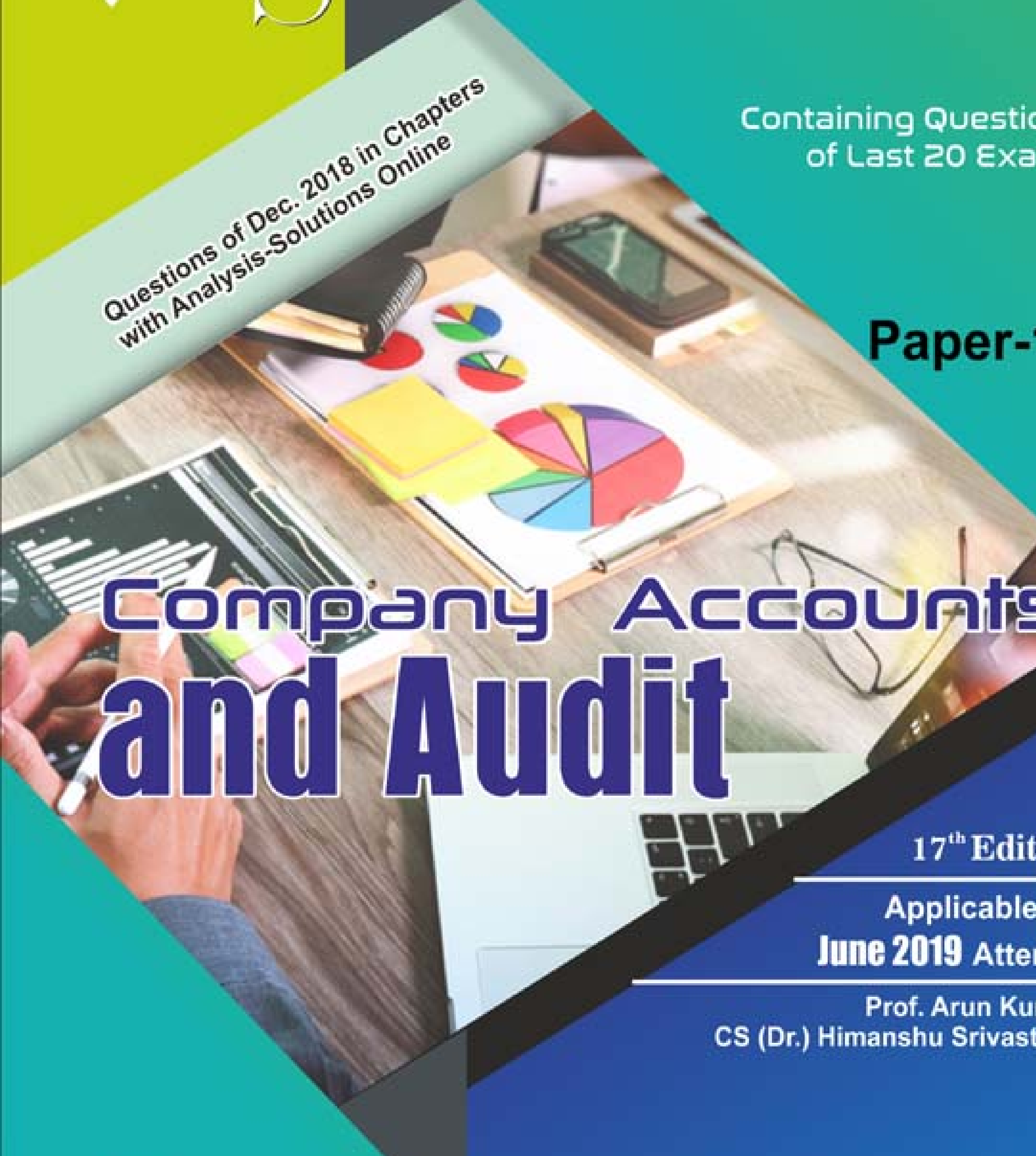
CMA Inter Group-II
(2016 Syllabus)

Questions of Dec. 2018 in Chapters with Analysis-Solutions Online

Containing Questions of Last 20 Exams

Paper-12



Company Accounts and Audit

17th Edition

Applicable for
June 2019 Attempt

Prof. Arun Kumar
CS (Dr.) Himanshu Srivastava

Shuchita Prakashan (P) Ltd.

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Arun Kumar

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In this edition

Questions	Solutions
June - 2009 to December - 2018 Duly incorporated in chapters.	June - 2009 to June - 2018 Duly incorporated in chapters.
	December - 2018 on companion.sauda.com

SCANNER®

CMA Inter Gr. II

(2016 Syllabus)
Paper 12 - Company Accounts and Audit

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"Scanner is a living document and is being updated after every examination since its inception"

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Preface to Scanner

It gives us great pleasure to present the Seventeenth edition of Scanner of Company Accounts and Audit for CMA Inter students.

This book covers all theoretical and practical aspects. It is our endeavour to make the book as much exhaustive as possible to make it useful to all students.

We would also like to mention that the answers given in this book are the suggested answers. So the students are advised to update themselves with the knowledge of various legal enactments and accounting norms.

Our special thanks to our friends Mr. Kundan Pandey & Jayendra Dubey. We are also thankful to all the members of Shuchita Prakashan for helping us to complete this book. We welcome suggestions for improvement in our book.

Best of Luck

Prof. Arun Kumar
CS (Dr.) Himanshu Srivastava

Contents to Scanner

Paper - 12 **Company Accounts and Audit**

Dedicated To

Dedicated to My Parents

Shri J.P. Srivastava

Smt. Chanda Srivastava

wife

Smt. Aneesha Srivastava

and

Daughters

Saanvi and Kuhoo

Our Story

Scanner contains questions of previous examinations which are arranged topic and category wise with lots of analysis to understand the trend of question papers. In 1989, Prof. Arun Kumar invented "Scanner" to reduce confusion and uncertainty in the preparation of CA Examination. Today, Scanner is the most sought after book by the professional students doing CA, CS & CMA.

UNIQUE FEATURES OF THIS EDITION

- → An **Examination Trend Analysis** for question paper based contents of last five examinations before the paper.
- → Questions are arranged according to the **subject/topic** in ascending order of examinations/years.
- → **Graph** for every chapter, showing marks allotment for last twenty examinations amongst Short Notes, Distinguish Between, Descriptive Questions and Practical Questions.
- → Line Chart Showing Relative Importance of Chapters.
- → Table Showing Marks of **Compulsory Questions** at the end of every chapter.
- → Analytical Classification of every Chapter in **Four** Categories:
  (1) Short Notes,
  (2) Distinguish Between,
  (3) Descriptive Questions and
  (4) Practical Questions.
- → **100%** Correct Answers of Practical Questions.
- → Complete list of **Repeatedly Asked Questions** at the end of every chapter.
- → Complete Question Paper of June 2018 and December 2018.
- → Pleasant **get-up**.

Praise for Scanner

It's really a wonderful book where we have everything under one place.

Rohit Kumar Gururani, New Delhi

Mirror that reflects our preparation.

Ms. Priya Sharma, Jamshedpur

Scanner is a good approach for CWA students. It had played an important role in my preparation. This book gives an idea about examination. It was really of great help to me in my preparation.

Ganesh Mallinath Kadage, Solapur

Scanner is very helpful because in it are given chapter-wise questions. Objective type questions are given at one place and it is very easy to prepare at the time of examination.

Mutyala Bala Krishana, Bargarh (Orissa)

"Scanner" is synonym of "Success". By using this book, a student comes to know the important chapters and topics having high ranks. This helps him to score high in very short period of time.

Chatar Singh Kalra, Punjab

Opportunity!!!
Improve your Scanner and Win Reward!

Scanner is a dynamic book to serve your needs with the shifting times. It is the product of immense effort of our team and we feel great pride to make timely editions of such volatile product for our students. Still some human errors may creep-in and some incompleteness may lie.
We seek your participation in improving your Scanner in two ways:

- **Making Your Scanners Error Free:** Find out any kind of mistake/error whatsoever it may be, including spellings etc. in this edition.
- **Making Your Own Working Notes in Scanners:** An expanded, clear, and described working note incorporating the smallest steps and fine nuances of the problem helps students score high.

How to Participate:

1. Mention about the mistake/error found by you. Please mention what according to you would be the correct thing.
2. In case of working notes, suggest the improvement in existing notes, and if required, write the new note where notes are not available. You may mark in the Scanner or write it fresh.
3. Clearly give exact location of mistake/improvement by mentioning: Book Name, Edition (January 2019), Page Number and Question Number.
4. Send the correction/improvement/suggestion to:

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5. You will be awarded ₹ **50 for each correction/improvement/ suggestion** approved by Editorial Board.
6. You will also receive **one Free Copy of Solved Scanner** as per your choice.
7. Send your information giving your name, address, mobile number, and complete postal address including the pin code and e-mail address.
8. The last date of sending the query is 31st May 2019 for January 2019 edition.
9. The decision of the Editorial Board will be final and binding.

Note: *If you are sending one or more mistake/error/suggestions/new working notes from one particular book, you are entitled for one free copy of Scanner of your choice only.*

Hey,
It's crucial for you to manage your time efficiently because time once gone is gone forever. We all have a 24 hour a day. What makes a difference is how well we use it. Let's learn how to manage our time effectively and efficiently with Time Management Technique (TMT).

Plan Your Work, Work Your Plan.

When to Study?

- As per the comprehensive study schedule or time table.
- Before use, first develop it.

How to prepare a time table?

1. Divide total months available into months for completing the course and revising the course.
2. Then, divide the entire syllabus in the months available for completing the course.
3. This way you get the number of days for finishing a chapter.
4. After that prepare a monthly time table followed by daily time table. Applicable to all the subjects.
5. A time table:
   - 5.1. Gives us concrete idea of what to study when
   - 5.2. Saves our time
   - 5.3. Helps in prevention of leaving the things on mood or chance
   - 5.4. Makes us efficient and competent to do the scheduled assignment within the stipulated time
   - 5.5. Removes the tendency of postponement, on our part.
6. Time table must be realistic taking into consideration our interest, availability of time, ability and moral pressures.

What to Study?

1. Be thorough with the content of your syllabus and fix priority of chapters/topics to be studied.
2. Fix the priority by analysing past years examination papers.

3. Weightage of a topic is determined on the basis of:
   3.1. Being repetitively asked
   3.2. Weightage of marks of the questions asked
4. Make the rank table.

Rank Table

Chapter in	Chapters	Total marks asked last 20 exams.	Repeatedly Asked Questions	Rank

From where to Study?

1. Although the syllabus seems vast, the scope of the syllabus is restricted to the various laws, common authenticated and well established rules and regulation and their application.
2. Be it accounts, economics, audit, law cost accounts, direct tax or indirect tax etc. Law/rule/regulation cannot be changed by any author. The difference which is apparent is the presentation, explanation and examples used. So we should be very careful while selecting our source and should stick to it.

How to Study?

The Theory Subject

1. Make maps of topics/chapters in your mind and also on paper to interconnect your entire syllabus to understand the big picture
2. Use Pneumonic Code assets to help you remember things for long.
3. Make your own notes.
4. Make and use cards that bears topic on one face and its points to remember on the other face. It helps you do a quick revision.

The Practical Subject:

1. First grasp the concept of the topics along with the method and formula used.
2. Make a summary notes on it, regarding related laws, rules, formulae or techniques used. During revision this will be a handy tool instead of

struggling with the book.

3. In each chapter there are about 30-40 problems. We should we solve all the questions. Different questions are based on different specific problem areas which needs a particular techniques to solve. Underline these specific problem areas with notes so that during subsequent revision we pay attention to those areas.
4. Categorise questions that belongs to same problem area. This way the 30 - 40 questions will be reduced to groups of 8-10 or 10-12 (as the case may be).
5. This makes us solve the questions speedily as and skip similar problem already solved.

Retain and Remember

6. Do not waste time on common problems but concentrate on specific problem areas in every question.
7. Develop the habit of revising the whole syllabus at specific intervals.
8. Revision is necessary.

   First Revision : within 24 hours

   Second Revision : Exactly after 7 days of first learning

   Third Revision : Exactly after 15 days of first learning
9. Revision efforts gradually decreases with subsequent revisions.

Time Graph

How to Study Daily?

1. Do not study only one subject throughout the day. The general approach is to start and finish one subject and then start other subject. This way you forget the subjects very quickly and easily.
2. Study 3-4 subjects everyday.

3. Follow Mix-n-Match technique.

Mix-n-Match technique:

1. Some chapters are big and some small in every subject.
2. Mark the chapter as “B” if they are big and “S” if they are small. Do this for every subject.
3. Now mix and match the chapters of one subject with the other that makes it easier to study and also at the same time feel less burdened.
4. In addition, match one practical subject with two theory subjects.

How Much to Write?

1. The time allotted to answer each paper in the examination hall is 3 hours out of this 3 hours the effective time is 2 hours 45 minutes i.e. 165 minutes.
2. The maximum marks is 100:
3. Research suggests that a student can write 4000-5000 words in English and 3000-4000 words in Hindi at a stretch in 2½ to 3 hours.

So, we can solve our problem by using a bit of mathematics.

English:

For 100 marks-maximum of 4500 words (approx).

$\therefore$ For 1 marks – $\frac{4500}{100} = 45 \text{ words}$

Also

For 100 marks – 165 minutes

for 1 marks – $\frac{165}{100} = 1.65 \text{ minutes}$

Thus, our writing speed should be near about
45 words in 1.65 minutes.
or 27 words per minute (approx)

$$\therefore \quad \left[\frac{45 \text{ Words}}{1.65 \text{ Minutes}} = 27 \text{ words (approx)}\right]$$

Thus, for a theory question of 8 marks
Words : 45 words × 8 = 360 words

$$\text{Time} : \frac{360 \text{ Words}}{27 \text{ Words}} = 13.33 \text{ minutes.}$$

Hindi

For 100 marks - 3500 words (approx)

$$\text{for 1 marks - } \frac{3500}{100} = 35 \text{ words.}$$

Also for 100
marks – 165 minutes

$$\text{for 1 marks} - \frac{165}{100} = 1.65 \text{ minutes.}$$

Thus, the writing speed should be 21.2 words per minute.

Thus, for a theory question of 8 marks.

Words : 35 words × 8 = 280 words

$$\text{Time} = \frac{280 \text{ Words}}{21 \text{ Words}} = 13.33 \text{ minutes. If Possible}$$

Presentation of the Answer

- Present your answer in a clear and attractive way. Use tables flow diagrams etc.
- Always give precise and relevant answer to the question.
- No need to write introduction/conclusion for direct theory question.
- Length of the answer should commemorate with the weightage of the marks (already discussed) and manage the time in such a way which ensure that you spend at least 5-7 minutes at the end for reviewing purpose.
- Don't use red ink or any sketch pen for underlining the heading or important points. Use black pen/pencils for underlining.
- Don't strike off any answer even if it is 100% wrong especially when you have no other opportunity due to time constraint. It may happen that you may get step marks for parts of the wrong answer.

How to use the Various Schedules?

The schedules mentioned are scientific and systematic and are designed in such a way that if a student follows, he will complete the course within the stipulated time, revise it and retain it, not only till the date of examination but also thereafter.

The various schedules to be followed are:

1. Rank table
2. Time manager
3. Budgeted time schedule

In what order should the schedules be used?

1. Firstly analyse the GRAPH and QUICK LOOK and assign weightage accordingly.

2. Then on the basis of weightage of the chapter ranks make RANK TABLE. Next use the TIME MANAGER.

Benefits of schedules

Rank Table:

The chapters of the entire subject is ranked on the basis of various factors such as:

1. Total marks asked in last 20 exams.
2. Repeatedly asked question.
3. Frequency of question in last 20 exams

Use rank table. Ranking helps a student to give priority to the important chapters.

Time Manager:

It acts as a booster and inspires a student to complete the first learning or subsequent revision within the stipulated time.

Time Manager		Plan and Manage your Time						
Time	First In-depth learning	Instant Revision (In hours)		Periodic Revision (In hours)				
	i.e. .... Day 1	Next day i.e. .... Day 2	After 7 days i.e. on.................... Day 8	After 30 days i.e. on.................... Day 30	After 60 days i.e. on.................... Day 60	After 90 days i.e. on.................... Day 90	Fix as per your need	
1. Budgeted								
2. Actual								
3. Variance (1-2)								

Note:

1. Budgeted hours has been fixed on the basis of survey amongst the students, however you may fix it according to your capacity and ability.
2. Write the actual time taken by you.
3. Variance may be favourable or unfavourable
   - if favourable it is a positive sign.
   - if unfavourable then you try to recoup it in subsequent learning.

Over come Procrastination

Procrastinating is putting things off or delaying. Procrastination is the thief of time. It waste time. All the schedules and planners will fail if we procrastinate. Once we have defined are goals and set deadlines for achieving it we should stick to it. We should never wait for the right mood but start right away. No matter what causes the do it later urge- we should overcome the urge with a do-it-now action.

The best day to start is today and the best time is now. Plan well and execute well. When feel disappointed, come back with a bang.
Always there.

Syllabus

Paper 12

Company Accounts & Audit

A	Accounts of Joint Stock Companies	50%
B	Auditing	50%

Objective:

To gain in depth knowledge of the professional standards, principles and procedures regarding preparation of financial accounting statements. To provide basic knowledge of auditing.

Section A: Accounts of Joint stock companies (50 marks)

1. **Accounting of Shares and Debentures**
   (a) Issue of shares, rights issue, bonus issue, sweat equity shares, forfeiture of share, buy-back of shares
   (b) Issue and redemption of preference shares, debentures
   (c) Under writing of shares and debentures

2. **Presentation of Financial Statements (as per Schedule III)**
   (a) Statement of Profit and Loss
   (b) Balance Sheet

3. **Cash Flow Statement (AS 3)**

4. **Accounts of Banking, Electricity and Insurance Companies**
   (a) Accounts of Banking Company
   (b) Accounts of an Electricity Company
   (c) Accounts of Insurance Company

5. **Accounting Standards (AS - 11, 12, 15, 16, 17, 18 and 19)**

Section B – Auditing (50 marks)

6. Auditing Concepts

(a) Nature, Scope and Significance of Auditing

(b) Audit Engagement, Audit Program, Audit Working Papers, Audit Note Book, Audit Evidence and Audit Report

(c) Internal Check, Internal Control, Internal Audit - Industry Specific.

7. Provision relating to Audit under Companies Act

(a) Auditor's qualifications, disqualifications, appointment, remuneration, removal, powers and duties

(b) Cost Audit, Secretarial Audit

(c) Reporting Requirements under Companies Act, Report vs. Certificate, contents of the reports and qualifications in the report

(d) Miscellaneous Audit

- (i) Branch Audit, Joint Audit
- (ii) Audit of shares and debentures
- (iii) Audit of divisible profits and dividends
- (iv) Statutory Auditors vs. Internal Auditors
- (v) Auditing and Assurance Standards relating to audit of inventories and audit of fixed assets
- (vi) Auditing of different types of undertaking – Education, Hospitals, Cooperative Societies, Banks, Trusts, Municipalities, Panchayats

Section A

Accounts of
Joint Stock Companies

Examination Trend Analysis

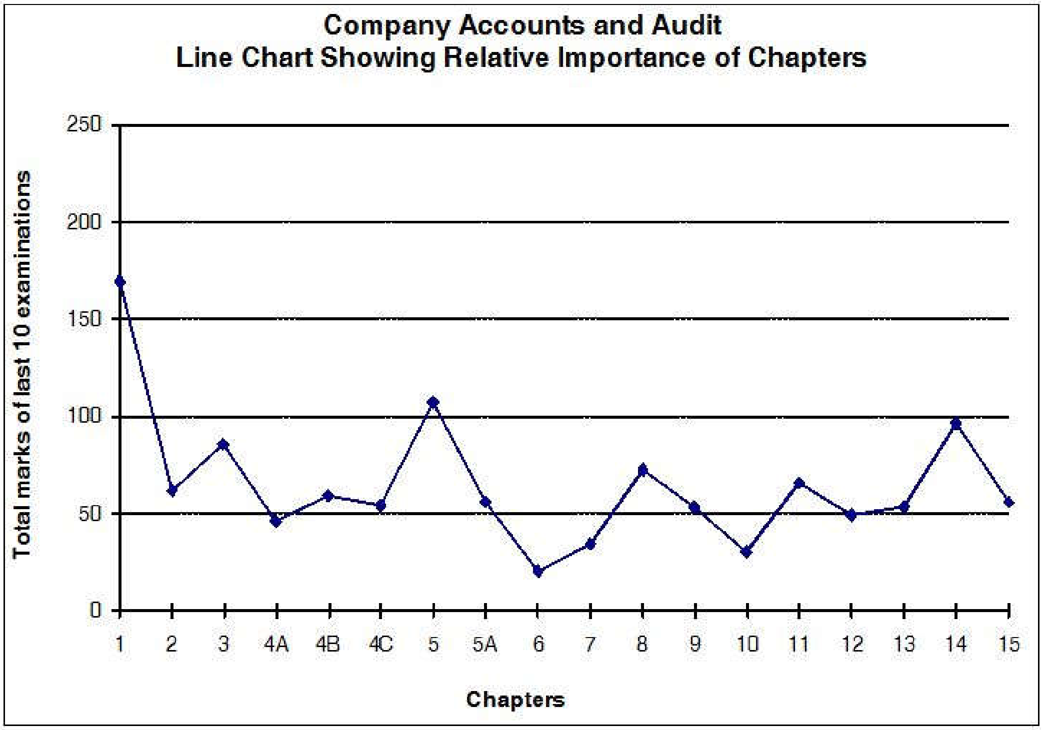
Paper 12
Company Accounts & Audit

Question Paper Based Contents of Last Five Examinations

Years	Q. No.		Chapter No.	Chapter Name	Page No.
2016	1.	(a)	5	Accounting Standards	273
Dec.		(c)	5	" "	273
		(d)	2	Presentation of Financial Statements	122
		(e)	5	Accounting Standards	273
	3.	(a)	7	Types of Audit	332
		(b)	7	" "	332
		(c)	8	Audit Engagement, Programme, Working Papers	351
		(e)	8	" " "	351
	5.	(a)	3	Cash Flow Statement	162
		(b)	1	Accounting of Shares and Debentures	35
	6.	(b)	14	Miscellaneous Audit	472
	7.	(a)	1	Accounting of Shares and Debentures	91
	8.	(a)	14	Miscellaneous Audit	473
	9.	(a)	6	Auditing Concepts	314
		(b)	12	Cost Audit and Secretarial Audit	420
	10.	(a)	9	Internal Check, Internal Control and Internal Audit	373
		(b)	13	Audit Report	433
2017	1.		5A	Objective Questions	295
June	2.	(a)	1	Accounting of Shares and Debentures	93
		(b)	5	Accounting Standards	274
	3.	(a)	3	Cash Flow Statement	164
		(b)	4B	Accounts of Electricity Company	213
	4.		2	Presentation of Financial Statements	122

	5.	(a)	5	Accounting Standards	245
		(b)	1	Accounting of Shares and Debentures	25
		(c)	4B	Accounts of Electricity Company	202
		(d)	3	Cash Flow Statement	141
	6.		15	Objective Questions	478
	7.	(a)	8	Audit Engagement, Programme, Working Papers	352
		(b)	9	Internal Check, Internal Control and Internal Audit	373
	8.	(a)	11	Company Auditor	403
		(b)	11	" "	403
	9.	(a)	13	Audit Report	435
		(b)	12	Cost Audit and Secretarial Audit	422
	10.	(a)	14	Miscellaneous Audit	454
		(b)	14	" "	463
		(c)	10	Vouching and Verification	381
		(d)	14	Miscellaneous Audit	454
2017	1.		5A	Objective Questions	298
Dec.	2.	(a)	1	Accounting of Shares and Debentures	94
		(b)	5	Accounting Standards	274
	3.	(a)	3	Cash Flow Statement	168
		(b)	4A	Accounts of Banking Company	194
	4.		2	Presentation of Financial Statements	126
	5.	(a)	5	Accounting Standards	245
		(b)	1	Accounting of Shares and Debentures	26
		(c)	4A	Accounts of Electricity Company	178
		(d)	1	Accounting of Shares and Debentures	26
	6.		15	Objective Questions	480
	7.	(a)	8	Audit Engagement, Programme, Working Papers	353
		(b)	9	Internal Check, Internal Control and Internal Audit	374
	8.	(a)	11	Company Auditor	405
		(b)	11	" "	405
	9.	(a)	12	Cost Audit and Secretarial Audit	422
		(b)	13	Audit Report	445

6.		15	Objective Questions	485
7.	(a)	8	Audit Engagement, Programme, Working Papers	355
	(b)	9	Internal Check, Internal Control and Internal Audit	361
8.	(a)	11	Company Auditor	409
	(b)	11	" "	409
9.	(a)	12	Cost Audit and Secretarial Audit	424
	(b)	13	Audit Report	446
10.	(a)	14	Miscellaneous Audit	462
	(b)	10	Vouching and Verification	382
	(c)	14	Miscellaneous Audit	462
	(d)	14	" "	463


Company Accounts and Audit
Line Chart Showing Relative Importance of Chapters
Total marks of last 10 examinations
250
200
150
100
50
0
1
2
3
4A
4B
4C
5
5A
6
7
8
9
10
11
12
13
14
15
Chapters

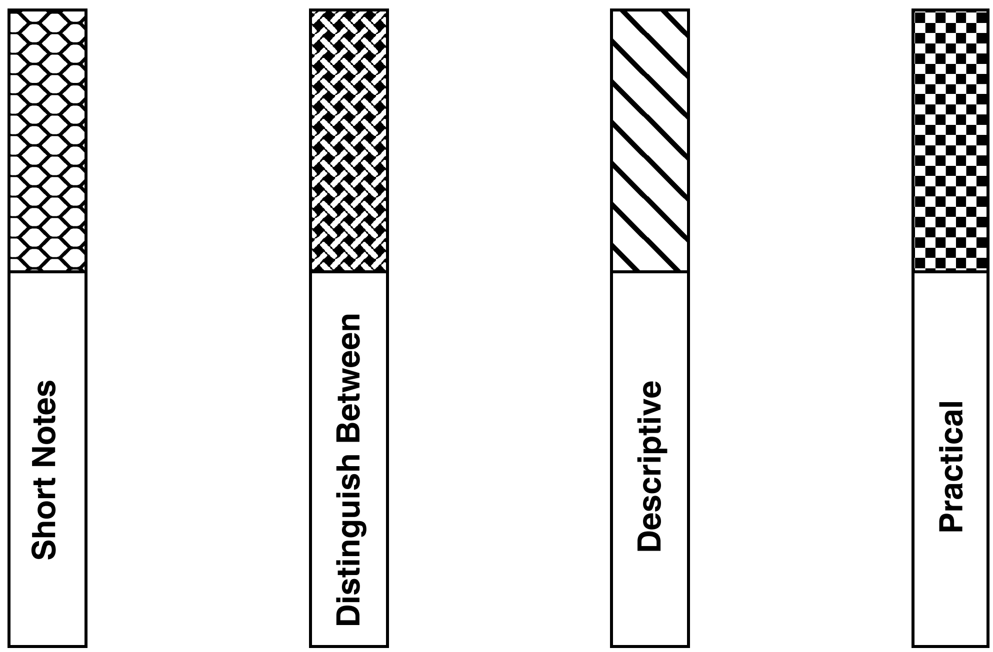
Frequency Table Showing Distribution of Marks

Chap. No.	Years Chapter Name	14 June	14 Dec.	15 June	15 Dec.	16 June	16 Dec.	17 June	17 Dec.	18 June	18 Dec.	Total	Ave.
1.	Accounting of Shares and...	24	28	12	20	15	16	12	17	14	11	169	16.9
2.	Presentation of Financial Statements	4			4		2	12	12	12	16	62	6.2
3.	Cash Flow Statement	10	10	10		9	9	13	8	8	9	86	8.6
4A.	Accounts of Banking Company	4	10		10	10			8	4		46	4.6
4B.	Accounts of Electricity Company	8	8	8	8	17		7			3	59	5.9
4C.	Accounts of Insurance Company	8	10	10	10	8				4	4	54	5.4
5.	Accounting Standards	18	4	18	16	11	6	8	7	10	9	107	10.7
5A.	Objective Questions							14	14	14	14	56	5.6
6.	Auditing Concepts	8	4				8					20	2.0
7.	Types of Audit	6		12	8	4	4					34	3.4
8.	Audit Engagement, Programme,...	12	8	8	2	10	4	8	8	6	6	72	7.2
9.	Internal Check, Internal Control...	6		10	7	2	8	4	4	6	6	53	5.3
10.	Vouching and Verification	4		6	5	7		4			4	30	3.0
11.	Company Auditor	2		4	4	8		12	12	12	12	66	6.6
12.	Cost audit and Secretarial Audit	4			8	7	7	8	4	5	6	49	4.9
13.	Audit Report		2	4	8	7	7	4	8	7	6	53	5.3
14.	Miscellaneous Audit	10	12	8	6		12	12	12	12	12	96	9.6
15.	Objective Questions							14	14	14	14	56	5.6

Frequency Table Showing Marks of Compulsory Questions

Chap. No.	Years / Chapter Name	14 June	14 Dec.	15 June	15 Dec.	16 June	16 Dec.	17 June	17 Dec.	18 June	18 Dec.	Total	Ave.
1.	Accounting of Shares and...	4										4	0.4
2.	Presentation of Financial Statements	4										4	0.4
3.	Cash Flow Statement												
4A.	Accounts of Banking Company	2										2	0.2
4B.	Accounts of Electricity Company					2						2	0.2
4C.	Accounts of Insurance Company					2						2	0.2
5.	Accounting Standards	2										2	0.2
5A.	Objective Questions												
6.	Auditing Concepts												
7.	Types of Audit	2										2	0.2
8.	Audit Engagement, Programme,...												
9.	Internal Check, Internal Control...	2										2	0.2
10.	Vouching and Verification												
11.	Company Auditor	2										2	0.2
12.	Cost audit and Secretarial Audit												
13.	Audit Report												
14.	Miscellaneous Audit	2										2	0.2
15.	Objective Questions												

Legends for the Graphs



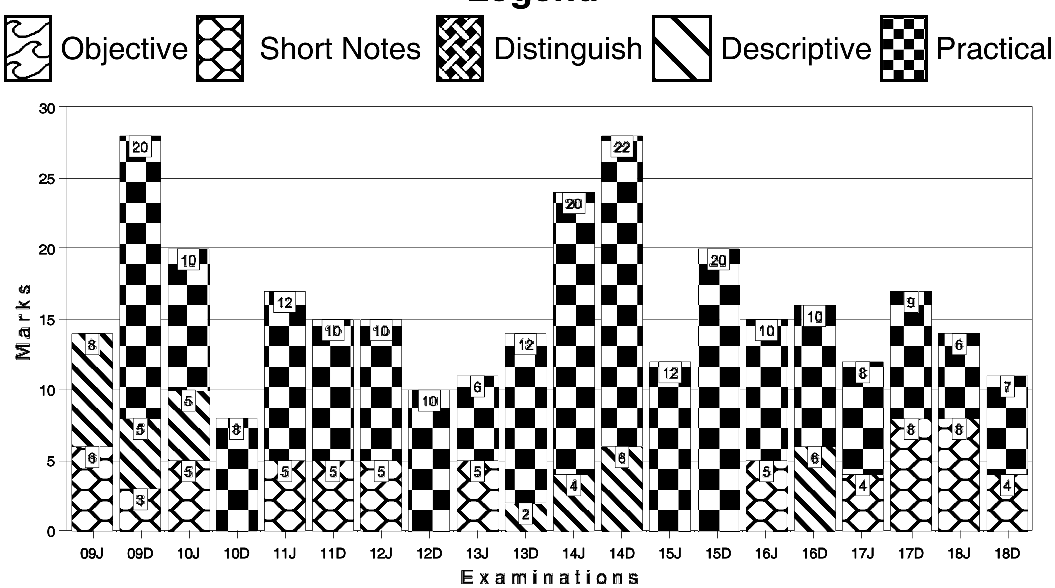
1 ACCOUNTING OF SHARES AND DEBENTURES

THIS CHAPTER INCLUDES

- Issue of Shares
- Rights Issue
- Bonus Issue
- Sweat Equity Shares
- Forfeiture of Shares
- Buy-back of Shares
- Issue and Redemption of Preference Shares and Debentures
- Underwriting of Shares and Debentures.

Marks of Objective, Short Notes, Distinguish Between, Descriptive & Practical Questions

Legend



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CHAPTER AT A GLANCE

S. No.	Topic	Important Highlights
1.	**Share capital**	Share capital of a company can be classified as: (a) nominal, authorized or registered capital; (b) issued and subscribed capital; (c) called up and uncalled capital.
2.	**Share**	A share is defined as a share in the share capital of a company, including stock except where a distinction between stock and shares is expressed or implied.
3.	**Two classes of shares**	The **Companies Act, 2013** permits a company limited by shares to issue two classes of shares, namely equity share capital and preference share capital.
4.	**Preference share**	A preference share or preference share capital is that part of share capital which carries a preferential right with respect to both dividend and capital.
5.	**Types of preference shares**	Preference shares may be of various types, namely participating and non-participating, cumulative and non-cumulative shares, redeemable and irredeemable preference shares.
6.	**Equity share capital**	Equity share capital means all share capital which is not preference share capital.
7.	**Sweat equity shares**	Means equity shares issued by a company to its employees or directors at a discount or for consideration, other than cash for providing know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called. • Issue of sweat equity shares to be authorized by special resolution at a general meeting.

		• The special resolution authorizing sweat equity shares is not valid if the allotment is made after 12 months of passing the resolution. i.e., the validity of special resolution is 12 months. • The price of sweat equity shares is to be determined by a registered valuer. • The company shall maintain a Register of Sweat Equity Shares in Form No. SH 3. • Issue of sweat equity shares to employees and directors at a discount **under section 54** is outside the scope of **Section 53.**
8.	**Rights issue**	Rights issue is an issue of capital to be offered to the existing shareholders of the company through a letter of offer. • Listed companies to inform concerned stock exchanges. • Company to give notice to equity shareholder giving him 15-30 days to decide. • Company can issue shares to other than existing share holder for cash or other than cash if a special resolution is obtained. • Price to be determined by the registered valuer's report. • The provisions of **Section 62** are applicable to all type of companies.
9.	**Bonus share**	When a company is prosperous and accumulates large distributable profits, it converts these accumulated profits into capital and divides the capital among the existing members in proportion to their entitlements. Members do not have to pay any amount for such shares. A company may, if its Articles provide, capitalize its profits by issuing fully-paid bonus shares.

		• Authorised by articles. • Authorised on recommendation of the board in general meeting. • No default in payment of interest or principle in respect of debt securities and fixed deposits and in respect of payment to employees. • Partly paid up shares to be made fully paid up on allotment. • Listed companies to follow SEBI regulations. • Once announced by the board about bonus issue no company shall withdraw the same.
10.	**Issue of shares at premium [Section 52]**	• Share premium to be transferred to share premium account. • Utilisation of share premium account should be as prescribed in **Section 52.**
11.	**Issue of shares at discount [Section 53]**	• Issue of shares at discount is prohibited except by issue of sweat equity shares. • Any share issued by the company at a discounted price shall be void. **In Section 53 of the Companies Act, 2013,—** (i) in sub-section (2), for the words "discounted price", the word "discount" shall be substituted; (ii) after sub-section (2), the following sub-section shall be inserted, namely:— (2A) Notwithstanding anything contained in sub-sections (1) and (2), a company may issue shares at a discount to its creditors when its debt is converted into shares in pursuance of any statutory resolution plan or debt restructuring scheme in accordance with any guidelines or directions or regulations specified by the Reserve Bank of India under the **Reserve Bank of India Act, 1934 or the Banking (Regulation) Act, 1949.**

12.	**Issue of shares with differential voting rights [Section 43(a) (ii)]**	• Articles to authorise the issue. • Ordinary resolution to be passed and if shares are listed then approval through postal ballot. • Not to exceed 26% of total post issue paid up equity capital including shares with differential voting rights at any point of time. • The company not to be penalised under specified legislature in last 3 years. • No default in filing financial statements in the last 3 years. • No default in payment of dividend.
13.	**Issue / redemption of preference shares [Section 55]**	• Issue to be authorised by special resolution. • Explanatory statement to be annexed to the notice of general meeting containing the relevant material facts. • No company shall issue irredeemable preference shares of redeemable preference shares with the redemption period beyond 20 years. • Infrastructural companies may issue preference shares for a period exceeding 20 years but not exceeding 30 years.
14.	**Surrender of shares**	Surrender of shares means surrender to the company on part of shareholder of shares voluntarily. It amount to reduction of capital.
15.	**Stock**	Stock is always fully paid-up. These are the consolidated value of share capital. They comes into existence after conversion of shares into stock and there by the provisions of the Act governing the shares shall cease to apply to the share capital as it is converted into stock.

16.	**Forfeiture of shares**	A company may if authorized by its articles, forfeit shares for non-payment of calls and the same will not require confirmation of the Tribunal and amounts to reduction of capital.
17.	**Buy-back of shares**	The repurchase of shares by a company in order to reduce the number of shares on the market. Companies will buy back shares either to increase the value of shares still available (reducing supply) or to eliminate any threats by shareholders who may be looking for a controlling stake.
18.	**Issue and Redemption of Preference Shares [Section 55]**	1. No company limited by shares shall, after the commencement of this Act, issue any preference shares which are irredeemable. 2. A company limited by shares may, if so authorised by its articles, issue preference shares which are liable to be redeemed within a period not exceeding twenty years from the date of their issue subject to such conditions as may be prescribed. Provided that a company may issue preference shares for a period exceeding twenty years for infrastructure projects, subject to the redemption of such percentage of shares as may be prescribed on an annual basis at the option of such preferential shareholders.
19.	**Under writing of shares and debentures**	Underwriting is an agreement, with or without conditions, to subscribe to the securities of a body corporate when existing shareholders of the corporate or the public do not subscribe to the securities offered to them.

		When a company goes in for an Initial Public Offer (IPO), it may face certain uncertainty about whether its Offer of shares or other securities will be subscribed in full or not. If the public issue does not get fully subscribed, the project for which the funds are being raised cannot be implemented. As per law, it is required that if the company is not able to collect 90% of the offer amount, then it needs to compulsorily return the money to those who have subscribed to the shares.
20.	**Underwriting Commission**	It may be paid in cash or in fully paid-up shares or debentures or a combination of all these. It is paid on the issue price of the shares or debentures so underwritten. As per the provision of **Section 40** of the **Companies Act, 2013**.

SHORT NOTES

2008 - Dec [8] Write a note on:

(c) Bonus shares. **(3 marks)**

Answer:

Bonus Shares: Bonus Shares are shares issued to existing Shareholders free of Cost by Capitalizing Free Reserves. But Company can issue Bonus Shares when Articles of Association authorize the same. In case the Company issuing bonus shares is a Listed Company, the Guidelines issued by SEBI must be complied with. Only existing Shareholders are entitled to receive Bonus Shares. Bonus Shares are be issued to only those Shareholders who hold fully paid up Shares. The bonus shares shall be issued only after expiry of 12 month from the date of Public Issue or Right Issue by the Company.

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2009 - June [8] Write a short notes on:
(a) Escrow Account; **(3 marks)**
(e) Reserve Capital. **(3 marks)**

Answer:

(a) Escrow Account: An Escrow Account is an Account established by a broker, under the provisions of license law, for the purpose of holding funds on behalf of the broker's principal or some other person until the consummation or termination of a transaction, or a trust Account held in the borrower's name to pay obligations such as property taxes and insurance premiums. An escrow Account is the money held by the mortgage company to pay your yearly property taxes and insurance premiums.

Answer:

(e) Reserve Capital : Reserve Capital is that part of Share Capital which is not called up and will be called up only in the event of Liquidation of a Company. It adds to the credibility of the Company and Lenders and Creditors may feel comfortable with such Company.

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2009 - Dec [8] Write a note on:
(a) Issue of Shares in consideration other than cash; **(3 marks)**

Answer:

Issue of shares for consideration other than cash:

Sometimes company issues fully paid shares to the vendors from whom it buys assets. This type of issue is called issue of shares to vendors for consideration other than cash. When such shares are issued then it must be clearly stated in Balance sheet; and must be distinguished from the issue made for cash. This may be further issued either at par or at a premium; Journal entries are:-

(i)	Assets A/c –	Dr. 7,00,000	
	To Vendors A/c		7,00,000
	(For purchase of assets)		

(ii) Vendors A/c – Dr. 7,00,000
To Share Capital A/c 7,00,000
(For issue of shares)

Often the company issues fully paid shares for consideration other than cash to promoters or any other party for furnishing technical information engineering services, plant layout, drawings and specifications; when shares allotted in such a way the journal entry is as under:

Goodwill A/c Dr.
To Share Capital A/c

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2010 - June [8] Write a short note on:

(b) Capital Redemption Reserve **(5 marks)**

Answer :

When a company seeks to redeem preference shares it can redeem them either out of profit or by issue of new shares, or partly by one way and partly by another way. To redeem the fully paid preference shares the company has to transfer equivalent amount from general reserve or profit and loss account to an account called Capital Redemption Reserve. The following journal entry is passed to this effect:

P & L A/c or General Reserve A/c Dr.
To Capital Redemption Reserve A/c

Having been passed the above journal entry the company can redeem the preference shares as follows:

Preference Share Capital A/c Dr.
To Preference Share Holders A/c
Preference Share Holders A/c Dr.
To Bank A/c

The Balance of capital redemption reserve after redemption of shares becomes a free reserve and can be utilised to issue bonus shares etc.

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2011 - June [8] Write a short note on:

(c) Source of Buy-back of shares; **(5 marks)**

Answer:

Sources to buy back:

A company may purchase its own shares or other specified securities out of-

(i) its free reserve; or

(ii) the Securities premium account; or

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

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

In case shares are bought back out of free reserves, then a sum equal to the nominal value of shares bought back shall be transferred to a reserve account to be called as the Capital Redemption Reserve Account **(Sec. 69 of Companies Act, 2013).** The detail of such transfer shall be disclosed in the balance sheet. This account, as per SEBI Guidelines, shall be allowed to be used for the issue of fully paid bonus shares.

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2011 - Dec [8] Write a short note on:

(c) Conditions for buy back of shares; **(5 marks)**

Answer:

Condition for Buy - back:

No company shall purchase its own shares or other specified securities as referred to above unless :

(a) the buy back is authorised by its Articles.

(b) Pass a board resolution for buy back up to 10% of the total paid up equity capital & for reserves or pass a special resolution of members of company for buy back up to 25% of total paid up capital and free reserves of the company.

(c) the ratio of the debt owed by the company is not more than twice the capital and its free reserves after such buy-back.

The Central Government may prescribe a higher ratio of the debt for a class or classes of companies.

(d) all the shares or other specified securities are fully paid-up.

(e) the buy back of the shares or other specified securities listed on any Stock Exchange is in accordance with the regulation made by the SEBI in this behalf.

(f) Separate guidelines shall be issued with respect to unlisted specified securities.

Notice of the meeting: The notice of the meeting at which special resolution is proposes to be passed shall be accompanied by an explanatory statement stating :

(a) a full and complete disclosure of all material fact.

(b) the necessity for the buy back :

(c) the class of security intended to be purchased under the buy back.

(d) the amount to be invested under the buy back,

(e) the time limit for completion of buy back **[Sec. 68 (4) of Companies Act, 2013]**

Period for completion of buy back : Every buy - back shall be completed with in 12 month from the date of passing the special resolution.

Modes of buy back: The buy back of shares may be by any one or more of the following modes:

(a) from the existing security holders on a proportionate basis through the tender offer

(b) from the open market through
   (i) Book Building Process,
   (ii) Stock Exchange,

(c) from odd-lot holders

(d) by purchasing the securities issued to employees of the company pursuant to scheme of Stock option or sweat equity, **[Sec. 68(5)].**

Filing of declaration of solvency :

A declaration of Solvency in the prescribed Form No. SH.9 verified by an affidavit and along the declaration (signed by at least two directors of the company, one of whom shall be the managing director, if any) shall be filed with the Registrar of Companies in case of listed companies also with SEBI.

The declaration of solvency is not required to be filed by an unlisted company **[Sec. 68(6)]**

Extinguishment and physical destruction of securities :
Where a company buys back its own securities, it shall extinguish and physically destroy the securities so bought back with in 7 days of the last day of completion of buy-back. **[Sec. 68(7)]**

Restriction on further issue of Securities within 6 months:
When a company complete a buy-back of its share or other specified securities, the company shall not make a further issue of shares or other specified securities for a period of six month. **[Sec. 68(8)]**

Maintenance of register :
The company has to maintain register of the securities bought back with relevant particulars.

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2012 - June [8] Write a short note on:
(e) Profit prior to Incorporation. **(5 marks)**

Answer:

Profit prior to incorporation:
- Sometimes a company purchases a running business from a date prior to its incorporation.
- If the company has earned any profit from the date of purchase to the date of incorporation such profit is called as profit prior to incorporation.
- Such profit cannot be said to have been earned by the company as it is not available for distribution as dividend to the shareholders.
- Such profit is treated as capital profit and is transferred to Capital Reserve Account.
- If there is any loss prior to incorporation such loss is in the nature of capital loss and is debited to Goodwill Account.
- It should be noted that, the date of incorporation and not the date of commencement of business should be taken into consideration for calculating profit or loss prior to incorporation.

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2013 - June [8] Write a short note:

(a) Over/Under subscription; **(5 marks)**

Answer :

- Where the total number of shares for which applications are received is less than the number of shares issued, it is a case of under subscription.
- If the actual applications received are more than the shares offered to the public it is case of over subscription.
- In the case of under subscription as the applications received are less than those required for minimum subscription, the company cannot proceed with allotment. The entire application money has to be refunded.
- If the subscription for shares is more than what is offered to the public the Board of Directors may make allotment in full to required number of applicants and reject the other applications.
- Alternatively, they may allot shares proportionately to the applications received to all applicants which is known as pro-rata allotment.
- It is possible that they may resort to selective partial allotment by which the pro-rata allotment may be different for various ranges of share applications received.

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2016 - June [5] (b) Write a short note on the sources of Buy Back of Shares. **(5 marks)**

Answer:

Please refer 2011 - June [8] (c) on page no. 21

—— Space to write important points for revision ——

2017 - June [5] Write a short note:

(b) Sweat Equity Shares **(4 marks)**

Answer:

Issue of Sweat Equity Shares [Section 54]

Notwithstanding anything contained in **Section 53**, a company may issue sweat equity shares of a class of shares already issued, if the following conditions are fulfilled, namely:

(a) the issue is authorised by a special resolution passed by the company;
(b) 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;
(c) not less than one year has, at the date of such issue, elapsed since the date on which the company had commenced business; and
(d) 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.

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2017 - Dec [5] Write short notes:
(b) Right Issue of Shares **(4 marks)**

(d) Money Received against Share Warrants **(4 marks)**

Answer:

(b) Right Issue of Shares

Where at any time, a company having a share capital proposes to increase its subscribed capital by the issue of further shares, such shares shall be offered to persons who, at the date of the offer, are holders of equity shares of the company in proportion, as nearly as circumstances admit, to the paid-up share capital on those shares by sending a letter of offer subject to the following conditions, namely:—

(i) the offer shall be made by notice specifying the number of shares offered and limiting a time not being less than fifteen days and not exceeding thirty days from the date of the offer within which the offer, if not accepted, shall be deemed to have been declined;

(ii) unless the articles of the company otherwise provide, the offer aforesaid shall be deemed to include a right exercisable by the person concerned to renounce the shares offered to him or any of them in favour of any other person; and the notice referred to in clause (i) shall contain a statement of this right;

(iii) after the expiry of the time specified in the notice aforesaid, or on receipt of earlier intimation from the person to whom such notice is given that he declines to accept the shares offered, the Board of Directors may dispose of them in such manner which is not disadvantageous to the shareholders and the company.

(d) Money received against Share Warrants

- As per Sch. III Disclosure Requirements, it is to be shown as a separate line item on the face of Balance Sheet.
- In case of Listed Companies, Share warrants are issued to Promoters and others in terms of the Guidelines for Preferential Issues viz. SEBI (Issue of Capital and Disclosure Requirements), Guidelines, 2009.
- Effectively, Share Warrants are amounts which would ultimately form part of the Shareholder's Funds. Since Shares are yet to be allotted against the same, these are not reflected as part of Share Capital, but as a separate line - item.

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2018 - June [5] Write short notes:

(b) Advantages of buy-back of shares **(4 marks)**

(d) Share Application money pending allotment. **(4 marks)**

Answer:

(b) Buy-back of shares have the following advantages:

(i) A company with capital, which cannot be profitably employed, may get rid of it by resorting to buy-back, and re-structure its capital.

(ii) Free reserves which are utilized for buy-back instead of dividend enhance the value of the company's shares and improve earnings per share.

(iii) Surplus cash may be utilized by the company for buy-back and avoid the payment of dividend tax.

(iv) Buy - back may be used as a weapon to frustrate any hostile take-over of the company by undesirable persons.

(d) Share application money pending allotment:

As per Schedule III it is to be shown as a separate line item on the face of Balance Sheet. Other provisions in this respect are as follows:

(i) Share Application Money not exceeding the Issued Capital and to the extent not refundable, is to be disclosed as a separate line item after - Share Holders Funds and before - Non-Current Liabilities.

(ii) 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 - Other Current Liabilities.

(iii) The amount shown as Share Application Money Pending Allotment will not include Share Application Money to the extent refundable. **For example, the amount** in excess of Issued Capita or where Minimum Subscription requirement is not met. Such amount will have to be shown separately under 'Other Current Liabilities'.

(iv) Calls Paid in Advance are to be shown under - Other Current Liabilities. The amount of interest which may accrue on such advance should also is to be reflected as a Liability.

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2018 - Dec [5] Write short note:

(c) Forfeiture of Shares *vis-a-vis* reissue of Forfeited Shares **(4 marks)**

DISTINGUISH BETWEEN

2008 - Dec [1] {C} (a) Distinguish between shares and stock. **(3 marks)**

Answer:

	Shares	**Stock**
1.	Shares may be fully or partly paid up.	Stocks are fully paid up.
2.	Shares are serially numbered.	Stocks are not numbered.
3.	Shares are always registered and non-transferable by mere delivery.	Stocks may be registered or unregistered.
4.	Shares are of equal nominal value.	Stocks may be divided into nominal amount.
5.	Shares are issued when a company is incorporated.	Stocks are not issued when companies are incorporated. Only fully paid shares can be converted into stock.

Space to write important points for revision

DESCRIPTIVE QUESTIONS

2008 - Dec [2] (b) Mention any five purposes for which securities premium account can be utilised. **(5 marks)**

Answer:

As per **Section 52** of **Companies Act, 2013**, the Securities Premium Account can be utilized for the following purposes.

(i) For writing off preliminary expenses of the Company.

(ii) For providing for premium payable on redemption of redeemable preference shares or debentures of the Company.

(iii) For issuing fully paid bonus shares to the members of the Company.

(iv) For writing off expenses of commission paid or discount allowed on issue of Sweat equity shares or debentures of the company.

Space to write important points for revision

2008 - Dec [7] (b) State the prerequisites to be complied with by a company for issue of shares at a discount. **(5 marks)**

Answer:

Prohibition to Issue the Shares at Discount

Section 53 states that except as provided in **Section 54** (i.e. issue of sweat equity shares), a company shall not issue shares at a discount. Any share issued by a company at a discounted price shall be void.

When a company contravenes the provisions of this section, the company shall be punishable with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees and every officer who is in default shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees, or with both.

- Issue of shares at discount is prohibited except by issue of sweat equity shares.
- Any share issued by the company at a discounted price shall be void.

In Section 53 of the Companies Act, 2013,—

(i) in sub-section (2), for the words "discounted price", the word "discount" shall be substituted;

(ii) after sub-section (2), the following sub-section shall be inserted, namely:—

(2A) Notwithstanding anything contained in sub-sections (1) and (2), a company may issue shares at a discount to its creditors when its debt is converted into shares in pursuance of any statutory resolution plan or debt restructuring scheme in accordance with any guidelines or directions or regulations specified by the Reserve Bank of India under the **Reserve Bank of India Act, 1934 or the Banking (Regulation) Act, 1949.**

—— Space to write important points for revision ——

2009 - June [1] {C} (e) Can dividend be declared out of Security Premium Account? **(3 marks)**

Answer:

Dividend cannot be declared out of Security Premium Account. Any balance in the Security Premium Account can be utilised only in the following four ways:

(i) By writing off Preliminary Expenses.
(ii) By writing off Discount on issue of Sweat equity shares and debentures shares.
(iii) By writing off Premium paid on Redemption of Preference Shares.
(iv) By issue of Fully Paid Bonus Shares.

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2009 - June [7] (b) Discuss the conditions of Companies Act with regard to buy-back of shares. **(5 marks)**

Answer :

Please refer 2011 - Dec [8] (c) on page no. 22

—— Space to write important points for revision ——————————

2009 - Dec [4] (b) Enumerate the objectives of Buy back of shares. **(5 marks)**

Answer:

The following are the objectives of buy back of shares:

1. To return surplus cash to investors. Companies want to have back their shares since it facilitates them to manage their surplus cash. If it is paid as dividend companies will have to pay dividend tax on the distribution on the other hand; if cash is distributed through buy back, the tax burden shifts to shareholders who have to pay capital gains tax.
2. To increase underlying share value. Buy back reduces equity and enables the company to increase earnings per share, which would result on enhancing the share value. A share buy back may also be announced when share prices are depressed in the market.
3. To prevent hostile takeover bids. By eliminating surplus cash through buy back such a bid can be avoided.
4. Buy – backs also facilitate a company to maintain a target capital structure. Buy back aids a company to achieve an optimal debt equity ratio.

5. To profit from treasury operations. Companies can buy shares when the prices are low and reissue later at attractive price thus making profit. In India, treasury operation is not possible. This is because shares bought will have to be extinguished.

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2010 - June [1] {C} (f) What are the rates of interest in respect of the following

(i) Calls in advance

(ii) Calls in arrear **(1 mark)**

(g) State any four purposes for which the Securities Premium Account balance may be applied by a company. **(4 marks)**

Answer :

(f) (i) calls in advance – 12%

(ii) calls in arrears – 10%

Answer:

(g) Four purposes for which the securities premium A/c balance may be applied by a company are :

1. In paying up un-issued securities of the company to be issued to members of the company as fully paid bonus securities.
2. To write off preliminary Expenses.
3. To write off the expenses of or commission paid or discount allowed on any of the securities or debentures of the company.
4. To pay premium on the redemption of preference securities or debentures of the company.

—— Space to write important points for revision ——

2013 - Dec [3] {C} Answer the following:

(c) What are the sources available for buy-back of shares for a Company as per Section 68 of Companies Act? **(2 marks)**

Answer:

Please refer 2011 - June [8] (c) on page no. 21

—— Space to write important points for revision ——

2014 - June [3] {C} Answer the following:

(a) What is surrender of shares? What is the accounting treatment in the books of a company for surrender of shares? **(2 marks)**

(d) State the objects of the issue of debentures according to the guidelines issued by the Controller of Capital Issues. **(2 marks)**

Answer:

(a) Surrender of Shares:

- After the allotment of shares, sometimes a shareholder is not able to pay the further calls and returns his shares to the company for cancellation.
- Such voluntary return of shares to the company by the shareholder himself is called surrender of shares.
- Surrender of shares has no separate accounting treatment but it will be like that of forfeiture of shares.
- The same entries (as are passed in case of forfeiture of shares) will be passed in case of surrender of shares.

Answer:

(d) According to the guidelines issued by the Controller of Capital Issues, the objects of the issue can be among other things:

(1) Setting up of new projects;
(2) Expansion or diversification of existing projects;
(3) Normal capital expenditure for modernization;
(4) To augment long-term resources of the company for working capital requirements;
(5) Merger /Amalgamation of companies in pursuance of schemes approved by banks, financial institutions and/or any legal authority.

—— Space to write important points for revision ——

2014 - Dec [1] Answer the question:

(e) What are the various modes of buy-back of shares by a Limited Company? **(2 marks)**

Answer:

Modes of Buy-Back

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.

—— Space to write important points for revision ——

2014 - Dec [3] Answer the question:

(a) (ii) State the conditions for issue of Sweat Equity Shares. **(4 marks)**

Answer:

Primary Market - Public Issues - Sweat Equity Shares

Securities and Exchange Board of India (Issue of Sweat Equity Share) Regulations, 2002.

Section 2 (88) Companies Act, 2013 defines Sweat Equity Shares as under: expression "sweat equity shares" means equity shares issued by the company to employees or directors at a discount or for consideration other than cash for providing know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called.

The conditions for issue of such shares by a company are specified in the section of **Companies Act, 2013** as under:

(a) the issue of sweat equity shares is authorised by a special resolution passed by the company in the general meeting;

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

(c) not less than one year has, at the date of the issue elapsed since the date on which the company was entitled to commence business;

(d) the sweat equity shares of a company whose equity shares are listed on a recognised stock exchange are issued in accordance with the regulations made by the Securities and Exchange Board of India in this behalf.

—— Space to write important points for revision ——

2016 - Dec [5] (b) When Underwriting Commission is payable as per Companies Act, 2013? **(6 marks)**

Answer:

It may be paid in cash or in fully paid-up shares or debentures or a combination of all these. It is paid on the issue price of the shares or debentures so underwritten. As per the provision of Section 40 of the Companies Act, 2013, commission is payable if the following conditions are satisfied:

(i) The payment of the commission is authorized by the articles;

(ii) The commission paid or agreed to be paid does not exceed in the case of shares, five per cent of the price at which the shares are issued or the amount or rate authorized by the articles, whichever is less, and in the case of debentures, two and a half per cent of the price at which the debentures are issued or the amount or rate authorized by the articles, whichever is less;

(iii) The amount or rate per cent of the commission paid or agreed to be paid is in the case of shares or debentures offered to the public for subscription, disclosed in the prospectus, and in the case of shares or debentures not offered to the public for subscription, disclosed in the statement in lieu of prospectus, or in a statement in the prescribed form signed in like manner as a statement in lieu of prospectus and filled in before the payment of the commission with the Registrar and, where a circular or notices not being a prospectus inviting subscription for the shares or debentures, is issued, also disclosed in that circular or notice;

(iv) The number of shares or debentures which persons have agreed for a commission to subscribe absolutely or conditionally is disclosed in the manner aforesaid; and

(v) A copy if the contract for the payment of the commission is delivered to the Registrar at the time of delivery of the prospectus or the statement in lieu of prospectus for registration.

—— Space to write important points for revision ——

PRACTICAL QUESTIONS

2008 - Dec [7] (a) The summarized balance sheet of A Co. Ltd. as on 30th June 2008 is as under:

Share capital :	
10% redeemable preference shares of ₹ 100 each	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 2008 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 2008.

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. 20000 equity shares were issued for cash at a premium of ₹ 20 per share, ₹12.50 payable on application on 15th July 2008 and the balance on allotment on 31st July 2008. All cash due was received on the due dates.

During the three months ended 30th September 2008, the company traded at a profit of ₹ 2,50,000.

Required :

(i) Pass journal entries (including each transactions) showing the relevant entries in respect of the above.

(ii) Prepare summarized balance sheet of the company as on 30th September 2008. **(10 marks)**

Answer :

Journal Entries in the books of A Co. Ltd.

S.No.	Particulars	(₹)	(₹)
1.	Bank A/c (20,000 × 12.5) Dr. To Share Application A/c (Being share Application money received)	2,50,000	2,50,000
2.	Share Application & Allotment A/c Dr. (20,000 × 30) To Equity Share Capital A/c (2,000 × 10) To Securities Premium A/c (20,000 × 20)	6,00,000	2,00,000 4,00,000
3.	Bank A/c To Share Application Allotment A/c (20,000 × 175) (Being Share Allotment amount received)	3,50,000	3,50,000
4.	10% Preference shares A/c Dr. To Preference shareholders A/c (Being preference shares transferred to preference Shareholders A/c)	10,00,000	10,00,000
5.	Preference shareholders A/c Dr. To Bank A/c (Being amount of Preference Shareholders Due paid to them.)	10,00,000	10,00,000

6.	Revenue Reserve A/c Dr. To Capital redemption reserve A/c (Being ₹10,00,000 to Preference Shares redeemed with ₹2,00,000 of equity capital and hence balance is net from reserved)	8,00,000	 8,00,000
7.	12% Debentures A/c Dr. Securities premium A/c Dr. To Debentures Holders A/c (Being debentures transferred to debentures holders A/c)	7,00,000 70,000	 7,70,000
8.	Debentures holders A/c Dr. To Bank A/c (Being amount paid & debenture holders)	7,70,000	 7,70,000
9.	Net assets A/c Dr. To Revenue Reserves A/c (Being profits earned and invested in assets)	2,50,000	 2,50,000

Balance Sheet of A Co. Ltd. (As Per Revised Schedule III) as on 30.09.2008

Particulars	Note No.	Figures as at the end of current reporting period	Figures as at the end of previous reporting period
I. EQUITY AND LIABILITIES			
1. Shareholders' Funds			
(a) Share Capital	1	17,00,000	
(b) Reserve and Surplus	2	45,80,000	
(c) Money received against share warrants			
2. Share application money pending allotment			

3. Non - Current Liabilities			
(a) Long - term borrowings			
(b) Deferred tax liabilities (Net)			
(c) Other Long term liabilities			
(d) Long term provisions			
4. Currents Liabilities			
(a) Short - term borrowings			
(b) Trade payables			
(c) Other current liabilities			
(d) Short - terms provisions			
Total		62,80,000	
II. Assets			
1. Non Current Assets			
(a) Fixed assets			
(i) Tangible assets			
(ii) Intangible assets			
(iii) Capital work - in - progress			
(iv) Intangible assets under development			
(b) Non - current investments			
(c) Deferred tax assets (net)			
(d) Long term loans and advances			
(e) Other Non Current Assets		62,80,000	
2. Current Assets			
(a) Current investments			
(b) Inventories			
(c) Trade receivables			
(d) Cash and cash equivalents			
(e) Short - term loans and advances			
(f) Other current assets			
Total		62,80,000	

Notes on Account:

1. Share Capital:		
Subscribed, Issued & Paid up Capital:		
1,70,000 Equity share of 10 each	17,00,000	
	17,00,000	
2. Reserve & Surplus:		
Security Premium A/c	3,30,000	
Reserves	34,50,000	
Capital Redemption Reserve	8,00,000	
	45,80,000	

—— Space to write important points for revision ——

2009 - Dec [4] (a) The following is the balance sheet of Sachin Ltd. as on 31.03.2008:

Liabilities	₹	Assets		₹
Share Capital :		Fixed Assets :		
Authorised		Gross Block	6,00,000	
20,000, 10% redeemable		*Less:* Depreciation	2,00,000	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		Cash & Bank		
and paid up capital :		balances	1,00,000	2,00,000
20,000, 10% redeemable		Miscellaneous		
preference share of		Expenditure to the extent		40,000
₹ 10 each	2,00,000	not written off		
20,000 equity shares				
of ₹ 10 each	2,00,000			
	4,00,000			
Reserve and Surplus :				
General Reserve	2,40,000			
Securities premium	1,40,000			
Profit and Loss Account	37,000			
Current Liabilities & Provision	23,000			
Total	8,40,000			8,40,000

For the year ended 31.3.2009, 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 ended 31.3.2009 was paid before 31.3.2009.
(2) Except cash & bank balances, other current assets and current liabilities on 31.3.2009, was the same as on 31.3.2008.
(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 31.3.2009.
(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 31.3.2009.
Prepare
   (i) Necessary journal entries to record redemption and issue of shares.
   (ii) Cash & Bank Account.
   (iii) Balance Sheet as on 31.3.2009 **(10 marks)**

Answer :

Journal Entries in the books of Sachin Ltd.

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			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)			

Cash & Bank A/c

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

Balance Sheet Sachin Ltd.
As on 31.03.09 (After Redemption)

Particulars	Note No.	Figures as at the end of current reporting period	Figures as at the end of previous reporting period
EQUITY AND LIABILITIES			
1. Shareholders' Funds			
(a) Share Capital	1	3,00,000	
(b) Reserve and Surplus	2	2,97,000	
(c) Money received against share warrants I.			
2. Share application money pending allotment			

3. Non - Current Liabilities			
(a) Long - term borrowings			
(b) Deferred tax liabilities (Net)			
(c) Other Long term liabilities			
(d) Long term provisions			
4. Current Liabilities			
(a) Short - term borrowings			
(b) Trade payables		23,000	
(c) Other current liabilities			
(d) Short - term provisions			
Total		6,20,000	
II. Assets			
1. Non Current Assets			
(a) Fixed assets	3	3,60,000	
(i) Tangible assets			
(ii) Intangible assets			
(iii) Capital work - in - progress			
(iv) Intangible assets under development		1,00,000	
(b) Non - Current investment			
(c) Deferred tax assets (net)			
(d) Long term loans and advances			
(e) Other Non Current Assets			
2. Current Assets			
(a) Current investment			
(b) Inventories			
(c) Trade receivables		50,000	
(d) Cash and cash equivalents		50,000	
(e) Short - term loans and advances		60,000	
(f) Other current assets			
Total		6,20,000	

Notes on Accounts:

1.	**Share Capital:**			
	Authorized share capital		20,00,000	
			20,00,000	
	Issued, Subscribed & Paid up			
	30,000 Equity share of ₹ 10 each		3,00,000	
			3,00,000	
2.	**Reserved & Surplus:**			
	General Reserve		40,000	
	Security Premium		1,20,000	
	Profit & Loss (Rel - WN - 2)		37,000	
	Capital Redemption Reserve		1,00,000	
			2,97,000	
3.	**Tangible Assets:**			
	Fixed Assets	6,00,000		
	Less : Dep	2,00,000		
	Less : For c/y	40,000	3,60,000	
			3,60,000	

Space to write important points for revision

2009 - Dec [7] (a) The following balances appeared in the books of Gomex Ltd. on 1.04.2008:

(i) Debenture Redemption Fund A/c—₹ 40,000 represented by investment at cost of an equal amount (nominal value ₹ 50,000).

(ii) The 12% Debentures stood at ₹ 90,000.

The company sold ₹ 30,000 investments at ₹ 90 for the purpose of Redemption of ₹ 25,000 Debentures at a premium of 2% during the year.

Show (a) 12% Debentures account, (b) Debenture Redemption Fund A/c, (c) Debenture Redemption Fund investment A/c. for the year ending 31.3.2009.

Ignore interest and brokerage etc. **(10 marks)**

Answer:

Debenture Redemption Fund A/c

Particulars	Amount	Particulars	Amount
To General Reserve " Premium redemption of debentures A/c " Balance c/d	25,000 500 17,500	By Balance b/d " Debenture Redemption fund A/c	40,000 3,000
	43,000		43,000

Debentures Redemption Fund Investment A/c

	Nominal Value	Cost		Nominal Value	Cost
To Balance b/d To Debenture redemption fund A/c– Profit on sale (B/f)	50,000 —	40,000 3,000	By Bank A/c " Balance c/d	30,000 20,000	27,000 16,000
	50,000	43,000		50,000	43,000

12 % Debentures A/c

Particulars	Amount	Particulars	Amount
To Debenture holders A/c To Balance c/d	25,000 65,000	By Balance b/d	90,000
	90,000		90,000

Space to write important points for revision

2010 - June [6] (a) Adarsh Ltd., was formed with an authorized capital of ₹ 30,00,000 divided into equity shares of ₹ 10/- each. The company invited applications for 2,00,000 equity shares of ₹ 10/- each at a premium of 20%. The money was payable as follows:
On application ₹ 5/-, on allotment ₹ 4/- (including premium of ₹ 2/-), ₹ 2/- on first call and rest on the final call.

Applications were received for 2,40,000 shares and allotment was made as under:

(a) To applicants for 1,00,000 shares in full;

(b) To applicants for 80,000 shares—60,000 shares were allotted;

(c) To the applicants for 60,000 shares, the rest of the shares were allotted.

Applicants for 1,000 shares in the (a) category and applicants for 1,200 shares falling in category (b) failed to pay the allotment monies. These shares were forfeited on their failure to pay the first call. Holders of 1,200 shares in category (c) failed to pay the first and final call and these shares were also forfeited after the final call. Of the shares forfeited 1,300 shares were re-issued @ of ₹ 8/- per share as fully paid up. The re-issued shared included 1,000 shares of category (a).

Journalise the above transactions and also show the Cash Book.

(10 marks)

Answer :

Working Note

	Capital	Premium
Application	5	-
Allotment	2	2
First Call	2	-
Final Call	110	2

Category	Applied	Proportion	Allotted
	2,40,000		2,00,000
	1,00,000	(1 : 1)	1,00,000
	1,40,000		1,00,000
	80,000	(4 : 3)	60,000
	60,000	(3 : 2)	40,000

Bank A/c	Dr.	12,00,000	
To Share Application A/c			12,00,000
(Being share application money received)			
Share application A/c	Dr.	12,00,000	
To Equity share capital A/c			10,00,000
To Share Allotment A/c			2,00,000
(Being application money received on 2,40,000 shares transferred to Share capital and on 40,000 shares adjusted towards amount due on allotment)			
Share Allotment A/c	Dr.	8,00,000	
To Equity Share Capital A/c			4,00,000
To Securities Premium A/c			4,00,000
(Being allotment money of ₹ 4 per share including premium of ₹ 2 per share)			
Bank A/c (w.n.1)	Dr.	5,93,900	
Calls –in arrears A/c	Dr.	6,100	
To Share Allotment A/c			6,00,000
(Being allotment money is received in full, after adjustment of excess application money)			
Share first call A/c	Dr.	4,00,000	
To Equity share capital A/c			4,00,000
(Being first call money on 2,00,000 shares @ ₹ 2 per share)			
Bank A/c	Dr.	3,93,800	
Calls –in arrears A/c Dr. (W.N 2)		6,200	
To Share first call A/c			4,00,000
(Being first call money received on 1,96,900 shares @ ₹ 2 per share)			
Share Capital	Dr.	17,100	
Sec. Premium	Dr.	3,800	
To Calls in Arrear A/c			9,900
To Share forfeited A/c			11,000
(Being forfeiture of 1900 shares on which first call & allotment was due as for Board's Resolution)			
Share Second call A/c	Dr.	1,98,100	
To Equity share capital A/c			1,98,100
(Being second call money on 1,97,300 shares @ ₹ 1 per share)			

Bank A/c	Dr.	1,96,900	
Calls in arrears A/c	Dr.	1,200	
To Shares Second Call A/c			1,98,100
(Being second call money on 1,97,300 shares @ ₹ 1 per share)			
Bank A/c	Dr.	10,400	
Forfeited shares A/c	Dr.	2,600	
To Equity share capital A/c			13,000
(Being issue of 1300 forfeited shares at ₹ 8 fully paid up)			
Forfeited shares A/c	Dr.	4,400	
To Capital Reserve A/c			4,400
(Being transfer of forfeited shares to Capital Reserve A/c)			

Bank A/c

Particulars	Amount	Particulars	Amount
To Share Application A/c	12,00,000	By Bal. c/d	23,95,000
To Share Allotment A/c	5,93,900		
To Share first call A/c	3,93,800		
To Share Second call A/c	1,96,900		
To Equity share capital A/c	10,400		
	23,95,000		23,95,000

Working Note for call in arrear

1. Category (A) 100 x 4 = 4000

(No excess in Application full Allotment as made in 1:1)

Category (B) Applied 1200 shares

Allotted = 1200 x ¾ = 900 shares

Application money received on 1200 share x 5	= 6,000
(-) Application money Adjusted	= 4,500
Excess Application money Adjusted in Allotment	1,500
Allotment due on 900 shares x 4	= 3,600
(-) Excess Adjusted	1,500
Call in arrear	2,100

Total call in arrear

Category (A) + Category (B)

4000 + 2100 = 6100

W.N. 2 Call in Arrear on First call

Category

A = 1000 shares

B = 900 shares

C = 1200 shares

3,100 shares @ 2/- per share = 6,200/-

Call in Arrear

	Allotment	First Call	Final Call
(a)	1000	1000	--
(b)	900	900	--
(c)	--	1200	1200
	1900	3100	1200

Space to write important points for revision

2010 - Dec [3] (a) KC limited has declared 15 percent dividend on equity share capital of ₹ 20,00,000 (divided into shares of ₹ 100 each) for the year ending 31st March, 2010 and despatched dividend warrants on 18th July, 2010 by opening a separate bank account on the day. A person holding 800 equity shares did not claim the amount of his share of dividend.

What journal entries will be passed in the books of the company for declaration and the despatch of dividend warrants and transferring the unclaimed amount to Unclaimed Dividend Account? What further journal entry will be passed in the books of the company when the unclaimed amount is not claimed by the claimant within stipulated time U/S 123 of 7 years. Corporate dividend tax may be taken at 17 percent (gross)

(8 marks)

Answer:

Journal Entries in the books of KC Ltd.

Date	Particulars	L.F.	Amount	Amount
July 1	Proposed Equity dividend A/c Dr. Provision for corporate dividend tax A/c Dr. To Equity dividend A/c To Dividend tax A/c (Being proposed dividend and provision for corporate dividend tax transferred to actual liability account on the date of declaration of final dividend)		3,00,000 51,000	3,00,000 51,000
July 18	Separate Bank A/c Dr. To Bank A/c (Being transfer of divd. Amt. to separate account)		3,00,000	3,00,000
July 18	Equity Dividend a/c Dr. To Separate Bank A/c (Being payment of Equity dividend on 19200 Equity shares @ 15/- each)		2,88,000	2,88,000
July 18	Dividend tax a/c Dr. To Bank a/c (Being payment of corporate dividend tax)		51,000	51,000
Date of transfer i.e 17.8.10	Equity dividend a/c Dr. To Unclaimed dividend a/c (Being transfer of unclaimed dividend)		12,000	12,000
Date of transfer i.e 17.8.10	Unpaid dividend Bank A/c Dr. To Separate Bank A/c (Being transfer of unpaid dividend to Separate Bank A/c)		12,000	12,000
At the time of Expiry i.e 7 years	Unclaimed divd. A/c Dr. To unpaid dividend Bank A/c (Being transfer of unclaimed dividend to the central govt. account on expiry of 7 years as per sec 205(A) (5))		12,000	12,000

2011 - June [6] (a) Following is the Balance Sheet of Madox Ltd. as at 31.3.2011 :

(Fig. in ₹)

Liabilities		Assets	
1 lakh Equity shares of ₹ 10 each fully paid	10,00,000	Fixed Assets	12,80,000
5,000, 12% Redeemable Preference Shares of ₹ 100 each	5,00,000	Current Assets	10,20,000
		Bank	3,30,000
Securities Premium	1,00,000		
Profit & Loss A/c	5,50,000		
Current Liabilities	4,80,000		
	26,30,000		26,30,000

On 1.4.2011, the company issued further 30,000 equity shares @ ₹ 10 per share at a premium of ₹ 5 per share. The amount payable was ₹ 6 on application, ₹ 7 on allotment including premium and the balance on First and Final Call. Application were received for 45,000 shares. Application money of 5,000 shares were refunded. Pro-rata allotment was made. The excess application money were adjusted towards allotment. Mr. X holding 3,000 shares failed to pay the allotment money and his shares were forfeited after final call and thereafter, out of these shares 2,000 shares were re-issued at a discount of ₹ 3 per share. Preference shares were redeemed at a premium of 10%. Considering the above transactions, show journal entries and the Balance Sheet in the books of Madox Ltd. **(12 marks)**

Answer :

Application		Allotment				Adjustment of Excess Money		
No.	**Amount @ 6**	**Nos**	**Allotment money**	**Application money adj.**	**Excess application money**	**Against Allotment**	**Calls in advance**	**Refund**
45,000	2,70,000	–	–	–	90,000	–	–	30,000
		30,000	2,10,000	1,80,000		60,000	–	–
45,000	2,70,000	30,000	2,10,000	1,80,000	90,000	60,000	–	30,000

Allotment money received :
Amount x failed to pay

Share premium @ 5/-	1,50,000	Gross amount due from X (3000 x 7)	21,000
Share capital @ 2/-	60,000		
Total allotment dues	2,10,000	(-) Excess application money	
(-) Excess Application money adjusted	60,000	Adjusted $\frac{60,000 \times 3,000}{30,000}$	6,000
Net due	1,50,000	Net due from x which he failed to pay	
(-) not recd. from Mr. X	1,50,000		
Allotment money received	1,35,000		15,000

Journal Entries in the Books of Madox Ltd.
Particulars Dr. ₹ Cr. ₹

Bank A/c	Dr.	2,70,000	
To Share Application A/c			2,70,000
(Application money received)			
Share allotment A/c	Dr.	2,10,000	
Share Application A/c	Dr.	1,80,000	
To Share capital A/c			2,40,000
To Security premium A/c			1,50,000
(Shares allotted, allotment money due of application money on the shares allotted adjusted)			
Share Application A/c	Dr.	90,000	
To Bank A/c			30,000
To Share Allotment A/c			60,000
(Excess Application money adjusted/refunded)			
Bank A/c	Dr.	1,35,000	
To Share Allotment A/c			1,35,000
(Share allotment money received from all except x holding 3000 shares)			
1st & Final Call A/c	Dr.	60,000	
To Share capital			60,000
(1st & Final Call @ 2 due)			

Bank A/c	Dr.		54,000	
To 1st & Final Call				54,000
(1st & Final call reed from all except Mr. X holding 3000 shares)				
Share Capital A/c	Dr.	(3000 x 10)	30,000	
Security Premium A/c	Dr.	(3000 x 5)	15,000	
To Share Allotment A/c				15,000
To 1st & Final call A/c				6,000
To Share forfeiture A/c				24,000
(3000 shares of x forfeited for non payment of allotment money & 1st & final call)				
Bank A/c	Dr.	(2000 x 7)	14,000	
Share forfeiture A/c	Dr.	(2000 x 3)	6,000	
To Share Capital A/c				20,000
(2000 forfeited shares originally belonging to x reissued at a discount of ₹ 3)				
Share forfeiture A/c			10,000	
To Capital Reserve A/c				10,000
(Balance of share forfeiture A/c 2000 of X reissued (24000/3000) x 2000 = 16000 less discount allowed on reissue ₹ 6000/- transferred to capital reserve)				
12% Redeemable preference share A/c	Dr.		5,00,000	
Premium on redemption A/c	Dr.		50,000	
To Preference Share holder A/c				5,50,000
(Amount due on redemption of 5000, 12% redeemable preference shares face value of ₹ 100 each at 10% premium)				
Security Premium A/c			50,000	
Profit & Loss A/c			5,00,000	
To Premium on redemption A/c				50,000
To Capital redemption Reserve A/c				5,00,000
(Amount of face value of redeemable preference share transferred to CRR A/c & premium on redemption transferred to security premium A/c)				
Preference shares holder A/c			5,50,000	
To Bank A/c				5,50,000
(Amount paid to preference share holder)				

(Balance Sheet of Madox Ltd.)

Particulars	Note No.	Figures as at the end of current reporting period	Figures as at the end of previous reporting period
EQUITY AND LIABILITIES			
1. Shareholders' Funds			
(a) Share Capital	1	12,90,000	
(b) Reserve and Surplus	2	7,53,000	
(c) Money received against share warrants			
2. Share application money pending allotment			
3. Non - Current Liabilities			
(a) Long - term borrowings			
(b) Deferred tax liabilities (Net)			
(c) Other Long term liabilities			
(d) Long term provisions			
4. Current Liabilities			
(a) Short - term borrowings			
(b) Trade payables			
(c) Other current liabilities		4,80,000	
(d) Short - term provisions			
Total		25,23,000	
II. Assets			
1. Non Current Assets			
(a) Fixed assets			
(i) Tangible assets		12,80,000	
(ii) Intangible assets			
(iii) Capital work - in - progress			
(iv) Intangible assets under development			

(b) Non - Current investment			
(c) Deferred tax assets (net)			
(d) Long term loans and advances			
(e) Other Non Current Assets			
2. Current Assets			
(a) Current investment			
(b) Inventories			
(c) Trade receivables			
(d) Cash and cash equivalents	3	2,23,000	
(e) Short - term loans and advances			
(f) Other current assets		10,20,000	
Total		25,23,000	

Notes on Account:

1. Share Capital:		
Issued, Subscribed & Paid up		
1,29,000 Equity share of ₹ 10 each	12,90,000	
	12,90,000	
2. Reserve & Surplus:		
Capital Redemption Reserve	5,00,000	
Capital Reserve	10,000	
Share Forfeiture A/c	8,000	
Security Premium	1,85,000	
Profit & Loss	50,000	
	7,53,000	
3. Cash & Cash Equivalent:		
Bank (3,30,000 + 4,43,000 - 5,50,000)	2,23,000	
	2,23,000	

Space to write important points for revision

2011 - Dec [5] (a) The following balances are appearing in the Books of All Xerox Ltd. on 1-4-2011 :

	₹
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. Rahul 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. **(10 marks)**

Answer:

Book of All Xerox Ltd.
Journal Entries

Date	Particulars	Dr. Amount (₹)	Cr. Amount (₹)
	Redeemable Preference Share Capital A/c Dr. Premium on Redemption on Pref. Shares a/c Dr. To Preference Shareholders A/c (Being 19,500 fully paid Red, Pref. Shares along with premium payable on redemption as per Board resolution no. dt.)	1,95,000 19,500	 2,14,500

	General Reserve A/c To Capital Redemption Reserve A/c (Being General Reserve transferred)	Dr.	50,000	 50,000
	Bank A/c To Equity Shares Capital A/c To Equity Shares Premium A/c (Being issue of 14,500 Equity shares at a premium of 20%)	Dr.	1,74,000	 1,45,000 29,000
	Share Premium A/c To Premium on Redemption on P.V. of Shares A/c (Being premium payable adjusted)	Dr.	19,500	 19,500
	Preference Shareholders A/c To Bank A/c (Being amount paid off to Pref. shareholders)	Dr.	2,14,500	 2,14,500
	Capital Redemption Reserve A/c To Bonus to Shareholders A/c (Being Bonus declared and transferred to Capital Redemption Reserve account)	Dr.	50,000	 50,000
	Bonus to Shareholders A/c To Equity Share capital A/c (Being amount transferred to Equity Share capital)	Dr.	50,000	 50,000

Working Note:

Sources of redemption as per Sec. 55 of Companies Act, 2013

Nominal Value of Share Redemed ₹ 1,95,000

Out of Free reserves
₹ 5,000 Reserve
General

Out of Proceeds of
new issue of shares
₹ 1.45.000

2012 - June [7] (a) Ashok Ltd. furnishes you with the following Balance Sheet as at 31st March, 2012:

(₹ 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 1st April, 2012. 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

(i) Pass Journal entries to record the above;

(ii) Prepare Balance Sheet as at 01.04.2012. **(10 marks)**

Answer :

(i) Journal Entries in the books of Ashok Ltd.

(₹ in crores)

Date	Particulars	Dr.	Cr.
1st April, 2012	12% Preference share capital A/c Dr. To Preference shareholders A/c (Being preference share capital account transferred to shareholders account)	75	 75
	Preference share holders A/c Dr. To Bank A/c (Being payment made to shareholders)	75	 75
	Shares buy back A/c Dr. To Bank A/c (Being 50 Lakhs equity shares bought back @ .₹ 50 per share)	25	 25
	Equity share capital A/c (50 Lakhs × ₹ 10) Securities premium A/c (50 Lakhs × ₹ 40) To Shares buy back A/c (Being cancellation of shares bought back)	5 20	 25
	Revenue reserve A/c Dr. To Capital Redemption Reserve A/c (Being creation of capital redemption reserve to the extent of the value of preference shares redeemed and equity shares bought back)	80	 80

Balance Sheet of Ashok Ltd. as on 01.04.2012

Particulars	Note No.	Figures as at the end of current reporting period	Figures as at the end of previous reporting period
EQUITY AND LIABILITIES		**(₹ in crore)**	
1. Shareholders' Funds			
(a) Share Capital	1	20	
(b) Reserve and Surplus	2	280	
(c) Money received against share warrants			
2. Share application money pending allotment			
3. Non - Current Liabilities			
(a) Long - term borrowings			
(b) Deferred tax liabilities (Net)			
(c) Other Long term liabilities			
(d) Long term provisions			
4. Current Liabilities			
(a) Short - term borrowings			
(b) Trade payables			
(c) Other current liabilities		40	
(d) Short - term provisions			
Total		340	
II. Assets			
1. Non Current Assets			
(a) Fixed assets			
(i) Tangible assets	3	Nil	
(ii) Intangible assets			
(iii) Capital work - in - progress			
(iv) Intangible assets under development		100	

(b) Non - Current investment			
(c) Deferred tax assets (net)			
(d) Long term loans and advances			
(e) Other Non Current Assets			
2. Current Assets			
(a) Current investment			
(b) Inventories			
(c) Trade receivables			
(d) Cash and cash equivalents	4	240	
(e) Short - term loans and advances			
(f) Other current assets			
Total		340	

Notes on Account:

1. Share Capital:		**(₹ in crore)**	
Issued, Subscribed & Paid up			
200 Lakh equity share of ₹ 10 each		20	
Preference share	75		
Less: Redeemable	75	Nil	
		20	
2. Reserve & Surplus:			
Capital Reserve		15	
Capital Redemption Reserve		80	
Share Premium (25 - 20)		5	
Revenue Reserve (260 - 80)		180	
		280	
3. Tangible Assets:			
Fixed Assets		100	
Less: Provision for Dep.		100	
		Nil	
4. Cash and Cash equivalent:			
Current Assets		340	
Less: Redemption & Buy Back		(100)	
		240	

Space to write important points for revision

2012 - Dec [6] (a) The following was the Balance Sheet of Wonder World Ltd. as at 31.03.2012: **(₹ in lakhs)**

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 01.04.2012, 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 held by the equity shareholders.

Show Journal entries and Balance Sheet after the above transactions were completed. **(10 marks)**

Answer :

Journal Entries in the books of wonder world Ltd.

2012			
April 1	Bank A/c Dr. To Investments A/c To P and L A/c (Being Investments Sold)	2.30	 1.80 0.50
April 1	Bank A/c Dr. To Preference share application A/c (Being application money @ 60/- each received on 1,500 Preference Shares)	0.90	 0.90
April 1	Preference Share application A/c Dr. To 12% PSC A/c (Being allotment made)	0.90	 0.90

April 1	Preference share allotment A/c Dr. To 12% PSC A/c (Being allotment money due on 1,500 pref shares @ 40/- each)	0.60	0.60
April 1	Bank A/c Dr. To Preference Share Allotment A/c	0.06	0.06
April 1	ESC A/c Dr. Security Premium A/c Dr. To Equity Shareholders A/c (Being 20%Eq. Shares bought back at a premium of 10/- each as per board resolution dated............)	2.00 2.00	4.00
April 1	Equity Shareholders A/c Dr. To Bank A/c (Being amount paid to equity shareholders against buy back)	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 W.N.1]	0.50	0.50
April 1	Capital Redemption Reserve A/c Dr. Security Premium A/c Dr. To Bonus to Shareholders A/c (Being profits transferred to issue bonus shares in the ratio of 1:5 [Refer W.N.2]	0.50 1.10	1.60
April 1	Bonus to Shareholders A/c Dr. To ESC A/c (Being Bonus Shares issued in the ratio of 1:5 as per board resolution dated........)	1.60	1.60

W.N. (1)

Buy Back of Shares can be done out of two sources (Sec. 77 A)

2,00,000

Out of proceeds of issue of new shares
1500 Pref. Shares × 100/ = 1,50,000

Out of Free Profit

General Reserve Balance ₹ 50,000

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

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

Balance Sheet of Wonder World Ltd. as on 1.4.12

Particulars	Note No.	Figures as at the end of current reporting period	Figures as at the end of previous reporting period
EQUITY AND LIABILITIES			
1. Shareholders' Funds			
(a) Share Capital	1	11.10	
(b) Reserve and Surplus	2	4.60	
(c) Money received against share warrants			
2. Share application money pending allotment			
3. Non - Current Liabilities			
(a) Long - term borrowings	3	7.50	
(b) Deferred tax liabilities (Net)			
(c) Other Long term liabilities			
(d) Long term provisions			

4. Current Liabilities			
(a) Short - term borrowings			
(b) Trade payables-(Sundry Creditors)		5.00	
(c) Other current liabilities			
(d) Short - term provisions			
Total		28.20	
II. Assets			
1. Non Current Asset			
(a) **Fixed assets**			
(i) Tangible assets	4	15.90	
(ii) Intangible assets			
(iii) Capital work - in - progress			
(iv) Intangible assets under development			
(b) Non - Current investment			
(c) Deferred tax assets (net)			
(d) Long term loans and advances			
(e) Other Non Current Assets			
2. Current Assets			
(a) Current investment			
(b) Inventories		7.20	
(c) Trade receivables		2.30	
(d) Cash and cash equivalents		2.80	
(e) Short - term loans and advances			
(f) Other current assets			
Total		28.20	

Notes on Accounts:

	(₹ in lakh)	
1. Share Capital:		
Issued, Subscribed & Paid up:		
96,000 Equity share of ₹ 10 each	9.60	
15,000 Preference of ₹ 100 each	1.50	
	11.10	

	Reconciliation of Share Capital:		
	Opening balance of equity 1,00,000		
	Less - Buy back 20,000		
	Add:- Issue bonus share 16,000		
	Add:- Issue Preference share 15,000		
	1,11,000		
2.	**Reserve & Surplus:**		
	Capital Redemption Reserve	0.50	
	Profit & Loss	1.10	
	General Reserve (3.1 - 0.5)	2.60	
	Security Premium (3.5 - 2- 1.1)	0.40	
		4.60	
3.	**Long term borrowings:**		
	14 % Debenture	7.50	
		7.50	
4.	**Tangible Assets:**		
	Plant & Machinery	13.50	
	Furniture	2.40	
		15.90	

Space to write important points for revision

2013 - June [3] (c) X Co. Ltd. decided to buyback 10,000 equity shares of ₹ 10 each. It sold investments (Face value) ₹ 70,000 for ₹ 95,000. It bought 10,000 equity shares in the open market for ₹ 90,000 out of free reserves. The shares bought back were cancelled. The expenses of buyback were ₹ 1,000.

Pass necessary journal entries in the books of X Co. Ltd. to record the above transactions. **(6 marks)**

Answer :

Journal of X Co. Ltd.

Particulars	Dr. ₹	Cr. ₹
Bank A/c Dr. To Investment A/c To Profit on sale of investment (Being Sale of investment)	95,000	 70,000 25,000
Equity Share Capital Account Dr. To Equity Shareholder account To Capital reserve account (Being transfer of equity share capital to shareholders account and profit on purchase of own shares)	1,00,000	 90,000 10,000
Free reserves account Dr. To Capital Redemption reserve account (Being the nominal value of shares purchased)	1,00,000	 1,00,000
Buyback expenses account Dr. To Bank (Being Expenses of buyback)	1,000	 1,000
Profit on sale of investment account Dr. To Profit and Loss Account (Being transfer of profit on sale of investment to P&L account)	25,000	 25,000
Profit and Loss Account Dr. To Buyback expenses account (Being transfer of buyback expenses to P&L Account)	1,000	 1,000

Space to write important points for revision

2013 - Dec [4] (a) (i) The following is the Balance Sheet of Superstar Ltd. as at 31.03.2013:

Liabilities	**Amount (₹ in Lakhs)**
10% Redeemable Pref. Shares of ₹ 10 each, fully paid	2,500
Equity Shares of ₹ 10 each, fully paid	8,000
Capital Redemption Reserve	1,000

Securities Premium	800
General Reserve	6,000
Profit and Loss A/c	300
9% Debentures	5,000
Sundry Creditors	2,300
Sundry Provisions	1,000
	26,900
Assets	**Amount (₹ in Lakhs)**
Fixed Assets	14,000
Investments	3,000
Cash at Bank	1,650
Other Current Assets	8,250
	26,900

On 1st April, 2013 the company redeemed all of its preference shares at a premium of 10% and bought back 25% of its equity shares @ ₹ 20 per share. In order to make cash available, the company sold all the investments for ₹ 3,150 lakh and raised a bank loan amounting to ₹ 2,000 lakhs on the security of the company's plant.

Pass Journal Entries for all the above mentioned transactions including Cash transactions. The amount of securities premium has been utilised to the maximum extent allowed by law. **(8 marks)**

(iii) ABC Ltd. issued 40,000 Equity shares. Three Underwriters were appointed to underwrite the shares and the shares were underwritten as under:

Underwriter	No. of Shares Underwritten
X	24,000
Y	10,000
Z	6,000

The above Underwriters made application for 'firm' underwriting as under: Underwriter X for 3,200 nos. shares, Underwriter Y for 4,000 nos. shares and underwriter Z for 1,200 nos. shares.

The Company received application for 20,000 nos. shares, excluding 'firm' underwriting but including marked applications which were as under:

Underwriter	Marked application for No. of Shares
X	4,000
Y	5,000
Z	2,000

You are required to calculate the allocation of liability of the respective Underwriters.

(As per contract, the Underwriters are to be given credit for 'firm' applications and that credit for unmarked applications be given in proportion to the shares underwritten.) **(4 marks)**

Answer:

(i) **Journal Entries**

(Amount in Lakhs)

S.N.	Particulars		Debit (₹)	Credit (₹)
1.	Bank A/c	Dr.	3,150	
	To Investment A/c			3,000
	To Profit & Loss A/c			150
	(Being sale of investment & profit thereon)			
2.	Bank A/c	Dr.	2,000	
	To Bank Loan A/c			2,000
	(Being Loan taken from bank)			
3.	10% Redeemable Pref. Share Capital A/c	Dr.	2,500	
	Premium on redemption of Pref. Shareholder A/c	Dr.	250	
	To Preference Shareholder A/c			2,750
	(Being redemption of Pref. Share)			
4.	Preference Shareholder A/c	Dr.	2,750	
	To Bank A/c			2,750
	(Being payment of amount due to Preference Shareholder)			

5.	Securities Premium A/c	Dr.	250	
	To Premium on redemption of Pref. Shareholder A/c			250
	(Being use of securities premium to provide premium on redemption of Pref. Shares)			
6.	Equity Share Capital A/c	Dr.	2,000	
	Securities Premium A/c	Dr.	550	
	General Reserve A/c	Dr.	1,450	
	[(200 x 20) - 2,000 - 550]			
	To Equity Shareholders A/c			4,000
	(Being buy back of equity shares)			
	Note: Balance of General Reserve [6,000 - 1,450] = ₹ 4,550			
7.	General Reserve A/c	Dr.	4,500	
	To Capital Redemption Reserve A/c			4,500
	[2,000 + 2,500]			
	(Being creation of capital redemption reserve to the extent of the face value of preference share redeemed & equity shares bought back.)			
	Note : Balance in General Reserve as on 1.4.2013 (4,550 - 4,500) = 50.			
8.	Equity Shareholders A/c	Dr.	4,000	
	To Bank A/c			4,000
	(Being payment of amount due to equity shareholders)			
	Note: Cash at Bank [1,650 + 3,150 + 2,000 - 2,750 - 4,000] = 50			

(iii) Calculation of allocation of liability of the respective underwriters :

Particulars	x	y	z	Total
Gross Liability (No. of shares)	24,000	10,000	6,000	40,000
Marked Application	(4,000)	(5,000)	(2,000)	(11,000)
	20,000	5,000	4,000	29,000
Unmarked Application [24:10:6]	(5,400)	(2,250)	(1,350)	9,000
[20,000 - 11,000 = 9,000]	14,600	2,750	2,650	20,000

Firm Underwriting	(3,200)	(4,000)	(1,200)	8,400
Balance	11,400	(1,250)	1,450	11,600
Negative Adjustment [24:6]	(1,000)	1,250	(250)	-
Net Liability	10,400	-	1,200	11,600
Add : Firm Underwriting	3,200	4,000	1,200	8,400
Total Liability	13,600	4,000	2,400	20,000

—— Space to write important points for revision ——

2014 - June [4] (a) (i) The following was the summarized financial position of Chanakya Ltd. as on 31st March, 2014:

Equity & Liabilities	₹ Lakhs	Assets	₹ Lakhs
Share Capital:		Fixed Assets	15,000
Equity Shares of ₹ 10 each	7,000	Investments	3,000
fully paid Up		Cash at Bank	1,450
10% Redeemable Pref. Shares	3,000	Other Current	
of ₹ 10 each fully Paid Up.		Assets	7,550
Reserve & Surplus			
Capital Redemption Reserve	1,100		
Securities Premium	700		
General Reserve	5,800		
Profit & Loss Account	500		
Secured Loans:			
9% Debentures	4,000		
Current Liabilities:			
Trade payables	3,800		
Sundry Provisions	1,100		
	27,000		27,000

On the 1st April, 2014 the Company redeemed all its Preference Shares at Premium of 10% and bought back 10% of its Equity Shares at ₹ 11 per Shares. In order to make funds available, the Company sold all the investments for ₹ 3,200 lakhs and raised a Bank Term Loan for the balance.

You are required to prepare the Balance Sheet of the Company after the redemption/buy back of shares. Assume that the securities premium account was utilised to the maximum possible extent. **(10 marks)**

Answer:

Balance Sheet of Chanakya Ltd. as on 1.4.2014
(after Redemption and Buyback)
as per Schedule III (Extracts)

	Particulars	Note No	Amount (₹ Lakhs)
(I)	**Equity and Liabilities**		
1	**Shareholders' Funds:**		
	(a) Share Capital	1	6,300
	(b) Reserves and Surplus	2	7,930
2	**Non-Current Liabilities**		
	(a) Long Term Borrowings	3	4,870
3	**Current Liabilities**		
	(a) Trade Payables		3,800
	(b) Short Term Provisions		1,100
	Total		24,000
(II)	**Assets**		
(1)	**Non Current Assets**		
	Fixed Assets		15,000
	Current Assets:		
	(a) Cash and Cash equivalents (W N)		1,450
	(b) Other Current Assets		7,550
	Total		24,000

Notes of Accounts
(Related Notes)

		₹ In Lakhs		
1	**Share Capital** 630 lakh Equity Shares of ₹10 each Fully Paid up (70 lakh Equity Shares bought back)			6,300
2	**Reserve and Surplus**			
	General Reserve	5,800		
	Less: Transfer to CRR	3,700	2,100	
	Capital Redemption Reserve	1,100		
	Add: Transfer due to buy-back of shares from Gen. res.	3,700	4,800	
	Securities premium	700		
	Less: Adjustment for premium paid on redemption of preference shares	(300)		
	Less: Adjustment for premium paid on buy back	70	330	
	P&L A/c	500		
	Add: Profit of sale of investment	200	700	7930
3	**Long-term borrowings**			
	Secured			
	9% Debentures		4000	
	Terms Loans-From Banks		870	4870

Working Note:

Bank Account

Dr. **Cr.**

Particulars	Amount (₹ Lakhs)	Particulars	Amount (₹ Lakhs)
To balance b/d	1,450	By Preference Shareholders A/c	3,300
To Investment A/c (Sale Proceeds)	3,200	By Equity Shareholders A/c	770
		By Balance C/d	1,450
To Bank Loan A/c (Loan received)	870		
	5,520		5,520

Space to write important points for revision

2014 - June [4] (b) (i) On January 1, 2004 Vardhaman Ltd. allotted 20,000, 9% Debentures of ₹ 100 each at par, the total amount having been received along with applications.

(1) On 1st Feb., 2005 the Company purchased in the open market 2,000 of its own debentures @ ₹ 102 each and cancelled them immediately.

(2) On 1st January, 2008 the Company redeemed at per debentures for ₹ 3,00,000 by draw of a lot.

(3) On 1st June, 2010 the Company purchased debentures of the face value of ₹ 2,00,000 for ₹ 1,97,800 in the open market, held them as investments for one year and then cancelled them.

(4) Finally, as per resolution of the Board of Directors, the remaining debentures were redeemed at a premium of 3% on 1st Feb., 2014 when Securities Premium Account in the company's ledger showed a balance of ₹ 50,000.

Pass journal entries for the above mentioned transactions ignoring debentures redemption reserve, debenture-interest and interest on own debentures. **(10 marks)**

Answer:

Journal Entries in The Books of Vardhman Ltd.

Date	Particulars	Amount Dr.	Amount Cr.
01-01- 2004	Bank A/c Dr.	20,00,000	
	To 9% Debenture Application A/c		20,00,000
01-01-2004	9% Debenture Application A/c Dr.	20,00,000	
	To 9% Debenture		20,00,000
01-02-2005	Own Debenture A/c Dr.	2,04,000	
	To Bank A/c		2,04,000
01- 02-2005	9% Debenture Dr.	2,00,000	
	Loss on Cancellation Dr.	4,000	
	To Own Debenture A/c		2,04,000
01-01- 2008	9% Debenture A/c Dr.	3,00,000	
	To Debentureholder		3,00,000
01-01- 2008	Debentureholder A/c Dr.	3,00,000	
	To Bank		3,00,000
01-06- 2010	Own Debenture A/c Dr.	1,97,800	
	To Bank A/c		1,97,800
01-06- 2010	9% Debenture Dr.	2,00,000	
	To Capital Reserve		2,200
	To Own Debenture A/c		1,97,800
01-06-2010	Profit on cancellation of own Debenture A/c Dr.	2,200	
	To Capital Reserve A/c		2,200
	(Being transfer of profit on cancellation of own debenture to capital reserves)		
01-02- 2014	9% Debenture A/c Dr.	13,00,000	
	Premium on redemption of debenture Dr.	39,000	
	To Debentureholder		13,39,000

01-02- 2014	Debentureholder A/c Dr.	13,39,000	
	To Bank		13,39,000
01-02- 2014	Securities Premium A/c Dr.	39,000	
	To Premium on redemption of debenture		39,000

—— Space to write important points for revision ——

2014 - Dec [1] Answer the question:

(f) X Ltd. decides to redeem 650, 15% preference shares of ₹ 100 each at 10% premium. It has General Reserve of ₹ 45,500 and securities premium of ₹ 1,000. The new equity shares of ₹ 10 each are to be issued at 25% premium for the purpose of redemption of preference shares. Calculate the minimum number of equity shares to be issued by X Ltd. **(2 marks)**

Answer:

Nominal Value of Preference Shares +Premium on Redemption = Existing Securities Premium + Divisible Profits available for redemption + Sale Proceeds of fresh issue of New Shares.

65,000 + 6,500 = 1,000 + 45,500 + X

X = 25,000

Minimum number of equity shares to be issued for redemption of preference share = Sale Proceeds of fresh issue of New Shares/ Issue Price

= 25,000/12.50

= 2000.

—— Space to write important points for revision ——

2014 - Dec [2] Answer the question:

(b) (i) Kachari Limited granted 25,000 employees stock options (face value ₹ 10) on 1st April, 2012 at ₹ 100, when the market price was ₹ 425. The options were to be exercised between 16th October, 2012 and 15th March, 2014. The employees exercised their options for 22,500 shares only. The remaining options lapsed. The company closes its books on 31st March every year. Pass Journal entries. **(4 marks)**

Answer:

Journal of Kachari Limited

01/4/12	Employee Compensation Expense A/c Dr. To Employee Stock Options Outstanding A/c (Being grant of 25000 stock options to employees at ₹100 when market price is ₹ 425)	81,25,000	 81,25,000
(16/10/12 to 15/3/14)	Bank A/c Dr. Employee stock options outstanding A/c Dr. To Equity share capital A/c To Security premium A/c (Being allotment to employees of 22500 equity shares of ₹10 each at a premium of ₹415 per share in exercise of stock options by employees)	22,50,000 73,12,500	 2,25,000 93,37,500
16/3/14	Employee stock options outstanding A/c Dr. To Employee compensation expense A/c (Being entry for lapse of stock options for 2500 Shares)	8,12,500	 8,12,500
31/3/14	Profit & Loss A/c Dr. To Employee compensation expense A/c (Being transfer of employee compensation Expense to profit and loss account)	73,12,500	 73,12,500

Note: *Employee stock options outstanding will appear in the Balance Sheet as part of Net Worth or Shareholders' Equity.*

Space to write important points for revision

2014 - Dec [3] Answer the question:

(a) (i) Masood Ltd. came out with an issue of 45 lakh 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 P, Q and R respectively.

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

P	7,25,000 shares
Q	8,40,000 shares
R	13,10,000 shares
	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:

(1) Compute the underwriters' liability (number of shares);

(2) Compute the amount payable as due to underwriters; and

(3) Pass necessary Journal Entries in the books of Masood Ltd. relating to underwriters.

(**Note:** As per contract, the underwriters are to be given credit for 'firm' applications and that credit for unmarked applications be given in proportion to the shares underwritten.) **(8 marks)**

(b) (ii) Mogari Limited has 10% Redeemable Preference share capital of ₹ 30,00,000 consisting of ₹ 10 shares fully paid up. The company wants to redeem these shares at 25% premium. The ledger accounts show the following balances:

Securities premium ₹ 1,00,000; General Reserve ₹ 13,00,000 and Profit & Loss Account (Cr.) ₹ 7,00,000

In order to facilitate the redemption of preference shares, the company decided the following:

1. 1,20,000 Equity shares of ₹ 10 each were issued at 50% premium.
2. 10,000, 12% Debenture of ₹100 each were issued at par.
3. Investments of book value ₹ 5,00,000 were sold at ₹ 5,60,000.

Pass the necessary journal entries to record above transactions and redemption of preference shares. **(8 marks)**

Answer:

(i) (a) Computation of liabilities of underwriters (No. of shares):

Particulars	P	Q	R
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 applications	7,25,000	8,40,000	13,10,000
	3,75,000	2,60,000	(2,10,000)
Less: Unmarked applications distributed to P and Q in equal ratio	1,12,500	1,12,500	Nil
	2,62,500	1,47,500	(2,10,000)
Less: Surplus of R distributed to P and Q in equal ratio	1,05,000	1,05,000	2,10,000
Net liability (excluding firm underwriting)	1,57,500	42,500	Nil
Add: Firm underwriting	1,00,000	1,00,000	1,00,000
Total liability (No. of shares)	2,57,500	1,42,500	1,00,000

(b) Computation of amounts payable by underwriters: (₹)

Particulars	P	Q	R
Liability towards shares to be subscribed @12 per share	30,90,000	17,10,000	12,00,000
Less: Commission (5% on 12 lakhs shares @ 10 each)	6,00,000	6,00,000	6,00,000
Net amount to be paid by underwriters	24,90,000	11,10,000	6,00,000

(c) In the Books of Masood Ltd.

Journal Entries

Particulars	Dr. (₹)	Cr. (₹)
Underwriting commission A/c Dr.	18,00,000	
To P A/c		6,00,000
To Q A/c		6,00,000
To R A/c		6,00,000
(Being underwriting commission on the shares underwritten)		

P A/c Dr.	30,90,000	
Q A/c Dr.	17,10,000	
R A/c Dr.	12,00,000	
To Equity share capital A/c		50,00,000
To Share premium A/c		10,00,000
(Being shares including firm underwritten shares allotted to underwriters)		
Bank A/c Dr.	42,00,000	
To P A/c		24,90,000
To Q A/c		11,10,000
To R A/c		6,00,000
(Being the amount received towards shares allotted to underwriters less underwriting commission due to them)		

Answer:

(b) (ii) **Books of Mogari Limited**

Journal (in Lakhs)

Particulars	**Dr.** (₹)	**Cr.** (₹)
(i) Bank A/c Dr.	28,00,000	
To E. S. Application A/c		18,00,000
To Debenture A/c		10,00,000
(Application money received on 1,20,000 equity shares @₹15 per share and on 10,000 debentures @ ₹ 10 each)		
(ii) Bank A/c Dr.	5,60,000	
To Profit & Loss A/c		60,000
To Investment A/c		5,00,000
(Profit on sale of Investments)		
(iii) E. S. Application A/c Dr.	18,00,000	
To E. S. Capital A/c		12,00,000
To Securities Premium A/c		6,00,000
(Application money transferred)		
(iv) Debenture Application A/c Dr.	10,00,000	
To 12% Debenture A/c		10,00,000

(v) Security Premium A/c	Dr.	7,00,000	
General Reserve A/c	Dr.	50,000	
To Premium on redpm. of pref. sh. A/c			7,50,000
(vi) General Reserve A/c	Dr.	12,50,000	
Profit & Loss A/c	Dr.	5,50,000	
To Capital Redemption Reserve A/c			18,00,000
(vii) 10% Redeemable P. S. Capital A/c	Dr.	30,00,000	
Premium on Red. of P. S. A/c	Dr.	7,50,000	
To Bank A/c			37,50,000

Note: *Preference shares are redeemed either out of distributable profits or proceeds from fresh issue of shares or both. Hence, Preference shares of ₹ 12,00,000 redeemed through fresh issue of equity shares and remaining of ₹ 18,00,000 redeemed out of profits.*

—— Space to write important points for revision ——

2015 - June [1] Answer the question:

(a) Neel Limited issued 10,000 debentures of ₹ 10 each redeemable at the end of 10 years, but reserves the right to redeem earlier from the end of 3rd year. The company decides at the end of 5th year to redeem 2,000 debentures out of its profits. Pass necessary journal entries in the books of Neel Limited on redemption of debentures. **(2 marks)**

Answer:

Journal Entries in the books of Neel Limited on redemption of debentures

5th Year Dec. 31	Particulars		Dr. (₹)	Cr. (₹)
I	Debentures A/c	Dr.	20,000	
	To Debentureholders A/c			20,000
	(Being the amount due on redemption of debentures) 2,000 × 10			

II	Profit & Loss Appropriation A/c Dr. To Debenture Redemption Reserve A/c (Being the transfer of Profit to Debenture Redemption Reserve A/c as per SEBI guidelines)	20,000	20,000
III	Debentureholders A/c Dr. To Bank A/c (Being the amount paid to debenture-holders)	20,000	20,000

Space to write important points for revision

2015 - June [3] (a) Answer the question:

(ii) Vikash Ltd. resolved by a special resolution to buy-back its 5,00,000 equity shares of ₹ 10 each (paid up value ₹ 8) at a premium of ₹ 15 per share. At the time of buy-back the following balances appeared in its books:

	₹
Securities Premium Account	60,00,000
General Reserve Account	50,00,000
Profit and Loss Account (Cr.)	45,00,000

The company utilized the whole of the securities premium for buy-back purpose.

You are required to pass the necessary journal entries in the books of the company. **(4 marks)**

Answer:

Buy Back of Shares
Journal Entries in the books of Vikash Limited

I	Equity share final call A/c Dr. To Equity share capital A/c (Being final call money due for 5,00,000 equity shares @ ₹ 2 per share)	10,00,000	10,00,000
II	Bank A/c Dr. To Equity share final call A/c (Being final call money received for 5,00,000 equity shares @ ₹ 2 per share)	10,00,000	10,00,000

III	Equity shareholders A/c Dr. To Bank A/c (Being amount paid on buy back of shares @ ₹ 25 per share)	1,25,00,000	 1,25,00,000
IV	Equity share capital A/c Dr. Securities premium A/c Dr. General Reserve A/c Dr. To Equity Shareholders A/c (Being cancellation of 5,00,000 equity shares on buy back)	50,00,000 60,00,000 15,00,000	 1,25,00,000
V	General Reserve A/c Dr. Profit & Loss A/c Dr. To Capital Redemption Reserve A/c (Being transfer of General Reserve of ₹ 35,00,000 & ₹ 15,00,000 to cover the nominal amount of shares brought back to Capital Redemption Reserve A/c)	35,00,000 15,00,000	 50,00,000

Space to write important points for revision

2015 - June [3] (c) Answer the question:

(ii) Seth Co. Ltd. issued 20,000 shares which were underwritten as: Ram: 12,000 shares, Raghu: 5,000 shares and Ravi: 3,000 shares. The underwriters made applications for firm underwriting as follows: Ram: 1,600 shares; Raghu: 600 shares; Ravi: 2,000 shares. The total subscriptions excluding firm underwriting (including marked applications) were 10,000 shares. The marked applications were: Ram: 2,000 shares; Raghu: 4,000 shares; Ravi: 1,000 shares. Show the net liability of underwriters (number of shares).

(6 marks)

Answer:

Statement showing the liability of under writers

No. of shares

Underwriters	Ram	Raghu	Ravi
Gross liability	12,000	5,000	3,000
Less: Marked Applications (excluding firm under writing)	2,000	4,000	1,000
	10,000	1,000	2,000
Less: Unmarked applications in the ratio of gross liability (Note - 1)	4,320	1,800	1,080
Resultant liability or surplus	5,680	(800)	920
Less: Surplus of B allocated to A&C in the ratio of 12:3	(640)	800	(160)
Net liability as per agreement	5,040	Nil	760
Add: Firm underwriting	1,600	600	2,000
Total liability	6,640	600	2,760

Working Notes:

Under this method, firm underwriting is treated as "unmarked application" and it is dividend in the ratio of gross liability. Total unmarked applications are calculated as follows:

1. Calculation of Unmarked Applications:

Total subscriptions (excluding firm underwriting)	10,000
Less: Marked application (excluding firm underwriting)	7,000
Unmarked application by public	3,000
Add: Application under firm underwriting	4,200
Total unmarked applications	7,200

Unmarked Applications are allotted in the ratio of gross liability = 12:5:3

2. Total Allocation of Shares:

Unmarked Application by Public	3,000
Marked Application by Public	7,000
Total liability (6,640 + 600 + 2,760)	10,000
	20,000

2015 - Dec [1] Answer the questions:

(d) Mahi Ltd. taken a loan of ₹ 15,00,000 from the SBI by issuing 25000, 12% Debentures of ₹ 100 each as collateral security. Pass the necessary journal entries in the books of company. **(2 marks)**

(f) On 1st June, 2015 Suku Ltd. purchased 250 of its own 12% debentures from the open market at ₹ 97 (cum-interest) each for immediate cancellation. Face value of each debenture is ₹ 100. Debenture interest is payable on 30th June and 31st December every year. Pass necessary journal entry to record the above transaction. **(2 marks)**

Answer:

(d) **Journal of Mahi Ltd.**

Particulars		**(₹)**	**(₹)**
Bank A/c	Dr.	15,00,000	
To Bank Loan A/c			15,00,000
(Loan taken from SBI)			
Debenture Suspense A/c	Dr.	25,00,000	
To 12% Debentures A/c			25,00,000
(12% Debentures worth ₹ 20 Lakhs issued as collateral security for a Loan from SBI as per Board's Resolution No…… Date)			

(f)

Particulars		**Dr. (₹)**	**Cr. (₹)**
12% Debentures A/c (250 x ₹ 100)	Dr.	25,000	
Debenture Interest A/c	Dr.	1,250	
To Bank A/c (250 x ₹ 97)			24,250
To profit on Redemption of Debentures A/c			2,000
(250 debentures cancelled by purchase from open market)			

Accrued Interest upto 1.6.2015 = 250 x 100 x $\frac{12}{100} \times \frac{5}{12}$ = ₹ 1,250.

—— Space to write important points for revision ——

2015 - Dec [3] Answer the questions:

(a) (i) On 31st March 2015, following was the Balance Sheet of FCS Limited:

Liabilities	₹ (in lakhs)	Assets	₹ (in lakhs)
Equity Share Capital (₹ 10)	2,400	Machinery	3,600
Securities Premium	350	Furniture	452
General Reserve	930	Investments	148
Profit and Loss Account	340	(Face Value	
Current Liabilities	2,640	₹ 200 lakhs)	
		Current Assets	2,460
	6,660		**6,660**

On 1st April, 2015 the company announced the buy-back of 25% of its equity shares @ 15 per share. For this purpose, it sold all of its investments for ₹ 150 Lakhs and issued 2,00,000, 14% preferences shares of ₹ 100 each at par, the entire amount being payable with application.

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

Required: Show journal entries for all transactions including cash transactions. **(10 marks)**

(b) (ii) Sonic Ltd. incorporated on 1st June, 2015 issued a prospectus inviting applications for 10,00,000 equity shares of ₹ 10 each. The whole issue was fully underwritten by four underwriters:

	S	T	U	V
Underwriter	4,00,000 shares	3,00,000 shares	2,00,000 shares	1,00,000 shares

Applications were received for 9,00,000 shares of which marked applications were as follows:

	S	T	U	V
Underwriter	4,40,000 shares	1,80,000 shares	2,20,000 shares	20,000 shares

Find out the liability of each underwriter individually. **(6 marks)**

Answer:

(a) (i) **In the books of FCS Ltd.**

Journal Entries

(₹ In Lakhs)

Date	Particulars	L.F.	Dr.(₹)	Cr.(₹)
1.	Bank A/c Dr. To Investments A/c (Being the Sale of investments)		150	150
2.	Investments A/c Dr. To Profit and Loss A/c (Being the t/f of Profit on sale of Investments)		2	2
3.	Bank A/c Dr. To 14% Preference Share Application & Allotment A/c (Being the Application money received)		200	200
4.	14% Preference Share Application & Allotment A/c Dr. To 14% Preference Share Capital A/c (Being the Allotment of shares)		200	200
5.	Equity Shares Buy Back A/c Dr. To Bank A/c (Being the payment made to equity shareholders on buy-back)		900	900
6.	Equity Share Capital A/c Dr. Securities Premium A/c Dr. To Equity Shares Buy Back A/c (Being the cancellation of share bought back)		600 300	900

7.	General Reserve A/c Dr. To Capital Redemption Reserve A/c (Being creation of Capital Redemption Reserve A/c to the extent of the face value of equity shares bought back)		600	 600
8.	Capital Redemption Reserve A/c Dr. Securities Premium A/c Dr. To Bonus Issue A/c (Being the utilisation of Capital Redemption reserve and securities premium to issue one bonus share for every four shares held)		400 50	 450
9.	Bonus Issue A/c Dr. To Equity Share Capital A/c (Being the Issue of one bonus share for every four equity shares)		450	 450

Note: *Amount of Bonus Issue = 25% of (2400 - 25% of 2400) = ₹ 450 lakhs.*

(b) (ii) Statement of Underwriters' Liability

Particulars	S	T	U	V	TOTAL
Gross Liability	4,00,000	3,00,000	2,00,000	1,00,000	10,00,000
Less: Marked Applications	4,40,000	1,80,000	2,20,000	20,000	8,60,000
Balance Left	(40,000)	1,20,000	(20,000)	80,000	1,40,000
Less: Unmarked Application	16,000	12,000	8,000	4,000	40,000
Applications in the ratio of gross liability	(56,000)	1,08,000	(28,000)	76,000	1,00,000
Division of surplus of S and U to T and V in the ratio of (3:1)	(56,000)	(63,000)	28,000	(21,000)	0
Net Liability	NIL	45,000	NIL	55,000	1,00,000

2016 - June [5] (a) The following balances were shown in the Balance Sheet of Anukula Limited as at 31st March, 2015:

	₹
8,00,000 Equity Shares of ₹ 10 each fully paid up	80,00,000
50,000 8% Preference Shares of ₹ 100 each ₹ 80 paid up	40,00,000
Capital Reserve	35,00,000
General Reserve	80,00,000
Securities Premium	70,00,000
Profit & Loss Account	52,00,000
12% Debentures	10,00,000
Non-Current Investment at cost	65,00,000
Cash and Bank	92,00,000

Additional Information:

(i) The company passed a resolution to buy-back 20% of its equity capital @ ₹ 35 per share. For this purpose, it sold its investments of ₹ 30 lakhs for ₹ 28 lakhs.

(ii) The company redeemed the preference shares at a premium of 25%.

(iii) Included in its investments were 'Investments in own debentures' costing ₹ 10 lakhs (face value ₹ 11.50 lakhs). These debentures were cancelled.

You are required to pass necessary journal entries in the books of the company for above. **(10 marks)**

Answer:

(a) Journal Entries In the Books of Anukula Ltd:

(₹ in Lakhs)

	Particulars	Dr.	Cr.
1.	Bank A/c Dr. Profit and Loss A/c Dr. To Investment A/c (Being investment sold for the purpose of buy-back of Equity Shares)	28 2	 30

2.	Preference Share Final Call A/c Dr. To 8% Preference Share Capital A/c (Being call money due)	10	 10
3.	Bank A/c Dr. To Preference Share Final Call A/c (Being call money received)	10	 10
4.	8% Preference Share Capital A/c Dr. Premium on Redemption of Preference Shares A/c Dr. To Preference Shareholders A/c (Being redemption of preference share capital at premium of 25%)	50 12.50	 62.50
5.	Preference Shareholders A/c Dr. To Bank A/c (Being payment made to preference shareholders)	62.50	 62.50
6.	General Reserve A/c Dr. To Capital Redemption Reserve A/c (Refer Note) (Being creation of capital redemption reserve)	66	 66
7.	Equity Share Capital A/c Dr. Securities Premium A/c Dr. (Premium payable on buy-back) To Equity Shares Buy-back A/c (Being the amount due on buy-back of equity shares)	16 40	 56
8.	Equity Shares Buy-back A/c Dr. To Bank A/c (Being payment made for buy-back of equity shares)	56	 56
9.	12% Debentures A/c Dr. To Own Debentures A/c To Capital Reserve A/c (Profit on cancellation) (Being own debentures cancelled at profit)	11.5	 10 1.50

10.	Securities Premium A/c Dr. To Premium on Redemption of Preference Shares A/c (Being premium on redemption of preference shares adjusted through securities premium)	12.50	12.50

Note: Transfer to Capital Redemption Reserve A/c as:

	₹
For Redemption of P.S. Capital	50 lakhs
For Buy-back of Equity Shares	16 lakhs
Total	66 lakhs

Space to write important points for revision

2016 - Dec [7] (a) APC Ltd. has 12% redeemable preference share capital of ₹ 1,00,000 consisting shares of ₹ 100 each fully called and paid-up. The company wants to redeem them at 10% premium.

The ledger accounts show the following balances:

Securities Premium A/c: ₹ 4,000

Profit & Loss A/c: ₹ 20,000

The company wants to make a minimum fresh issue of equity shares of ₹ 10 each at 5% premium for redemption of the preference shares.

You are required to:

(i) Ascertain the amount of fresh issue to be made by the company;

(ii) Pass necessary journal entries regarding redemption of the preference shares and fresh issue. **(10 marks)**

Answer:

Calculation showing number of equity shares to be issued —

Total Liability = Preference Share Capital to be redeemed

= Profit and Loss Account balance + Securities Premium + Proceeds of fresh issue

Let, Numbers equity shares to be issued be X

∴ ₹ 1,10,000 = ₹ 4,000 + ₹ 20,000 + [1.05 X × ₹10]

Or, ₹10.5 X = ₹(1,10,000 – 4,000 – 20,000)

Or, X = ₹ 86,000 / ₹10.5

Or, X = 8,190

Hence, amount of fresh issue —

No. of shares to be issued 8,190

Equity Share Capital = 8,190 × ₹10	= ₹ 81,900
Securities Premium [₹10 × 5%] × 8,190	= ₹ 4,095
	₹ 85,995

APC Ltd.
Journal Entries

Particulars		Dr. (₹)	Cr. (₹)
Bank A/c	Dr.	85,995	
To Equity Share Capital A/c			81,900
To Securities Premium A/c			4,095
(8190 equity shares of ₹10 each at a premium of 5%)			
Securities Premium A/c	Dr.	8,095	
Profit & Loss A/c		1,905	
To Premium on Redemption of Preference Shares A/c			10,000
(Premium provided for redemption)			
Profit & Loss A/c	Dr.	18,100	
To Capital Redemption Reserve A/c			18,100
(Amount transferred to capital redemption reserve not covered by fresh issue)			
12% Redeemable Preference Share Capital A/c	Dr.	1,00,000	
Premium on Redemption of Preference Shares A/c	Dr.	10,000	
To Preference Shareholders A/c			1,10,000
(Redemption of preference shares made)			
Preference Shareholders A/c	Dr.	1,10,000	
To Bank			1,10,000
(Payment made)			

2017 - June [2] (a) A joint stock company resolved to issue 5 lakh equity shares of ₹ 10 each at a premium of ₹ 1 per share. 50000 of these shares were taken up by the directors and their relatives, the entire amount being received forthwith. The remaining shares were offered to the public, the entire amount being asked for with applications.
The issue was underwritten by P, Q and R for a commission of 2% of the issue price. 65% of the issue was underwritten by P, while Q and R's share were 25% and 10% respectively.
Their firm underwriting was as follows:
P 15000 shares, Q 10000 shares and R 5000 shares. The underwriters were to submit unmarked applications for shares underwritten firm with full application money along with the members of the general public.
Marked applications were as follows: P 59750 shares, Q 28750 shares and R 5250 shares. Unmarked applications totaled 350000 shares.
Accounts with the underwriters were promptly settled.
You are required to prepare a statement calculating liability of the Underwriters for shares other than shares underwritten Firm and also calculate the amount due from/to the Underwriters. **(8 marks)**

Answer :

Statement Showing the Liability of underwriters

Underwriters	P	Q	R	Total
Gross Liability	2,92,500	1,12,500	45,000	4,50,000
Less: Marked Application (excluding firm underwriting)	59,750	28,750	5,250	(93,750)
	2,32,750	83,750	39,750	3,56,250
Less: Unmarked Applications (in the ratio of gross Liability)	2,27,500	87,500	35,000	(3,50,000)
Result and Liability	5,250	(3,750)	4,750	6,250
Less: Surplus of a allocated to P & R (65:10)	(3,250)	(3,750)	(500)	—
Net Liability as per agreement	2,000	Nil	4,250	6,250
Add: Firm underwriting	15,000	10,000	5,000	30,000
Total Liability	17,000	10,000	9,250	36,250

Workings: Calculation of amount due from/to underwriters

Particulars	P	Q	R
No. of shares to be subscribed as per agreement (exc. Firm)	2,000	Nil	4,250
Amount payable @₹ 11	22,000	Nil	46,750
Underwriting commission @ 2%			
P: (292500 × 11× 2%)	64,350		
Q: (112500 × 11× 2%)		24,750	
R: (45000 × 11 × 2%)			9,900
Amount (paid)/received	(42,350)	(24,750)	36,850

—— Space to write important points for revision ——

2017 - Dec [2] (a) R Ltd. wants to buy-back 100000 equity shares of ₹ 10 each at a price of ₹ 20 each on 01.04.2017. The buy-back is allowed in its articles of association and the company has obtained necessary approval from the shareholders. The company has sufficient bank balance to make the payment for buy-back of shares.

The following information is available as on 31.03.2017:

	₹
Equity Share Capital (₹ 10 each fully paid)	50,00,000
General Reserve	60,00,000
Dividend Equalization Reserve	10,00,000
Balance of Profit and Loss (Cr.)	5,00,000
10% Debentures (₹ 100 each)	75,00,000
Bank Loan	40,00,000
Current Liabilities	66,00,000

Verify whether the buy-back plan of the company meets the conditions specified by the Companies Act 2013 as regards to the maximum amount of buy-back. Also pass necessary journal entries in the books of the company to give effect of the process, if the plan is found to be in place. **(9 marks)**

Answer:

Determination of maximum buyback permissible as per Companies Act 2013:

1. **Shares Outstanding Test:** Max. Permissible Limit = 25% of Outstanding Shares

Particulars	
Total number of shares outstanding	5,00,000
25% of the shares outstanding	1,25,000

2. **Resource Test:** Max. Permissible Limit = 25% of Paid up Capital plus Free Reserves

Particulars	
Equity share capital (₹)	50,00,000
Free Reserve (₹) (General Reserve + DER +P/L)	75,00,000
Paid up Capital plus Free Reserves (₹)	125,00,000
25% of Paid up Capital plus Free Reserves (₹)	31,25,000
Buy back price per share (₹)	20
No. of shares that can be bought back (31,25,000/20)	1,56,250

3. **Debt Equity Ratio Test:** Debt after buyback cannot exceed twice the paid up capital plus free reserves.

Particulars	
Total Debt (₹) (75,00,000 + 40,00,000 + 66,00,000)	181,00,000
Minimum Equity to be maintained after buyback in the ratio 2:1 (₹)	90,50,000
Paid up capital plus free reserves before buyback (₹)	125,00,000

Future Paid up capital plus free reserves (₹) (see working note: 1) (125,00,000 - 11,50,000)	113,50,000
Maximum permissible buyback (₹) (113,50,000 - 90,50,000)	23,00,000
Buy back price per share (₹)	20
No. of shares that can be bought back	1,15,000

Summary of three test results:

	No. of Shares
Permissible Buyback as per -	
Share Outstanding Test	1,25,000
Resource Test	1,56,250
Debt-Equity Ratio Test	1,15,000
Maximum permissible buyback (least of the three)	1,15,000
Actual buyback plan	1,00,000

Since actual buyback proposed is below the permissible limit, the company can buy back 100000 shares at ₹ 20 each.

Working Note 1:

In case buyback of shares is done out of free reserves and securities premium, a company is required transfer a sum equal to the nominal value of the shares buyback to Capital Redemption Reserve A/C. Thus shareholders' fund after buyback includes CRR. Now CRR is not a free reserve. Hence it cannot form part of paid up capital plus free reserve after buyback.

Let nominal value of shares bought back is x. Then CRR after buyback is x. Moreover total premium on buyback = x (₹ 10 face value and ₹ 20 buyback price, so premium on buyback ₹ 10). So total amount to be deducted from shareholders' fund for buyback = x (capital) +x (premium) = 2x. Moreover free reserves to be reduced by x.

Total paid up capital plus free reserves after buyback = 125,00,000 – x (i.e. CRR) – 2x (i.e. buyback proceeds)

Conditionally, 125,00,000 - x - 2x = 90,50,000, or, x = 11,50,000 Nominal value of buyback = 11,50,000 (i.e. CRR)

Journal

Date	Particular	Dr. (₹)	Cr. (₹)
1.4.2017	Equity Share Buyback A/c Dr. To Bank A/c (Being buyback of 100000 shares of ₹ 10 each at ₹ 20 per share.)	20,00,000	 20,00,000
1.4.2017	Equity Share Capital A/c Dr. General Reserve A/c To Equity Share Buyback A/c (Being cancellation of shares bought back and premium on buyback provided out of General Reserve)	10,00,000 10,00,000	 20,00,000
1.4.2017	General Reserve A/c Dr. To Capital redemption Reserve A/c (Being nominal value of shares bought back transferred to CRR)	10,00,000	 10,00,000

Space to write important points for revision

2018 - June [2] (a) On 01.01.2017 Jay Ltd. had 2,000, 12% Debentures of ₹ 100 each. On 01.05.2017 the company purchased 400 own Debentures at ₹ 97 cum-interest in the open market. Interest on debentures is payable on 30th June and 31st December each year.

Required: Give the necessary journal entries assuming that the own Debentures purchased were retained as investments till 31.12.2017, on which date they were cancelled.

Assume that the company follows English Calendar Year. **(6 marks)**

Answer:

Journal of Jay Ltd.

Date	Particulars	L.F.	Dr.(₹)	Cr.(₹)
May 01	Own Debentures A/c Dr. Interest on Own Debenture A/c Dr. To Bank A/c (Being the purchase of 400 debentures @ ₹ 97 cum - interest)		37,200 1,600	 38,800

June 30	Debentures Interest A/c Dr. To Interest on Own Debentures A/c To Bank A/c (Being the interest paid / credited on ₹ 2,00,000 debentures held by outsiders and by the company own debentures for 2 months).		12,000	 2,400 9,600
Dec. 31	Debentures Interest A/c Dr. To Bank A/c To Interest on Own Debentures A/c (Being the interest paid / credited on ₹ 1,60,000 debentures held by outsiders and ₹ 40,000 own debentures for six months)		12,000	 9,600 2,400
Dec. 31	Profit and Loss A/c Dr. To Debenture Interest A/c (Being the transfer of debenture interest to P & L A/c)		24,000	 24,000
Dec. 31	Interest on Own Debentures A/c Dr. To Profit and Loss A/c (Being the transfer of interest on own debentures to P & L A/c)		3,200	 3,200
Dec. 31	12% Debentures A/c Dr. To Own Debentures A/c To Capital Reserve A/c (Being the cancellation of 400 own debentures)		40,000	 37,200 2,800
Dec. 31	Profit and Loss Appropriation A/c Dr. To Debenture Redemption Reserve A/c (Being the transfer of an amount equivalent to the cash sum applied in redeeming the debentures)		37,200	 37,200

2018 - Dec [2] (a) Following is the extract of the Balance Sheet of Xeta Ltd. as at 31st March, 2017:

Authorised Capital:	
50,000 12% Preference shares of ₹ 10 each	5,00,000
4,00,000 Equity shares of ₹ 10 each	40,00,000
	45,00,000
Issued and Subscribed Capital:	
24,000 12% Preference shares of ₹ 10 each fully paid	2,40,000
2,70,000 Equity shares of ₹ 10 each, ₹ 8 paid up	21,60,000
Reserves and Surplus:	
General Reserve	3,60,000
Securities Premium	1,00,000
Profit and Loss Account	6,00,000

On 1st April, 2017, the Company has made final call @ 2 each on 2,70,000 Equity shares. The call money was received by 20th April, 2017. 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 30th April, 2017 after bonus issue.

(7 marks)

Table Showing Marks of Compulsory Questions										
Year	**14 J**	**14 D**	**15 J**	**15 D**	**16 J**	**16 D**	**17 J**	**17 D**	**18 J**	**18 D**
Descriptive	4									
Total	4									

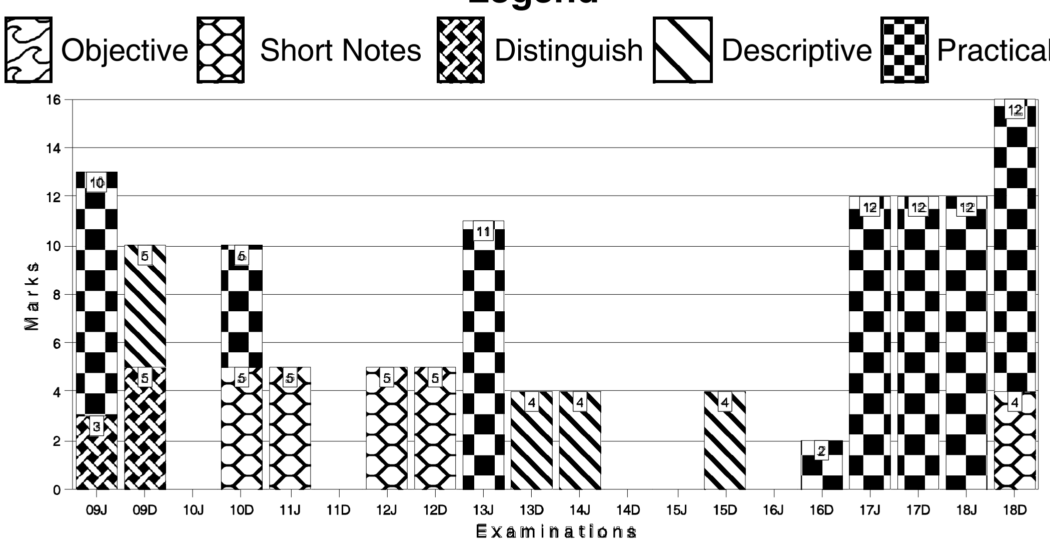
2 PRESENTATION OF FINANCIAL STATEMENTS

THIS CHAPTER INCLUDES

- Meaning of Financial Statements
- Objective of Financial Statements
- Components of Financial Statements
- Users and their Information Needs
- Statement of Profit and Loss Account
- Balance Sheet
- Schedule III:
  - Part I – Form of Balance Sheet;
  - Part II– Form of Statement of Profit and Loss;

Marks of Objective, Short Notes, Distinguish Between, Descriptive & Practical Questions

Legend



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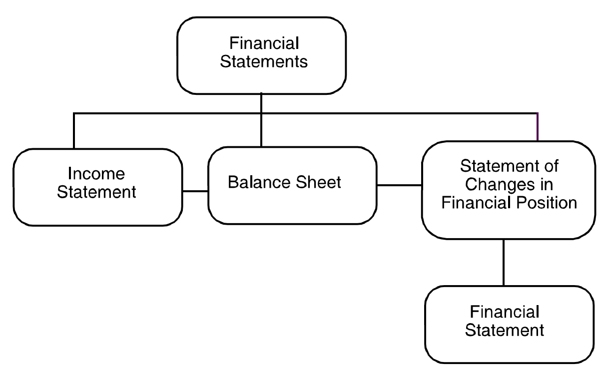
for registration and password see first page of this book.

CHAPTER AT A GLANCE

S. No.	Topic	Important Highlights
1.	**Meaning and Objective of Financial Statement**	Financial statements are compilation of financial data, collected and classified in a systematic manner according to the accounting principles, to assess the financial position of an enterprise as regards to its profitability, operational efficiency, long and short – term solvency and growth potential. Financial statements are basic and formal means through which management of an enterprise make public communication of financial information along with select quantitative details. They are structured financial representation of the financial position, performance and cash flows of an enterprise. Many users are rely on the general purpose financial statements as the major source of financial information and therefore, financial statements should be prepared and presented in accordance with their requirement.
2.	**Component of Financial Statement**	

3	**Statement of Profit and Loss**	**Name of the Company............................ Profit and Loss Statement for the year ended:.............. (₹ in..........)**				
			Particulars	**Note No.**	**Figures for the Current Reporting Period**	**Figures for the Previous Reporting Period**
		I	Revenue from Operations		xxx	xxx
		II	Other Income		xxx	xxx
		III	**Total Revenue (I+II)**		**xxx**	**xxx**
		IV	**Expenses:**			
			Cost of Materials Consumed		xxx	xxx
			Purchases of Stock-in-Trade		xxx	xxx
			Changes in Inventories of Finished Goods/Work-in-progress and Stock-in-Trade		xxx	xxx
			Employee Benefits Expense			
			Finance Costs			
			Depreciation and Amortization Expense			
			Other Expense			
			Total Expenses		**xxx**	**xxx**
		V	Profit before Exceptional & Extraordinary Items and Tax (III-IV)		xxx	xxx
		VI	Exceptional Items		xxx	xxx

		VII	Profit before Extraordinary Items and Tax (V-VI)		xxx	xxx
		VIII	Extraordinary Items		xxx	xxx
		IX	Profit before Tax (VII-VIII)		xxx	xxx
		X	Tax Expenses: (1) Current Tax (2) Deferred Tax		xxx xxx	xxx xxx
		XI	Profit/(Loss) for the period from Continuing Operations (IX-X)		xxx	xxx
		XII	Profit/(Loss) from Discontinuing Operations		xxx	xxx
		XIII	Tax Expense of Discontinuing Operations		xxx	xxx
		XIV	Profit/(Loss) from Discontinuing Operations (After Tax) (XII-XIII)		xxx	xxx
		XV	Profit/(Loss) for the period (XI + XIV)		xxx	xxx
		XVI	Earnings per Equity Share: (1) Basic (2) Diluted		xxx	xxx

4.	**Balance Sheet**	**Part I - From of Balance Sheet** **Name of the Company ....** **Balance Sheet as at: .... (₹ in..........)**				
			Particulars	**Note**	**Figures as at the end of Current Reporting Period**	**Figures as at the end of the Previous Reporting Period**
					₹	₹
		I. (1)	Equity and Liabilities Shareholders' Funds (a) Share Capital (b) Reserves & Surplus (c) Money Received against Share Warrants Share Application money pending allotment			
		(2)	Non-Current Liabilities			
		(3)	(a) Long Term Borrowings (b) DTL (Net) (c) Other Long Term Liabilities (d) Long Term Provisions			
		(4)	Current Liabilities (a) Short Term Borrowings (b) Trade Payables (c) Other Current Liabilities (d) Short Term Provisions			
			Total			

			Assets			
		(1)	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) DTA (Net)			
			(d) Long Term Loans & Advances			
			(e) Other Non-Current Assets			
		(2)	Current Assets			
			(a) Current Investments			
			(b) Inventories			
			(c) Trade Receivables			
			(d) Cash & Cash Equivalents			
			(e) Short Term Loans & Advances			
			(f) Other Current Assets			
			Total			

For the purpose of this Schedule, the terms used herein shall be as per the applicable Accounting Standards.

SHORT NOTES

2010 - Dec [8] Write a short note on

(d) Contingent liability. **(5 marks)**

Answer:

As per the accounting standard, a contingent liability is a possible obligation that arises from past event and existence of which will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise. To be called contingent liability the following conditions must be fulfilled:

- possible obligation as a result of past event,
- existence of which will be confirmed only by the occurrence or non-occurrence of future event,
- future event not wholly within the control of the enterprise.

—— Space to write important points for revision ——

2011 - June [8] Write a short note on :

(b) Treatment of past losses of limited companies; **(5 marks)**

Answer :

Treatment of Past losses of the company.

If a company Incurs a loss in any financial year falling after 28th December, 1960 then;

(i) The amount of loss, or

(ii) An amount which is equal to the amount provided for depreciation for that year or those years, whichever is less, must be set off against:

(a) The profits of the company, after providing for prescribed depreciation for the year for which dividend is proposed to be declared or

(b) The profits of the company for any previous financial year or years arrived at after providing for the prescribed depreciation; or

(c) The aggregate of (a) and (b) together.

—— Space to write important points for revision ——

2012 - June [8] Write a short note on:

(c) Objectives of Financial Statements; **(5 marks)**

Answer :

The main objectives in preparing the financial statements are as follows:

1. To provide financial information that is useful in making rational investment, credit and similar decisions.
2. To provide financial information to enable users to predict cash flows to the business.
3. To provide financial information about business resources (assets), claims to these resources (liabilities and owner's equity) and changes in these resources and claims.

—— Space to write important points for revision ——

2012 - Dec [8] Write a short note on:

(d) Contingent liability. **(5 marks)**

Answer :

Contingent liability can be termed as an obligation relating to an existing condition or situation which may arise in future depending on the occurrence or non- occurrence of one or more uncertain future events- For example, a company may have certain pending litigation, assessments made by tax authorities which are being contested etc, Which might result in company incurring financial liability in future and in all such cases, the amounts involved are shown as contingent liability.

Contingent liabilities are classified under the following head:-

(i) Claims against the company not acknowledged as debts
(ii) Uncalled liability on shares partly paid
(iii) Arrears of fixed cumulative dividend
(iv) Estimated amount of contracts remaining unexecuted on capital account not provided for, and
(v) Other money for which the company is liable contingently

—— Space to write important points for revision ——

2018 - Dec [5] Write a short note on:

(d) Schedule III disclosure requirement in respect of cash and cash equivalents. **(4 marks)**

DISTINGUISH BETWEEN

2009 - June [1] {C} (a) Distinguish between liability and provisions.
(3 marks)

Answer :

Liabilities	Provision
1. If an amount is payable in future and is exact it is a liability. 2. Eg:- Purchasing an asset and payment in installment creates a liability.	1. Provision is also a liability but the amount is measured by using a substantial degree of estimation. 2. Eg: For doubtful debts provision is required to be provided for.

Space to write important points for revision

2009 - Dec [6] (b) Distinguish between Reserve and Provisions. **(5 marks)**

Answer :

Reserves	Provisions
1. It is an appropriation of profit and doesn't affect the amount of net profit.	1. It is charge against profit and reduces the amount of net profit.
2. It is created to strengthen financial position and to meet unforeseen losses.	2. It is created to meet known liability of which the amount cannot be determined with substantial accuracy.
3. It is created only when profit earned.	3. It is created and charged to profit and loss Account even if there is a loss.
4. It can be invested outside the business and in that case, it is called a fund.	4. It cannot be invested.

Space to write important points for revision

DESCRIPTIVE QUESTIONS

2009 - Dec [7] (b) State the respective heads of the following items in the Balance sheet of a company:

(i) Loose Tools, (iii) Mortgage loan, (iv) Interest Accrued but not due on loans. (v) Public Deposit. **(5 marks)**

Answer :

(i) Loose Tools: Non Current Assets,

(iii) Mortgage loan : Non Current Liabilities

(iv) Interest Accrued but not due on loans: Current liabilities:
(A) Current Liabilities.

(v) Public deposits: Non Current Liabilities.

—— Space to write important points for revision ——

2013 - Dec [2] (c) (i) What are the characteristics of a liability? **(4 marks)**

Answer:

Characteristics of a Liability :

(i) Normally liability arises from present obligation. But future obligation may also create liability if they are irrevocable. A forward contract to buy goods is irrevocable; therefore, gain or loss on such contract is evaluated and recognized as an asset or a liability.

(ii) Liabilities result from past transactions or other past events. Even an irrevocable future obligation arises from past transactions or commitment (event) only.

(iii) Normally liabilities are measurable in money terms. Sometimes liabilities are estimated which are termed as provisions. Framework defines the term liability broadly that includes provisions.

(iv) Statement of liability means giving up resources embodying economic benefits. Liabilities are settled in any of the following ways :
- payment cash or transfer of other assets;
- provision of services;
- replacement by a new obligation;
- conversion of an obligation into equity;
- extinguished by way of waiver from the creditors.

—— Space to write important points for revision ——

2014 - June [1] {C} Answer the following:

(a) State the two main accounting assumptions, on which financial statements are prepared and presented. **(2 marks)**

Answer:

Accounting Assumption: Underlying assumptions for the preparation and presentation of financial statements are accrual and going concern. Under **accrual assumption**, the effects of transactions and other events are recognised when they occur (and not as cash or its equivalent is received or paid) and they are recorded in the books of account and reported in the financial statements of the periods to which they relate. It helps in performance measurement in a better manner and identifying the financial position appropriately.

Under **going concern assumption**, the financial statements are normally prepared on the assumption that an entity is a going concern and will continue in operation for the foreseeable future. Therefore, it is assumed that the entity has neither the intention nor the need to liquidate or curtail materially the scale of its operations; if such an intention or need exists, the financial statements may have to be prepared on a different basis. In case going concern basis could not be used, the entity shall disclose the basis used as well.

—— Space to write important points for revision ——

2014 - June [3] {C} Answer the following:

(b) Name four items which are required to be disclosed under the head 'Inventories' as per Schedule III disclosure requirement. **(2 marks)**

Answer:

Inventories

Schedule III Disclosure Requirement	Points
Inventories shall be classified as: (a) Raw Materials, (b) Work In Progress, (c) Finished Goods, (d) Stock-in-Trade, (e) Stores and Spares, (f) Loose Tools,	• Goods in Transit should be included under relevant heads with suitable disclosure. • The heading "Finished Goods" should comprise of all Finished Goods other

(g) Others (specify nature) **Note:** Goods-in-Transit shall be disclosed under the relevant sub-head of Inventories. Mode of Valuation shall be stated.	than those acquired for trading purposes. Those acquired for trading purposes are to be shown under "Stock in Trade".

—— Space to write important points for revision ——

2015 - Dec [2] (a) Answer the following:

(ii) What are the characteristics of a Liability? **(4 marks)**

Answer:

Please refer 2013 - Dec [2] (c) (i) on page no. 109

—— Space to write important points for revision ——

PRACTICAL QUESTIONS

2009 - June [2] (a) Prepare the Balance Sheet as at 31st March, 2008 from the particulars furnished by Vision Ltd., as per Schedule III of Companies Act.

	₹
Equity Share Capital (₹10 each fully paid)	8,00,000
Calls in arrear	800
Land	1,60,000
Building	2,80,000
Plant & Machinery	4,20,000
Furniture	40,000
General Reserve	1,68,000
Loan from IDBI	1,20,000
Loans (Unsecured)	96,800
Provision for Taxation	54,400
Sundry Debtors	1,60,000
Advances (Dr.)	34,160
Proposed dividend	48,000
Profit & Loss A/c.	80,000
Cash balance	24,000

Cash at Bank		1,97,600
Preliminary Expenses		10,640
Sundry Creditors (For goods & expenses)		1,60,000
Stock :		
Finished goods	1,60,000	
Raw material	40,000	2,00,000

Adjustment:

(i) 1500 equity shares were issued for consideration other than cash.

(ii) Loan of ₹ 1,20,000 from IDBI is inclusive of ₹ 6,000 for interest accrued but not due. The loan is hypothecated by plant & machinery.

(iii) Debtors of ₹ 50,000 are due for more than six months.

(iv) The cost of assets :

	₹
Building	3,20,000
Plant & Machinery	5,60,000
Furniture	50,000

(v) Bank balance includes ₹ 2,000 with Trust Bank Ltd., which is not a scheduled Bank.

(vi) Bills receivable for ₹ 2,20,000 maturing on 30th June, 2008 have been discounted.

(vii) The company had contract for the erection of machinery at ₹ 1,50,000 which is still incomplete. **(10 marks)**

Answer :

Balance Sheet of Vision Ltd.
as on 31st March, 2008

Particulars	Note No.	Figures as at the end of current reporting period	Figures as at the end of previous reporting period
I. EQUITY AND LIABILITIES			
1. Shareholders' Funds			
(a) Share Capital	1	7,99,200	
(b) Reserves and Surplus	2	2,85,360	
(c) Money received against share warrants			

2. Share application money pending allotment			
3. Non-Current Liabilities			
(a) Long-term borrowings	3	2,10,800	
(b) Other Long term Liabilities			
(d) Long term provisions			
4. Current Liabilities			
(a) Short-term borrowings			
(b) Trade payables	—	1,60,000	
(c) Other current liabilities	4	6,000	
(d) Short--term provision		54,400	
Total		**15,15,760**	
II. Assets			
1. Non Current Assets			
(a) Fixed assets	5	9,00,000	
(i) Tangible assets			
(ii) Intangible assets			
(iii) Capital Work-in-progress			
(iv) Intangible assets under development			
(b) Non-current investment			
(c) Deferred tax assets (net)			
(d) Long term loans and advances			
(e) Other Non Current Assets			
2. Current Assets			
(a) Current investments			
(b) Inventories			
(c) Trade receivables	6	2,00,000	
(d) Cash and cash equivalents	7	1,60,000	
(e) Short-term loans and advances	8	2,21,600	
(f) Other current assets	—	34,160	
Total		**15,15,760**	

Note:	
Contingent Liability & Commitment-	
B/R discounted	*2,20,000*
Contract for erection of- Machinery	*1,50,000*
	3,70,000

Notes on Account:

1. Share Capital				
Issue, Subscribed & Paid up Capital				
80,000 Share for ₹ 10 Each	8,00,000			
Less: Unpaid calls	800		7,99,200	
2. Reserve & Surplus				
General Reserve			1,68,000	
P&L			69,360	
Proposed dividend			48,000	
			2,85,360	
3. Long term Borrowings				
Loan From IDBI (1,20,000-6,000)			1,14,000	
Unsecured Loans			96,800	
			2,10,800	
4. Other Current Liabilities				
Interest accrued			6,000	
			6,000	
5. Tangible Assets				
Land			1,60,000	
Building	3,20,000			
Less-Dep.	40,000		2,80,000	
Plan & Machinery	5,60,000			
Less- Dep.	1,40,000		4,20,000	
Furniture	50,000			
Less-Dep.	10,000		40,000	
			9,00,000	

6. Inventories			
Finished Goods		1,60,000	
Raw Material		40,000	
		2,00,000	
7. Trade Receivable			
Debts O/S for a period exceeding 6 month Other Debts		50,000 1,10,000	
		1,60,000	
8. Cash & Cash Equivalents			
Balance with Bank		1,97,600	
Cash in hand		24,000	
		2,21,600	

Space to write important points for revision

2010 - Dec [6] (b) A limited company finds that the stock sheets as on 31.3.2010 had included an item twice, the cost of which was ₹ 50,000

You are asked to suggest, how the error would be dealt with in the accounts for the year ended on 31.3.2010. **(2 marks)**

(c) While preparing the financial statements of X Co. Ltd. for the year ended 31.12.2009, you came across the following information. State with reasons, how you would deal with them in the financial statements:

There was a major theft of stores valued at ₹ 20 lakhs in the preceding year which was detected only during the current accounting year ended on 31.12.2009. **(3 marks)**

Answer :

(b) As Per Accounting Standard 5. Prior Period Items are Income or expenses which arise in the current period as a result of errors or omissions" in the preparation of the financial statement of one or more prior period.

In the given case stock of ₹ 50,000 was included twice in the last year. For this the opening stock of the current year is overvalued it should be reduced by ₹ 50,000.

The closing stock of last year was overvalued by ₹ 50,000 therefore the profit of last year was recorded ₹ 50,000 more. It is a prior period item. Therefore the current year profit should be reduced by ₹ 50,000 as prior period items. It should be disclosed separately.

Answer:

(c) The major theft of stores in the preceding year 2008, detected only during the current financial year 2009, caused overstatement of closing stock of stores in the preceding year. This must have also resulted in the overstatement of profits of previous year, brought forward to the current year. The adjustments are required to be made in the current year as 'Prior Period Item' as per AS-5 (REVISED), "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies". As such the adjustments relating to both opening stock of the current year and profit brought forward from the pervious year should be separately disclosed in the statement of profit and loss together with their nature and amount in a manner that their impact on the current profit and loss can be perceived.

Alternatively, it can be assumed that in the preceding year, the value of stock of stores was found out by physical verification of stocks and that was considered in the preparation of financial statements of the preceding year. In such a situation, only the disclosure as to the theft and the consequential loss is required in the notes to the accounts for the current year i.e. year ended 31.12.2009

—— Space to write important points for revision ——

2013 - June [2] (a) Prepare the Balance Sheet as at 31.03.2012 from the particulars furnished by M/s PRAN Ltd. as per revised Schedule III of the Companies Act:

Particulars	Amount (₹)	Particulars	Amount (₹)
Share Capital	7,50,000	Capital Redemption Reserve	20,000
Calls in Arrear Land	5,000 2,20,000	Investment in 6% GP Notes (Tax Free)	3,00,000

Building	2,00,000	Profit and Loss Account	65,000
General Reserve	50,000	Cash in Hand	25,000
Loan from IDBI	1,00,000	Debtor	10,000
Sundry Creditors	1,50,000	Stock	1,00,000
		Goodwill	25,000

(5 marks)

Answer :

(a) Balance Sheet as at 31.03.2012

I. Equity & Liabilities	**Note No.**	**Current Year**	**Previous year**
1. Shareholders' Funds:			
(a) Share Capital	1	7,45,000	—
(b) Reserve & Surplus	2	1,35,000	—
(c) Money received against share warrant			
2. Share Application Money Pending Allotment			
3. Non-current Liabilities:			
(a) Long Term Borrowings	3	1,00,000	—
(b) Deferred Tax Liability			
(c) Other Long Term Liabilities			
(d) Long Term Provision			
4. Current Liabilities:			
(a) Short Term Borrowings			
(b) Trade Payable	4	1,50,000	—
(c) Other Current Liabilities			
(d) Short Term Provisions			
Total		**11,30,000**	—

II. Assets:			
1. Non Current Assets:			
(a) Fixed Assets			
1. Tangible Assets	5	6,70,000	—
2. Intangible Assets	6	25,000	—
3. Capital work in Progress			
4. Intangible Asset Under Development			
(b) Non-Current Investment	7	3,00,000	—
(c) Deferred Tax Asset (Net)			
(d) Long Term Loans and Advances			
(e) Other Non Current Assets			
2. Current Assets:			
(a) Current Investment			
(b) Inventories	8	1,00,000	—
(c) Trade Receivable	9	10,000	—
(d) Cash & Cash Equivalent	10	25,000	—
(e) Short Term Loans & Advances			
(f) Other Current Assets			
Total		**11,30,000**	—

Annexure

Note No. 1: **Share Capital**

Share Capital	7,50,000.00	
Less: Calls in Arrear	5,000.00	7,45,000.00
Total		7,45,000.00

Note No. 2: **Reserve & Surplus**

General Reserve	50,000.00	
Capital Redemption Reserve	20,000.00	
Profit & Loss A/c	65,000.00	1,35,000.00
		1,35,000.00

Note No. 3: Long Term Borrowings

Loan From IDBI	1,00,000.00	
		1,00,000.00
Total		1,00,000.00

Note No. 4: Trade Payables

Sundry Creditors	1,50,000.00	
		1,50,000.00
Total		1,50,000.00

Note No. 5: Tangible Assets

Land	2,20,000.00	
Building	2,00,000.00	
Plant & Machinery (Bal. Fig.)	2,50,000.00	6,70,000.00
Total		6,70,000.00

Note No. 6: Intangible Assets

Goodwill	25,000.00	
		25,000.00
Total		25,000.00

Note No. 7: Non Current Investments

Investment in 6% G.P. Notes	3,00,000.00	
		3,00,000.00
Total		3,00,000.00

Note No. 8: Inventories

Stock	1,00,000.00	
		1,00,000.00
Total		1,00,000.00

Note No. 9: Trade Receivables

Debtors	10,000.00	
		10,000.00
Total		10,000.00

Note No. 10: Cash & Cash Equivalents

Cash in Hand	25,000.00	
		25,000.00
Total		25,000.00

Note: *There is no item of Plant & Machinery in Question. It may be considered as balancing figure to tally the Balance Sheet.*

Space to write important points for revision

2013 - June [6] (b) The following items are extracted from the Balance Sheet of Best Ltd. as at 1st April, 2012:

		₹
(i)	9% Preference Shares of ₹ 100 each	50,00,000
(ii)	Equity Shares of ₹ 10 each (₹ 8 paid up)	80,00,000
(iii)	General Reserve	26,00,000
(iv)	Securities Premium	20,00,000
(v)	12% Debentures	40,00,000

Profit before interest and tax for the year ending on 31.03.2013 was ₹ 44,80,000.

The Board of Directors of the Company proposed payment of Preference Share Dividend and Equity Share Dividend @ 20%. The Board also declared Capital Bonus out of General Reserve for making partly paid-up shares into fully paid-up. Ignore Corporate Dividend Tax.

Provision to be made for Taxation @ 30%.

7.5% of Net Profit to be transferred to General reserve.

You are required to show the Journal entries to be passed to incorporate the Recommendations and adjustments. **(6 marks)**

Answer :

Journal of Best Ltd.

S. No.	Date	Particulars		Dr. ₹	Cr. ₹
(i)	31.3.13	P/L A/c	Dr.	4,80,000	
		To Debenture Interest A/c			4,80,000
(ii)	31.3.13	P/L A/c	Dr.	12,00,000	
		To Provision for Taxation A/c			12,00,000
		(Provision made for tax @ 30% on (44,80,000 – 4,80,000)			
(iii)	31.3.13	P/L A/c	Dr.	28,00,000	
		To Surplus A/c			28,00,000
		(Net profit 40,00,000 – 12,00,000 = 28 Lakhs transferred)			
(iv)	31.3.13	Surplus A/c	Dr.	20,50,000	
		To Proposed Pref. Dividend A/c			4,50,000
		To Proposed Equity Dividend A/c			16,00,000
		(Proposed Div. On P.S. 9% of 50,00,000 as on preference shares @ 20% on 80,00,000 on equity shares.)			
(v)	31.3.13	General Reserve A/c	Dr.	20,00,000	
		To Bonus to Shareholders A/c			20,00,000
		(Capital bonus declared to meet the final call money)			
(vi)	31.3.13	Surplus A/c	Dr.	2,10,000	
		To General Reserve A/c			2,10,000
		(General reserve @ 7.5% of net profit ₹ 28,00,000)			
(vii)	31.3.13	Equity Share Final Call A/c	Dr.	20,00,000	
		To E.S. Capital A/c			20,00,000
		(Equity share final call money due)			
(viii)	31.3.13	Bonus to Shareholders A/c	Dr.	20,00,000	
		To Equity Share Final Call A/c			20,00,000
		(Bonus to shareholder utilized)			

2016 - Dec [1] Answer the following question:

(d) PROMET LTD. follows a policy of refunding money to the dissatisfied customers if they claim within 15 days from the date of purchase and return the goods. It appears from the past experience that in a month only 0.2% of the customers claims refunds.

The company sold goods amounting to ₹ 30 Lakh during the March, 2016. State how the matter will have to dealt with in the accounts for the year 2015-16. **(2 marks)**

Answer:

There is a probable present obligation as a result of past obligating event. The obligating event is the sale of product. Provision should be recognized as per AS-29.

So, a provision of ₹ 6,000 (₹ 30 lakh × 0.2%) should be provided in the financial accounts for the year 2015-16.

—— Space to write important points for revision ——

2017 - June [4] Elixir Ltd. provides the following Trial Balance as on 31st March, 2016:

Particulars	Dr. Balance (₹)	Cr. Balance (₹)
Equity Share Capital 30,00,00 shares of ₹ 10 each fully paid		30,00,000
12% Bank Loan		2,00,000
Furniture	2,25,000	
Machinery	7,50,000	
Building	12,50,000	
Non-current Investment	2,00,000	
Sales		48,00,000
Sales Return	4,00,000	
Interest Received on Investment		20,000
Interest on Bank Loan	20,000	
Purchase	33,20,000	

Purchase Returns		4,20,000
Opening Stock	2,00,000	
Discount	6,250	
Carriage on Goods Sold	1,39,000	
Rent and Taxes	60,000	
Trade Receivables	12,00,000	
Trade Payables		80,000
Advertisement	1,20,000	
Bad Debt	10,000	
Salaries	4,00,750	
Audit Fees	27,000	
Contribution of P.F.	60,000	
Cash at Bank and in hand	1,32,000	
Total	85,20,000	85,20,000

Additional Information:

(i) Closing Stock as on 31st March, 2016 was ₹ 2,12,500

(ii) Depreciation Rates: Furniture 10%; Machinery 20% and Building 10%

(iii) Outstanding salaries as on 31st March, 2016 was ₹ 62,250

(iv) Trade receivables include a sum of ₹ 25,000 due from Mr. B. Reddy and trade payables include ₹ 15,000 due to him.

(v) Create a provision for doubtful debt @ 5% on trade receivables.

(vi) Provide for income tax ₹ 80,000.

Prepare a Statement of Profit and Loss for the year ended on 31st March, 2016 and a Balance Sheet as on that date. **(12 marks)**

Answer:

Notes to Accounts (Schedules):

Schedule -1. Employee Benefit Expenditure	₹
Salaries	4,00,750
Outstanding Salaries	62,250
Contribution to P.F.	60,000
	5,23,000

Schedule -2. Finance Cost	₹
Interest on loan	20,000
Outstanding Interest	4,000
	24,000

Schedule -3. Other Expenditure	₹
Discount	6,250
Carriage	1,39,000
Rent	60,000
Advertisement	1,20,000
Bad Debt	10,000
Audit fees	27,000
Provision for Bad Debt	59,250
	4,21,500

Schedule -4. Trade Receivable	₹
Total Receivable	12,00,000
(-) Set off	15,000
	11,85,000
(-) Provision @5%	59,250
	11,25,750

Schedule -5. Fixed Assets	Furniture (₹)	Machine (₹)	Building (₹)
Balance	2,25,000	7,50,000	12,50,000
(-) Depreciation	22,500	1,50,000	1,25,000
	2,02,500	6,00,000	11,25,000
Total Fixed Assets			19,27,500
Depreciation			2,97,500

Statement of Profit and Loss for the year ended on 31.03.2016

Particulars	Note	₹
I. Revenue from operation (sales less returns)		44,00,000
II. Other Income (Income from Investment)		20,000
III. Total revenue		44,20,000
IV. Expenses:		
Purchase		29,00,000
Changes in inventory i.e. opening less Closing		(12,500)
Employee Benefit expenses	1	5,23,000
Finance cost	2	24,000
Depreciation	5	2,97,500
Other expenses	3	4,21,500
		41,53,500
V. Profit before exceptional and extraordinary items and tax		2,66,500
VI. Exceptional Items		Nil
VI. Profit before extraordinary items and tax		2,66,500
VII. Extraordinary items		Nil
VIII. Profit before tax		2,66,500
IX Tax (provision for tax)		80,000
X Profit after tax		1,86,500

Balance Sheet as on 31.03.2016

I. Equity and Liabilities	Note	₹
1. Shareholders' Funds		
(a) Share Capital		30,00,000
(b) Reserve and Surplus (Balance of Profit)		1,86,500

2. Share Application money pending allotment		Nil
3. Non-current liabilities (12% Bank loan)		2,00,000
4. Current Liabilities		
Trade payable (after set off of ₹ 15,000)		65,000
Outstanding interest		4,000
Outstanding salary		62,250
Provision for Tax		80,000
Total		35,97,750
II. Assets		
1. Non-current Assets		
(a) Fixed Assets (Tangible)	5	19,27,500
(b) Non-current Investment		2,00,000
2. Current Assets		
Inventories		2,12,500
Trade Receivable	4	11,25,750
Cash and cash equivalent		1,32,000
Total		35,97,750

Space to write important points for revision

2017 - Dec [4] ABC Ltd. provides the following Trial Balance as on 31st March, 2017:

Particulars	Dr. Balances (₹)	Cr. Balances (₹)
Equity Share Capital: 350000 shares of ₹ 10 each fully paid		35,00,000
10% Debentures		3,00,000
Motor Van	4,00,000	

Machinery	20,00,000	
Land and Building	12,00,000	
12% Long Term Govt. Securities	2,00,000	
Sales		60,00,000
Sales Return	3,00,000	
Interest on Debenture	22,500	
Purchase	36,00,000	
Purchase Returns		4,00,000
Opening Stock	3,00,000	
Discount	7,500	
Carriage Outward	1,50,000	
Rent and Rates	50,000	
Income from Govt. Securities		24,000
Trade Receivables	10,00,000	
Trade Payables		2,00,000
Advertisement	1,50,000	
Bad Debt	20,000	
Salaries	6,72,000	
Misc. Expenditure	30,000	
Contribution to P.F. and Gratuity Funds	1,00,000	
Cash at Bank and in hand	2,22,000	
Total	**1,04,24,000**	**1,04,24,000**

Additional Information:

(i) Closing Stock as on 31st March, 2017 was ₹ 3,50,000.

(ii) Depreciation Rates: Motor Vehicle 10%, Machinery 20% and Land & Building 5%.

(iii) Misc. expenditure includes ₹ 20,000 as audit fees.

(iv) Interest on debenture is payable quarterly and the last quarter's interest is yet to be paid.

(v) Trade receivables include a sum of ₹ 25,000 due from Mr. X who has become insolvent and only 25 paisa in a rupee is expected to be recoverable from him.

(vi) Create a provision for doubtful debt @ 2% on trade receivables.

(vii) Provide for income tax ₹ 1,50,000.

Prepare a Statement of Profit and Loss for the year ended on 31st March, 2017 and a Balance Sheet as on that date. **(12 marks)**

Answer:

Notes to Accounts:

1.	Employee Benefit Expenditure	₹
	Salaries	6,72,000
	Contribution to P.F.	1,00,000
		7,72,000

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

3.	Other Expenditure	₹
	Discount	7,500
	Carriage	1,50,000
	Rent	50,000
	Advertisement	1,50,000

Bad Debt	20,000
Audit fees	20,000
Misc. Exp.	10,000
Provision for B/D	38,250
	4,45,750

4. Trade Receivable	₹
Total Receivable	10,00,000
(-) Provision @ 2%	38,250
	9,61,750
Provision = 25,000 × 0.75 + (10,00,000 – 25,000) × 0.02	38,250

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

Statement of Profit and Loss for the year ended on 31.03.2017

	Particulars	Note	₹
I.	Revenue from operation (sales less returns)		57,00,000
II.	Other Income (Income from investment)		24,000
III.	Total revenue		57,24,000
IV.	Expenses:		
	Purchase		32,00,000
	Changes in inventory i.e. opening less. Closing		(50,000)

	Employee Benefit expenses	1	7,72,000
	Finance cost	2	30,000
	Depreciation	5	5,00,000
	Other expenses	3	4,45,750
			48,97,750
V.	Profit before exceptional and extraordinary items and tax		8,26,250
VI.	Exceptional items		Nil
VII.	Profit before extraordinary items and tax		8,26,250
VIII.	Extraordinary items		Nil
IX.	Profit before tax		8,26,250
X.	Tax (provision for tax)		1,50,000
XI.	Profit after tax		6,76,250

Balance Sheet as on 31.03.2017

I.	**Equity and Liabilities**	**Note**	**₹**
1.	Shareholders' Funds		
(a)	Share Capital		35,00,000
(b)	Reserve and Surplus (Balance of Profit)		6,76,250
2.	Share Application money pending allotment		Nil
3.	Non-current liabilities (10% Debentures)		3,00,000
4.	Current Liabilities		
	Trade Payable		2,00,000
	Outstanding interest		7,500
	Provision for Tax		1,50,000
	Total		**48,33,750**

II.	**Assets**		
1.	Non-current Assets		
(a)	Fixed Assets (Tangible)	5	31,00,000
(b)	Non-current Investment (12% L.T. Govt. Securities)		2,00,000
2.	Current Assets		
	Inventories		3,50,000
	Trade Receivable	4	9,61,750
	Cash and cash equivalent		2,22,000
	Total		**48,33,750**

Space to write important points for revision

2018 - June [4] ABC Limited has an authorized capital of ₹ 5,00,000 divided into 5,000 equity shares of ₹ 100 each. On 31.3.2018, 2,500 shares were fully called up.

The following are the balance extracted from the ledger of the company as on 31.3.2018:

	₹		₹
Inventory	50,000	Advertisement	3,800
Sales	4,25,000	Bonus	10,500
Purchases	3,00,000	Accounts receivable	38,700
Productive wages	70,000	Accounts payable	35,200
Discount allowed	4,200	Plant and Machinery	80,500
Discount received	3,150	Furniture	17,100
Insurance (year up to 30.06.2018)	6,720	Cash at bank	1,30,000
Salaries	18,500	Cash in hand	4,700
Rent	6,000	Reserves	25,000
General expenses	8,950	Loan from Managing Director	15,700
Profit and Loss A/c (cr.)	6,220	Bad debts	3,200
Printing and Stationary	2,400	Calls in arrears	5,000
		Share capital	2,50,000

Also the following information are given:

(a) Closing inventory is ₹ 91,500

(b) Depreciation to be charged on plant and furniture at 15% and 10% respectively

(c) Outstanding liabilities—wages at ₹ 5,200, salaries at ₹ 1,200 and rent at ₹ 600

(d) Salesman are entitled to a commission of 1% on sales

(e) ₹ 4,000 are to be transferred to General reserves

(f) Dividend on paid up share capital is to be provided @ 5%

You are required to prepare Profit and Loss Statement for the year ended 31.03.2018 and the Balance Sheet as on that date in accordance with the Companies Act, 2013 in the Vertical Form along with the Notes on Accounts.

(12 marks)

Answer:

Balance Sheet of ABC Limited as on 31st March, 2018

Particulars	**Note No.**	**Amount (₹)**
I. Equity and Liabilities		
(1) Shareholders' Funds:		
(a) Share Capital	1	2,45,000
(b) Reserves and Surplus	2	30,995
(2) Non-Current Liabilities:		
(a) Long Term Borrowing	3	15,700
(3) Current Liabilities:		
(a) Trade Payable		35,200
(b) Other Current Liabilities	4	11,250
(c) Short Term Provision	5	12,250
		3,50,395

II. Assets		
(1) Non - Current Assets		
Fixed Assets		
Tangible Assets	6	83,815
(2) Current Assets:		
(a) Inventories		91,500
(b) Trade Receivables		38,700
(c) Cash and Cash Equivalents		1,34,700
(d) Short Term Loans and Advances (Prepaid Insurance)		1,680
		3,50,395

Profit and Loss Statement for the year ended 31st March, 2018

Particulars	Note No.	Amount (₹)	Amount (₹)
I. Revenue From Operation			4,25,000
II. Other Income			3,150
III. Total Revenue (I + II)			4,28,150
IV. Expenses:			
(a) Cost of material consumed	7	3,33,700	
(b) Employees cost/ benefits expenses	8	30,200	
(c) Depreciation and amortization expenses		13,785	
(d) Other expenses	9	38.440	
Total Expenses			**4,16,125**

V. Profit for the year (III - IV)			12,025
Balance brought forward from previous year			6,220
Profit available for appropriation			18,245
Appropriation:			
Proposed dividend		12,250	
Transfer to General Reserve		4,000	
			16,250
Balance carried forward			1,995

Notes:

1.	**Share Capital:**	₹
	Issued, Subscribed and Paid up	2,50,000
	Less: Calls in arrears	5,000
		2,45,000
2.	**Reserves and Surplus:**	
	General Reserve	29,000
	Surplus (P & L A/c)	1,995
		30,995
3.	**Long Term Borrowings:**	
	Unsecured:	
	Loan from Managing Director	15.700
		15,700
4.	**Other Current Liabilities:**	
	Outstanding Expenses	7,000
	Salesmen Commission	4,250
		11,250

5. Short Term Provisions:	
Proposed Dividend	12,250
	12,250

6. Tangible Fixed Assets:

Item	Closing Balance (₹)	Depreciation (₹)	Net (₹)
Plant and Machinery	80,500	12,075	68,425
Furniture	17,100	1,710	15,390
Total	**97,600**	**13,785**	**83,815**

7. Cost of Materials Consumed:	₹
Opening stock	50,000
Purchases	3,00,000
Less: Closing Stock	(91,500)
Wages	75.200
	3,33,700
8. Employees Benefit Expenses:	
Salary	19,700
Bonus	10,500
	30,200
9. Other Expenses:	
Administrative Expenses (5,040 + 6,600 + 8,950 + 2,400)	22,990
Provision for bad debts	3,200
Marketing Expenses (4,200 + 3,800 + 4,250)	12,250
	38,440

Space to write important points for revision

2018 - Dec [4] The following is the Trial Balance of Omega Limited as on 31.03.2018:

(**Figures in ₹.'000**)

	Debit		Credit
Land at cost	220	Equity Capital (Shares of ₹ 10 each)	300
Plant and Machinery at cost	770	10% Debentures	200
Trade Receivables	96	General Reserve	130
Inventories (31.03.18)	86	Profit and Loss A/c	72
Bank	20	Securities Premium	40
Adjusted Purchases	320	Sales	700
Factory Expenses	60	Trade Payables	52
Administration Expenses	30	Provision for Depreciation	172
Selling Expenses	30	Suspense Account	4
Debenture Interest	20		
Interim Dividend Paid	18		
	1,670		**1,670**

Additional Information:

(i) The Authorised Share Capital of the Company is 40,000, shares of ₹ 10 each.

(ii) The company on the advice of independent valuer wish to revalue the land at ₹ 3,60,000.

(iii) Declared final dividend @ 10% (over Interim Dividend of ₹ 18,000).

(iv) Suspense account of ₹ 4,000 represents cash received for the sale of some of the machinery on 01.04.2017. The cost of the machinery was ₹ 10,000 and the accumulated depreciation thereon being ₹ 8,000.

(v) Depreciation is to be provided on plant and machinery at 10% on cost.

You are required to prepare Omega Limited's Profit and Loss Statement for the year ended 31.03.2018 and the Balance Sheet as on that date in accordance with the Companies Act, 2013 in the Vertical Form along with the Notes on Accounts. Ignore previous years' figures and taxation.

(12 marks)

Repeatedly Asked Questions		
No.	**Question**	**Frequency**
1	Write short notes on Contingent liability. 10 - Dec [8] (d), 12 - Dec [8] (d)	2 Times
2	What are the Characteristics of a Liability? 13 - Dec [2] (c) (i), 15 - Dec [2] (a) (ii)	2 Times

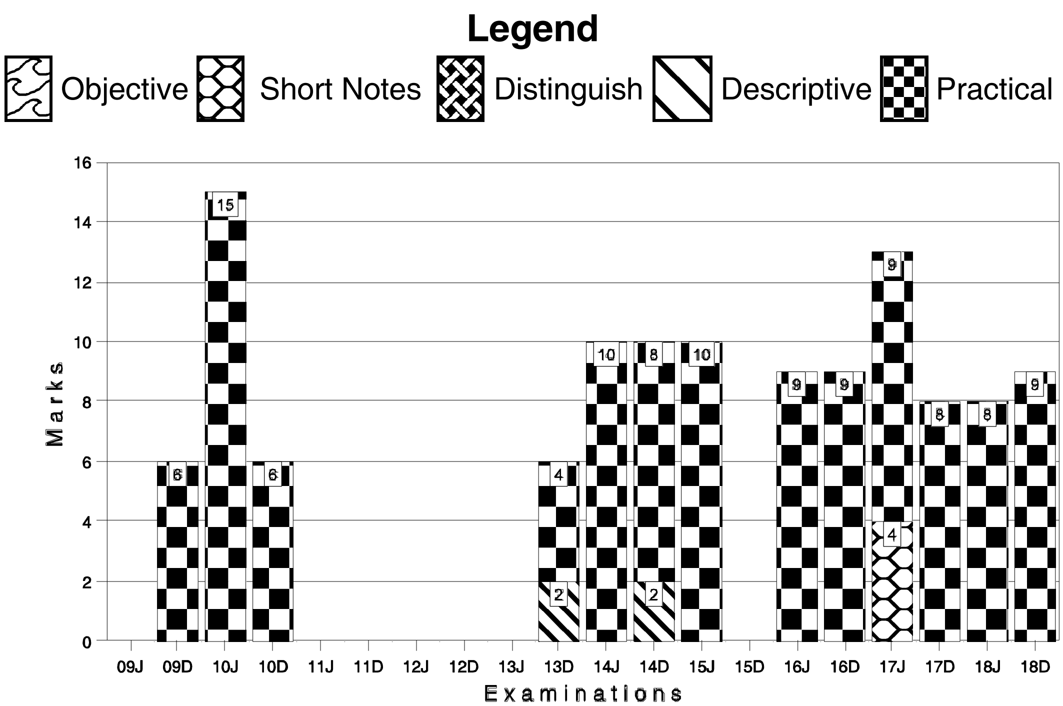
Table Showing Marks of Compulsory Questions

Year	**14 J**	**14 D**	**15 J**	**15 D**	**16 J**	**16 D**	**17 J**	**17 D**	**18 J**	**18 D**
Descriptive	4									
Total	4									

3 CASH FLOW STATEMENT

THIS CHAPTER INCLUDES	
• Statement of Cash Flows; • Meaning of Cash and Cash Equivalents;	• Types of Cash Flow • Ind AS - 7.

Marks of Objective, Short Notes, Distinguish Between, Descriptive & Practical Questions



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CHAPTER AT A GLANCE

S. No.	Topic	Important Highlights
1.	**Introduction**	Cash flow statement is additional information to user of financial statement. This statement exhibits the flow of incoming and outgoing cash and cash equivalent. It assesses the ability of the enterprise to generate cash and utilize cash. Cash Flow Statement is one of the tools for assessing the liquidity and solvency of the enterprise.
2.	**Statement of Cash Flow**	"The information provided in a statement of cash flows, if used with related disclosures and information in the other financial statements, should help investors, creditors, and others to (a) assess the enterprise's ability to generate positive future net cash flows; (b) assess the enterprise's ability to meet its obligations, its ability to pay dividends, and its needs for external financing; (c) assess the reasons for differences between net income and associated cash receipts and payments; and (d) assess the effects on an enterprise's financial position of both its cash and non-cash investing and financing transactions during the period." - SFAS 95 Statement of Cash Flows, Financial Accounting Standards Board, US

3.	**Importance of Cash flows**	• Cash flows are crucial to business decisions. Cash is invested in the business and the rationality of such investment is evaluated taking into account the future cash flows it is expected to generate. • Economic value of an asset is derived on the basis of its ability to generate future cash flows. • Economic value of an asset is given by the present value of future cash flows expected to be derived from the asset.
4.	**Meaning of Cash and Cash Equivalent**	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.
5.	**Types of Cash Flow**	**(i) Operating activities** are the principal revenue-producing activities of the enterprise and other activities that are not investing and financing. Operating activities include all transactions that are not defined as investing or financing. Operating activities generally involve producing and delivering goods and providing services. **(ii) Investment activities** are the acquisition and disposal of long term assets and other investments not included in cash equivalents. **(iii) Financing activities** are activities that result in changes in the size and composition of the owners' capital (including preference share capital in the case of a company) and borrowings of the enterprise.

6.	**Objective**	Information about the cash flows of an entity is useful in providing users of financial statements with a basis to assess the ability of the entity to generate cash and cash equivalents ,the needs of the entity to utilise those cash flows and the timing and certainty of their generation.

SHORT NOTES

2017 - June [5] Write a short note:
(d) Objective of preparing Cash Flow Statement. **(4 marks)**
Answer :
Objective of preparing Cash Flow Statement: The objectives are as follows:
(i) To provide information about firm's liquidity, flexibility and ability to generate future cash flow.
(ii) To provide information about firm's ability to meet future obligations.
(iii) To enhance comparability among firms.
(iv) To assess reliability of net profit and quality of earnings.
(v) To enable the users to assess how assets and liabilities have increased or decreased.
(vi) To project future cash flow streams.
(vii) To provide information on different types of cash flow.

—— Space to write important points for revision ——

DESCRIPTIVE QUESTIONS

2013 - Dec [3] {C} Answer the following:
(a) What is the meaning of the expression 'cash equivalent'? **(2 marks)**
Answer:
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. Investment in call money market, money market mutual funds, repo transactions, badla transactions, etc., are usually classified as cash equivalents.

—— Space to write important points for revision ——

2014 - Dec [1] Answer the question:

(a) State the classification of cash flow activities as per AS-3. **(2 marks)**

Answer:

Cash flow as per AS-3:

- Cash flow from Operating Activity
- Cash flow from Investing Activity
- Cash flow from Financing Activity

—— Space to write important points for revision ——

PRACTICAL QUESTIONS

2009 - Dec [6] (a) The following particulars pertain to PIOUS LTD.:

Income Statement for the year ended March 31, 2009

		(Amount in ₹ lakh)
Sales Revenue		3,200
Less: Cost of goods sold		2,000
		1,200
Add: Government Compensation for loss in riots		50
		1,250
Less: Operating expenses	790	
Interest on debentures	15	
Depreciation on Fixed Assets	210	
Cost of issue of Debentures (written off)	1	1,016
Profit before Tax		234
Less: Tax-Provision		92
Profit after tax		142

(Amount in ₹ lakh)

	As on March 31,2008	As on March 31,2009
Inventories	180	220
Debtors	40	38
Bills Receivables	30	55
Cash in hand and at Bank	102	248
Creditors	78	95
Bills Payables	20	15
Outstanding Expenses	31	44

Additional Information:

The following important transactions have taken place in the year ended March 31, 2009:

(i) Fully paid Equity Shares of the face value of ₹ 200 lakh were allotted at premium of 20%.

(ii) 10% Debentures for ₹ 300 lakh were redeemed at a premium of 2%.

(iii) Land was Purchased for ₹ 150 lakh and the consideration was discharged by the allotment to the vendor of zero percent convertible Debentures for the amount.

(iv) Dividend for the year ended March 31, 2008 amounting to ₹ 100 lakh was paid.

(v) Tax paid during the year totaled ₹ 95 lakh.

Required :

Prepare Cash Flow Statement for the year ended March 31, 2009 using the Direct Method on the line specified in AS-3. **(6 marks)**

Answer:

PIOUS LTD.

Cash Flow Statement for the Year Ended March 31, 2009

(Direct Method)	**(Amount in ₹ lakh)**	
Cash Flow from Operating Activities :		
Cash receipts from customers (WN-1)	3,177	
Cash payments to suppliers and employees (WN-2)	(2,805)	
Cash inflow from operations	372	
Income Tax paid	(95)	

Cash Flow from extraordinary item:	277	
Government compensation for loss in riots	50	327
NET CASH from OPERATING ACTIVITIES	327	
CASH FLOWS from FINANCING ACTIVITIES		
Issue of equity Share Capital at a premium		
Redemption of 10% Debentures at a premium	240	
Debenture interest paid"	(306)	
Dividend paid	(15)	(181)
Net increase in cash and cash equivalents	(100)	146
Cash and cash equivalents in the beginning		102
CASH AND CASH EQUIVALENTS AT THE END		248
Significant Non Cash Transaction: Land was purchased by issuing at par ZERO percent convertible debentures of ₹ 150 lakh		

**Alternatively, Debenture Interest paid may be treated as a flow from operating activities.

Working Notes:

(1) (₹ in lakh)

Sales revenue		3,200
Add: Debtors on 31.3.2008		40
Bills Receivables on 31.3.2008		30
		3,270
Less: Debtors on 31.3.2009	38	
Bills Receivables on 31.3.2009	55	(93)
CASH Receipt from the customers		3,177

(2) (₹ in lakh)

Cost of goods sold		2,000
Operating Expenses		790
		2,790
Add: Inventories on 31.3.2009		220
Creditors on 31.3.2008		78
Bills Payable on 31.3.2008		20
Outstanding Expenses on 31.3.2008		31
		3,130

Less: Inventories on 31.3.2008	180	
Creditors on 31.3.2009	95	
Bills Payable on 31.3.2009	15	
Outstanding Expenses on 31.3.2009	44	(334)
CASH PAID to Suppliers and Employees		2,805

Space to write important points for revision

2010 - June [5] Examine the following schedule prepared by X Ltd. Schedule of funds provided by operations for the year ended 31st July, 2009:

	(₹'000)		(₹ '000)
Sales	32,760		
Add: Decrease in bills receivable	1,000		
Less: Increase in accounts receivable	(626)		33,134
Inflow from operating revenues			
Cost of goods sold	18,588		
Less: Decrease in inventories	(212)		
Add: Decrease in trade payable	81	18,457	
Wages and Salaries	5,284		
Less: Increase in wages payable	(12)	5,272	
Administrative Expenses	3,066		
Add: Increase in prepaid payable	11	3,077	
Property taxes		428	
Interest expenses	532		
Add: Amortisation of premium on bonds payable	20	552	27,786
From Operations			5,348
Rent Income	207		
Add: Increase in unearned rent	3	210	
Income Tax	1,330	5,558	
Less: Increase in deferred tax	50	1,280	
Funds from operations		4,278	

Required:

(i) What is the definition of funds shown in the Schedule?
(ii) What amount was reported as gross margin in the Income Statement?
(iii) How much cash was collected from the customers?

(iv) How much cash was paid for the purchases made?

(v) As a result of change in inventories, did the working capital increase or decrease and by what amount?

(vi) How much rent was actually earned during the year?

(vii) What was the amount of tax expenses reported on the income statement?

(viii) Can you reconcile the profits after tax with the funds provided by the operation? **(15 marks)**

Answer :

(i) 'Funds' shown in the schedule refer to the cash and cash equivalents (as defined) in AS – 3 (Revised) on Cash Flow Statements

		₹('000)
(ii)	Gross margin in the income statement	32,760
	Sales	18,588
	Cost of goods sold	14,172
(iii)	Cash collected from the customers	33,134
(iv)	Cash paid for purchases made	18,457
(v)	Change in inventories would reduce the working capital by	212
(vi)	Rental income earned during the year	207
(vii)	Tax expenses reported in the income statement	1,330
(viii)	Reconciliation Statement	₹('000)
	Profit after tax (See W.N.)	3,719
	Decrease in bills receivable	1,000
	Increase in accounts receivable	(626)
	Decrease in inventories	212
	Decrease in trades payable	(81)
	Increase in wages payable	12
	Increase in prepaid expenses	(11)
	Increase in unearned rent	3
	Increase in deferred tax	50
	Fund from operation as shown in the schedule (i.e. cash and cash Equivalents)	4,278

Working Note :

Calculation of Profit after Tax		₹ (`000)
Sales		32,760
Less : Cost of goods sold		18,588
Gross margin		14,172
Add : Rental income		207
		14,379
Less : Wages and salaries	5,284	
Administrative expenses	3,066	
Property taxes	428	
Interest expenses	532	
Amortisation premium on bond payable	20	
Profit before Tax		9,330
Less : Income Tax		5,049
Profit after Tax		1,330
		3,719

—— Space to write important points for revision ——

2010 - Dec [8] (b) The following is an extract from the cash flow statement of VENTEX LTD. prepared for the year ended March 31, 2010.

Particulars		(₹ in Lakh)
Net Profit		600
Add: Sale of Investment		700
Depreciation of Assets		110
Issue of Preference shares		90
Loan raised		45
Decrease in stock		120
		1,665
Less: Purchase of Fixed Assets	650	
Decrease in Creditors	60	
Increase in Debtors	80	
Exchange Gain	80	
Profit on Sale of Investments	120.0	
Redemption of Debentures	57.0	

Dividend Paid	14.0	
Interest Paid	9.45	1070.45
		594.55
Add: Opening Cash & Cash equivalent		123.41
Closing Cash & Cash equivalent		717.96

Required:

Redraft and reconstruct the cash flow statement of VENTEX LTD. in proper order for the year ended March 31,2010 in accordance with AS-3 (Revised) using indirect method. **(6 marks)**

Answer:

VENTEX LTD.

Cash Flow Statement for the year ended March, 31,2010

₹ In Lakhs

1. Cash Flow from operating Activities:		
Net profit before Tax and Extra ordinary items:		600.0
Adjustment For:		
Depreciation	110.0	
Profit on Sale of Investment	(120.0)	
Foreign Exchange Gain	(80.0)	(90.0)
Working Capital Adjustment:		510.0
Decrease in Stock		
Decrease in Creditors	120.0	
Increase in Debtors	(60.0)	(20.0)
Cash from Operation	(80.0)	490.0
Tax paid		
Cash from Operating Activities		490.0
2. Cash flow from Investing Activities:		
Sale of investments	700.0	
Purchase of fixed assets	(650.0)	50.0
Net cash from investing Activities		50.0
3. Cash flow from Financing Activities:		
Loan raised	45.0	
Issue of Preference Shares	90.0	

Redemption of Debentures	(57.0)	
Dividend paid	(14.0)	
Interest paid	(9.45)	54.55
		54.55
Net Cash from financing Activities		594.55
Net increase in Cash and Cash Equivalents [(1)+ (2)+(3)]		
Cash and Cash equivalents at beginning of the year (April, 2009)		123.41
Cash and Cash Equivalents at the end of year (March, 2010).		717.96

Space to write important points for revision

2013 - Dec [4] (a) (ii) The following relevant items from the Balance Sheet of LM Limited are provided:

	Balance Sheet figures	
	As at 31.03.2012 ₹	As at 31.03.2013 ₹
Goodwill	90,000	75,000
Profit and Loss A/c	4,15,000	6,25,000
General Reserve	3,25,000	3,75,000
Inventories	4,15,000	5,10,000
Debtors	3,45,000	3,22,000
Prepaid Expenses	18,000	15,000
Creditors	2,35,000	2,70,000
Provision for Taxation	1,05,000	1,55,000
Provision for Doubtful Debts	17,250	15,000

Depreciation amounting to ₹ 1,42,000 and Profit on sale of Machinery amounting to ₹ 21,000 appeared in the Profit and Loss A/c for the year ending 31.03.2013. During the year 2012-13 ₹ 1,00,000 was paid as Income Tax.

You are required to calculate Net Cash Flow from operating activity for the year ending 31st March, 2013. **(4 marks)**

Answer:

Cash Flow Statement
(for the year ending 31st March, 2013)

Particulars	**Amount in ₹**
Cash flow from operating activities :	
Net profit (6,25,000 - 4,15,000)	2,10,000
(+) Transfer to General Reserve	50,000
(+) Provision for taxation	1,50,000
P.B.T.	4,10,000
Adjustment for :	
(+) Depreciation	1,42,000
(-) Profit on sale of machine	(21,000)
(+) Amortisation of Goodwill	15,000
Net operating profit before working capital changes.	5,46,000
(+) Increase in creditors	35,000
(+) Decrease in Debtors [23,000 - (17,250 - 15,000)]	20,750
(+) Decrease in Prepaid Expenses	3,000
(-) Increase in Stock	(95,000)
Operating profit before tax & extraordinary items	5,09,750
(-) Tax paid	(1,00,000)
Net Operating Income	4,09,750

Working Note :

Provision for Taxation

To Bank A/c	1,00,000	By Balance b/d	1,05,000
To Balance c/d	1,55,000	By P/L A/c	1,50,000
	2,55,000		2,55,000

—— Space to write important points for revision ——

2014 - June [4] (c) (ii) Shyama Limited has given the following information for the preparation of cash flow statement for the year 2013-14.

	₹ in '000
Net profit before tax	50,000
Dividend (including dividend tax) paid	17,070
Provision for income tax	10,000
Income tax paid during the year	8,496
Loss on sale of assets (net)	80
Book value of the assets sold	370
Depreciation charged during the year	40,000
Amortisation of capital grant	12
Profit on sale of investments	200
Cost of investment sold	55,530
Interest received on investments	5,012
Interest expenses	20,000
Interest paid during the year	21,040
Increase in Current Assets (excluding cash & Bank balance)	77,500
Decrease in Current Liabilities	34,650
Purchase of Fixed Assets	29,120
Purchase of investment	7,700
Expenditure on construction work in progress	69,480
Receipt of grant for capital projects	28
Proceeds from issue of share capital	51,960
Proceeds from issue of Debentures	41,150
Opening cash and Bank balance	10,006
Closing cash and Bank balance	13,976

You are required to prepare the Cash Flow Statement for the year 2013-14 in accordance with AS-3. **(10 marks)**

Answer:

Shyama Limited
Cash Flow Statement
for the year ended 31st December, 2014

(₹ **in lakhs**)

Cash flows from operating activities		
Net profit before taxation (50,000 + 10,000)	60,000	
Adjustments for:		
Depreciation	40,000	
Loss on sale of assets (Net)	80	
Amortisation of capital grant	(12)	
Profit on sale of investments	(200)	
Interest income on investments	(5,012)	
Interest expenses	20,000	
Operating profit before working capital changes	1,14,856	
Increase in Current Assets (Excluding cash and bank balance)	(77,500)	
Decrease in Current Liabilities	(34,650)	
Cash generated from operations	2,706	
Income taxes paid	(8,496)	
Net cash used in operating activities		(5,790)
Cash flows from investing activities		
Sale of assets	290	
Sale of investments (55,530 + 200)	55,730	
Interest income on investments	5,012	
Purchase of fixed assets	(29,120)	
Investment in joint venture	(7,700)	
Expenditure on construction work-in-progress	(69,480)	
Net cash used in investing activities		(45,268)

Cash flows from financing activities		
Receipts of grant for capital projects	28	
Proceeds from issue of share capital	51,960	
Proceeds from long-term borrowings	41,150	
Interest paid	(21,040)	
Dividend (including dividend tax) paid	(17,070)	55,028
Net increase in cash and cash equivalents		3,970
Cash and cash equivalents at the beginning of the period		10,006
Cash and cash equivalents at the end of the period		13,976

Working Notes:

Book value of the assets sold	370
Less: Loss on sale of assets	(80)
Proceeds of sale	290

Assumption: Interest income on investments ₹ 5,012 has been received during the year.

—— Space to write important points for revision ——

2014 - Dec [3] Answer the question:

(c) (ii) Relevant balance sheet accounts of Arti Limited, as on 31st March, 2013 and 2014 are as follows:

(₹ in lakhs)

Particulars	31.03.13	31.03.14
General Reserve	46	49.50
Profit and Loss A/c (Cr.)	41	47.00
Creditors	25	23.50
Bills Payable	3	4.00
Income Tax Payable	10	17.00
Proposed Dividend	15	18.00
Stock	30	27.00
Debtors	22	26.00
Bills Receivable	4	2.50
Prepaid Expenses	1	2.40

Other Information:

(1) During the year 2013-14, one old machine costing ₹ 6,45,000 (W.D.V. ₹ 3,92,000) was sold for ₹ 3,68,000 and some investments are sold at a profit of ₹ 15,000.

(2) During the year 2013-14, depreciation charged ₹ 4,50,000, goodwill written off ₹ 25,000 and Income tax paid ₹ 8,75,000.

You are required to calculate the net cash flow from operating activities. **(8 marks)**

Answer:

Calculation of Cash Flow from Operation Activities for the year ended 31st March, 2014

(₹ **in lakhs**)

Net Profit before tax and Extra Ordinary Items:	39.75
Adjustment for:	
Transfer to General Reserve	3.50
Loss on sale of old Machine (3,92,000 - 3,68,000)	0.24
Profit on sale of investments	(0.15)
Goodwill written off	0.25
Depreciation	4.50
Operating Profit before working capital changes	48.09
Adjustment for:	
Decrease in Creditors	(1.50)
Increase in Bills Payable	1.00
Decrease in Stock	3.00
Increase in Debtors	(4.00)
Decrease in Bills Receivable	1.50
Increase in Prepaid Expenses	(1.40)
Cash Generated from operations	46.69
Income Tax paid Net	(8.75)
Cash from Operating Activities	37.94

Working Notes:

1.	Net Profit before tax and Extra ordinary items:	(₹ In Lakhs)
	P/L A/c as on 31.3.14	47
	Less: P/L A/c as on 31.3.13	41
		6
Add: Proposed Dividend		18
Add: Provision for Tax		15.75
N.P. before tax		39.75

2.

Income Tax Payable A/c

	₹		₹
To Bank	8,75,000	By Balance b/d	10,00,000
To Balance c/d	17,00,000	By P/L A/c	15,75,000
	25,75,000		25,75,000

Statement showing surplus available before notional capital

Particulars	(₹)
Assets realized	14,28,000
(+) Surplus from secured creditors	1,22,000
(-) Expenses of liquidation (including Liquidator's remuneration)	72,000
(-) Preferential Creditors	29,400
(-) Unsecured Creditors	5,24,600
(-) Preference Shareholders	9,00,000
	24,000

Surplus available before notional capital	₹ 24,000
Add: Notional Capital	
[(8,000×25)+(6,400×40) + (56,000×5)]	₹ 7,36,000
Total	₹ 7,60,000

Surplus available for each equivalent number of equity shares of ₹ 10 each

$= \frac{₹7,60,000}{2,00,000} = ₹3.8$

Class A Equity Share will receive — [(₹ 3.8×10)- ₹ 25] = ₹ 13.00 per share.
Class B Equity Share will receive — [(₹ 3.8×10)- ₹ 40] = (₹ 2.00) per share.
Class C Equity Share will receive — [₹3.8-₹5] = (₹1.2) per share.

—— Space to write important points for revision ——

2015 - June [3] Answer the following:

(c) (i) Following details are provided by Patasha Ltd:

Particulars	31.03.2015 (₹)	31.03.2014 (₹)
Liabilities:		
Share Capital	25,00,000	22,00,000
General Reserve	4,00,000	3,50,000
Profit and Loss Account	3,00,000	1,50,000
Debentures	5,00,000	3,00,000
Provision for taxation	2,00,000	1,50,000
Proposed dividend	4,00,000	3,50,000
Trade payables	9,00,000	11,50,000
	52,00,000	46,50,000
Assets:		
Plant and Machinery	15,00,000	11,00,000
Land and Building	10,00,000	8,00,000
Investments (Non trading)	3,00,000	1,50,000
Trade receivables	9,00,000	10,50,000
Inventories	10,00,000	12,00,000
Cash in hand/Bank	5,00,000	3,50,000
	52,00,000	46,50,000

(1) Depreciation @ 15% was charged on the opening value of Plant and Machinery.
(2) At the year end, one old machine costing ₹ 1,50,000 (WDV ₹ 70,000) was sold for ₹ 1,10,000. Purchase was also made at the year end.
(3) ₹ 1,20,000 was paid towards Income tax during the year.
(4) ₹ 15,000 received as interest on investment during the year.
(5) Building under construction was not subject to any depreciation.

You are require to prepare Cash Flow Statement as per AS-3.

(10 marks)

Answer:

Cash flow statement for the year ended on 31st March, 2015

A. Cash flow from Operating Activities

	₹	₹
Profit & Loss A/c as on 31.03.2015	3,00,000	
Adjustments for:		
Transfer to General Reserve	50,000	
Provision for Taxation	1,70,000	
Proposed Dividend	4,00,000	
Depreciation	1,65,000	
Interest on Investment	(15,000)	
Profit on Sale of Machinery	(40,000)	
	10,30,000	
Less: Opening Balance of P&L A/c	(1,50,000)	
Operation Profit before working capital changes	8,80,000	
Decrease in trade payables	(2,50,000)	
Decrease in trade receivables	1,50,000	
Decrease in value of inventories	2,00,000	
Cash generated from operations	9,80,000	
Income tax paid	(1,20,000)	
Net Cash from Operating Activities		8,60,000

B.	**Cash flow from Investing Activities**		
	Purchase of Plant & Machinery	(6,35,000)	
	Purchase of Land & Building	(2,00,000)	
	Purchase of Investment	(1,50,000)	
	Proceeds from Sale of Plant & Machinery	1,10,000	
	Interest on Investments	15,000	
	Net Cash from Investing Activities		(8,60,000)
C.	**Cash flow from Financing Activities**		
	Proceeds from issue of share capital	3,00,000	
	Proceeds from issue of debentures	2,00,000	
	Payment of dividend	(3,50,000)	
	Net Cash from Financing Activities		1,50,000
	Net increase/decrease in cash and cash equivalent during the year		1,50,000
	Cash & Cash equivalent at the beginning of the year		3,50,000
	Cash & Cash equivalent of the end of the year		5,00,000

Working Note:

1. Provision for Taxation A/c

	₹		₹
To Bank A/c	1,20,000	By Balance b/d	1,50,000
To Balance c/d	2,00,000	By P&L A/c	1,70,000
	3,20,000		3,20,000

2. Plant & Machinery A/c

	₹		₹
To Balance b/d	11,00,000	By Bank A/c (Sale)	1,10,000
To P&L A/c	40,000	By Depreciation A/c	1,65,000

To Bank A/c (Purchase being balancing figure)	6,35,000	By Balance	15,00,000
	17,75,000		17,75,000

Space to write important points for revision

2016 - June [4] (a) Following balances are provided by the Meenakshi Ltd. for the year ended 31st March, 2015 and 2016:

Particulars	**31.03.2015** ₹	**31.03.2016** ₹
Equity Share Capital	120,00,000	140,00,000
General Reserve	74,00,000	89,00,000
Profit & Loss A/c	42,00,000	60,00,000
11% Debentures	100,00,000	60,00,000
Goodwill	20,00,000	16,00,000
Land & Building	140,00,000	130,00,000
Plant & Machinery	120,00,000	132,00,000
Investment (Non trading)	48,00,000	44,00,000
Creditors	37,00,000	43,00,000
Provision for tax	25,50,000	38,40,000
Proposed Dividend	18,00,000	25,20,000
Stock	80,00,000	77,00,000
Debtors	57,60,000	83,00,000
Cash at Bank	17,60,000	18,60,000
Prepaid Expenses	3,00,000	2,20,000

Additional Information:

(i) Investment were sold during the year for ₹ 7,00,000.

(ii) During the year an old machine costing ₹ 16,00,000 was sold for ₹ 7,20,000. Its written down value was ₹ 9,00,000.

(iii) Depreciation charged on plant and machinery @ 20% on the opening balance.

(iv) There was no purchase or sell of land and building during the year.

(v) Provision for tax made during the year was ₹ 32,20,000.

(vi) During the year premium on redemption of debentures ₹ 4,00,000 was written-off.

You are required to prepare a statement showing the net cash flow from the operating activities. **(9 marks)**

Answer:

Statement Showing Net Cash Flow from Operating Activities for the year ending 31st March, 2016:

Particulars	₹	₹
Profit & Loss A/c as on 31.03.2016		60,00,000
Less: Profit & Loss A/c as on 31.03.2015		42,00,000
		18,00,000
Add: Transfer to General Reserve	15,00,000	
Provision for tax	32,20,000	
Proposed Dividend	25,20,000	72,40,000
Profit before tax		90,40,000
Adjustment for Depreciation:		
Land & Building	10,00,000	
Plant & Machinery	24,00,000	34,00,000
Profit on sale of Investment (7,00,000 – 4,00,000)		(3,00,000)
Loss on sale of Plant & Machinery		1,80,000
Goodwill written-off		4,00,000

Premium on redemption debentures written-off		4,00,000
Operating Profit before Working Capital Changes		1,31,20,000
W.C. Changes:		
Decrease in Prepaid Expenses		80,000
Decrease in Stock		3,00,000
Increase in Debtors		(25,40,000)
Increase in Creditors		6,00,000
Cash generated from operations		1,15,60,000
Income Tax paid		(19,30,000)
Net Cash Inflow from Operating Activities		**96,30,000**

Working Notes:

Provision for Tax Account:

Dr. **Cr.**

Particulars	(₹)	Particulars	(₹)
To Bank A/c	19,30,000	By Balance b/d	25,50,000
(Balancing figure)			
To Balance c/d	38,40,000	By Profit & Loss A/c	32,20,000
	57,70,000		**57,70,000**

Dr. **Investment Account** **Cr.**

Particulars	(₹)	Particulars	(₹)
To Balance b/d	48,00,000	By Bank A/c (sale) By	7,00,000
To Profit & Loss A/c (profit)	3,00,000	By Balance c/d	44,00,000
	51,00,000		**51,00,000**

2016 - Dec [5] (a) EVVM INDIA LTD. has the following balances as on 1st April, 2015:

	Amount (₹)
Fixed Assets	5,70,000
Less: Depreciation	1,99,500
	3,70,500
Stocks and Debtors	2,37,500
Bank Balance	33,250
Creditors	57,000
Bills Payable	38,000
Capital (Shares of ₹ 100 each)	2,85,000

The company made the following estimates for financial year 2015-16:

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

(ii) The company will acquire fixed assets costing ₹ 95,000 after selling one machine for ₹ 19,000 costing ₹ 47,500 and on which depreciation provided amounted to ₹ 33,250.

(iii) Stocks and Debtors, Creditors and Bills payables at the end of financial year are expected to be ₹ 2,80,250, ₹ 74,100 and ₹ 49,400 respectively.

(iv) The profit would be ₹ 52,250 after depreciation of ₹ 57,000.

Prepare the projected cash flow statement and ascertain the bank balance of EVVM INDIA LTD. at the end of financial year 2015-16. **(9 marks)**

Answer:

Working Notes:

Particulars	**Amount** (₹)
Cash Flow from operations	
Profit for the year	52,250
Add: Depreciation (non cash item)	57,000
	1,09,250

Less: Profit on sale of machine	4,750
	1,04,500
Add increase in:	
Creditors (₹ 74,100 – ₹ 57,000) = ₹ 17,100	
Bills payable (₹ 49,400 – ₹ 38,000) = ₹ 11,400	28,500
	1,33,000
Less : Increase in Stocks & Debtors (₹ 2,80,250 – ₹ 2,37,500)	42,750
Cash from operations	90,250
Payment of Dividend	
10% on capital ₹ 2,85,000 = ₹ 28,500	
Gross up Amount	
Total Dividend ₹ 8,000	
Tax 25% ₹ 9,500	
Payment of Dividend ₹ 28,500	

Note: Income Tax on Company's Profit Ignored

Projected Cash Flow Statement
for the Year ending on 31st March, 2016

Particulars	Amount (₹)	Amount (₹)
Bank Balance as on 1st April, 2015		33,250
Add: Inflow of Cash		
Sale of Machine	19,000	
Cash From operation	90,250	1,09,250
Less: Outflow of Cash		
Purchase of Fixed Assets	95,000	
Payment of Dividend	28,500	
Tax Paid	9,500	1,33,000
Bank Balance on 31st March, 2016		9,500

Space to write important points for revision

2017 - June [3] (a) From the following information provided, prepare a Cash Flow Statement as per AS-3.

Balance Sheet of PQR Ltd.

		Particulars	**Note No.**	**As on 31.03.16 ₹**	**As on 31.03.15 ₹**
I		Equity and Liabilities			
	1.	Shareholders' fund			
		(a) Share Capital	1	20,00,000	20,00,000
		(b) Reserves and Surplus	2	10,00,000	8,70,000
	2.	Share application money pending allotment		Nil	Nil
	3.	Non-Current Liability		Nil	Nil
	4.	Current Liabilities		6,50,000	8,00,000
		Total		36,50,000	36,70,000
II		*Assets*			
	1.	Non-current Assets			
		(a) Fixed Assets (Tangible)		16,50,000	15,00,000
		(b) Non-current Investment		7,00,000	8,00,000
	2.	Current Assets			
		(a) Inventories		7,60,000	7,00,000
		(b) Trade Receivables		4,50,000	5,00,000
		(c) Cash and Cash Equivalent		6,000	74,000
		(d) Short term loan and advances (Prepaid Expenses)		84,000	96,000
				36,50,000	36,70,000

Notes to Accounts:

	1.	Share Capital		
		Equity Share Capital	20,00,000	15,00,000
		Redeemable Preference Share Capital of ₹ 100, ₹ 50 paid	Nil	5,00,000
			20,00,000	20,00,000
	2.	Reserve and Surplus		
		Balance of Profit	3,00,000	4,50,000
		General Reserve	2,00,000	4,00,000
		Capital redemption reserve	5,00,000	Nil
		Securities Premium	Nil	20,000
			10,00,000	8,70,000

Additional Information:

(i) During the year the company got income from investment ₹ 80,000.

(ii) Company paid ₹ 1,50,000 as equity dividend and ₹ 76,000 as preference dividend.

(iii) The company redeemed the preference shares at a premium of 5% after making a successful call of ₹ 50 per share to make the shares fully paid

(iv) During the year one machine was sold for ₹ 50,000 and the profit on sale of ₹ 6,000 was taken to Profit and Loss A/c. Depreciation for the year on fixed assets was ₹ 1,80,000. **(9 marks)**

Answer:

Cash flow statement (As per AS - 3)

Particulars	**Amount (₹)**	**Amount (₹)**
Cash From Operating Activities:		
Net profit as per Balance Sheet	3,00,000	
Add: Depreciation	1,80,000	

Dividend on equity shares	1,50,000	
Dividend on Preference Shares	76,000	
Premium on Redemption of Preference Shares	30,000	
Transfer to Capital Redemption Reserve A/c	3,00,000	
	10,36,000	
Less: Income from Investment	80,000	
Less: Profit on Sale of Machinery	6,000	
Less: Opening Balance of Profit & Loss A/c	4,50,000	
Cash from Operations		5,00,000
Adjustments for Working Capital Changes		
Add: Decrease in current assets & Increase in current liabilities		
Decrease in Trade Receivable	50,000	
Decrease in short term loan on advances	12,000	62,000
		5,62,000
Less: Decrease in current liabilities	1,50,000	
Increase in Inventories	60,000	2,10,000
Cash flow from Operating Activities		3,52,000
Cash flow from Investing Activities		
Sale of Non-current Investments	1,00,000	
Income from Investment	80,000	
Sale of Machinery	50,000	
Purchase of Machinery	(3,74,000)	(1,44,000)
Cash Flow from Financing Activities		
Issue of equity shares	5,00,000	
Find call on Preference Shares	5,00,000	

Redemption of Preference Shares	(10,00,000)	
Premium on Redemption of Preference Shares	(50,000)	
Payment of equity Dividend	(1,50,000)	
Payment of Dividend on Preference Shares	(76,000)	(2,76,000)
		(68,000)
Add: Opening Balance of Cash & Cash equivalent		74,000
Closing Balance of Cash & Cash equivalent		**6,000**

Working Note:

1. **General Reserve A/c**

Particulars	Amount (₹)	Particulars	Amount (₹)
To Transfer to Capital Redemption Reserve A/c	2,00,000	By Balance b/f	4,00,000
To Balance c/f	2,00,000		
	4,00,000		4,00,000

2. **Fixed Asset A/c**

Particulars	Amount (₹)	Particulars	Amount (₹)
To Balance b/f	15,00,000	By Sale of Machinery	50,000
To Profit on Sale of Machinery	6,000	By Depreciation	1,80,000
To Bank A/c (Purchase of machinery being balancing figure)	3,74,000	By Balance C/f	16,50,000
	18,80,000		18,80,000

2017 - Dec [3] (a) On the basis of the following information provided by X Ltd. prepare a Cash Flow Statement for the year ended on 31st March, 2017.

(i) X Ltd. sold all the goods for cash only and purchased the goods in credit only.

(ii) The company earned a Gross Profit of ₹ 4,00,000 with a Gross Profit Ratio of 25%.

(iii) The closing inventory was higher than the opening inventory by ₹ 20,000.

(iv) The company paid ₹ 4,50,000 as wages and ₹ 90,000 as office expenses during the year.

(v) Balance of Suppliers accounts on 31.03.2016 was higher than the balance on 31.03.2017 by ₹ 30,000.

(vi) Tax paid by the company amounts to ₹ 80,000 while provision for taxation was ₹ 70,000.

(vii) The company repaid bank loan of ₹ 1,75,000 which included interest of ₹ 15,000.

(viii) Dividend paid during the year ₹ 50,000 (including dividend distribution tax).

(ix) X Ltd. sold investments of ₹ 6,00,000 at a profit of ₹ 40,000.

(x) Depreciation charged on fixed assets ₹ 1,20,000.

(xi) Furniture purchased during the year ₹ 2,00,000.

(xii) Cash and Cash Equivalents as on 31.03.2016 was ₹ 1,00,000.

(xiii) Cash and Cash Equivalents as on 31.03.2017 was ₹ 4,95,000.

(8 marks)

Answer:

Working Note 1:

Gross Profit @ 25% on Sales = ₹ 4,00,000, So Total Sales = ₹ 16,00,000 (all for cash)

COGS = Sales - G.P = ₹ 12,00,000

Let closing inventory is x and hence opening inventory is (x – 20,000)

Now, COGS = Op. Inventory + Purchase + Wages - Cl. Inventory

Or. 12,00,000 = (x-20,000) + Purchase – 4,50,000 - x

Or. Purchase = 7,70,000.

Working Note 2:

Let closing balance of suppliers = y, hence opening balance = (y +30,000)

Suppliers' Account

Dr. **Cr.**

	₹		₹
To Payment to Suppliers (Bal. Fig.)	8,00,000	By Balance b/f	Y + 30,000
To Balance c/f	y	By Purchase	7,70,000
	y + 8,00,000		y + 8,00,000

Cash Flow Statement for the year ended on 31.03.2017

Particulars	₹	₹
A. Cash Flow from Operating Activities		
Cash Sales		16,00,000
(-) Cash payments		
Payment to suppliers	8,00,000	
Wages paid	4,50,000	
Office expenses paid	90,000	13,40,000
		2,60,000
(-) Income tax paid		80,000
		1,80,000
B. Cash Flow from Investing Activities		
Sale of Investments	6,40,000	
Purchase of furniture	(2,00,000)	4,40,000

C. Cash Flow from Financing Activities		
Bank loan repaid with interest	(1,75,000)	
Dividend paid with distribution tax	(50,000)	(2,25,000)
(A+B+C)		3,95,000
D. Opening Cash and Cash Equivalent		1,00,000
E. Closing Cash and Cash Equivalent		4,95,000

—— Space to write important points for revision ——

2018 - June [3] (a) The following are the summarized Balance Sheets of ABC Limited as on 31st March, 2016 and 2017:

Liabilities	31.03.16	31.03.17	Assets	31.03.16	31.03.17
	₹	₹		₹	₹
Share Capital	4,60,000	4,60,000	Land and Building	3,00,000	3,00,000
Profit and Loss Balance	32,000	46,000	Machinery	1,04,000	1,40,000
Reserve	1,20,000	1,20,000	Investments	2,20,000	1,48,000
8% Debentures	1,80,000	1,40,000	Stock	1,64,000	2,12,000
Depreciation Fund	80,000	88,000	Debtors	1,34,000	86,000
Creditors	2,06,000	1,92,000	Cash	1,80,000	1,80,000
Outstanding expenses	26,000	24,000	Prepaid expenses	2,000	4,000
	11,04,000	10,70,000		11,04,000	10,70,000

Additional Information :

(i) 10% Dividend was paid during 2016-17.

(ii) Old Machinery costing ₹ 24,000 (accumulated depreciation ₹ 12,000) was sold for ₹ 8,000.

(iii) 40,000 8% Debenture were redeemed by purchase from open market at ₹ 96 for a debenture of ₹ 100 on 31.03.2017.

(iv) Investments worth ₹ 72,000 were sold at book value.

(v) Bad debt written off during the year ₹ 10,000.

Prepare a Statement of Cash Flow for the year ended 31.3.2017.

(8 marks)

Answer:

ABC Ltd.

Cash Flow Statement for the year ended 31.03.2017

Particulars	₹	₹	₹
1. Cash Flows under Operating Activities			
Operating Profit (As per adjusted P / L A/c)		96,800	
Add: Decrease in Debtors		48,000	
		1,44,800	
Less: Increase in stock	48,000		
Increase in prepaid expenses	2,000		
Decrease in creditors	14,000		
Decrease in outstanding expenses	2,000	66,000	
Net cash from Operating Activities			78,800
2. Cash Flows from Investing Activities:			
Sale of machinery		8,000	
Sale of investment		72,000	
Less: Purchase of machinery		80,000	
Net cash from Investing		60,000	20,000
3. Cash Flows from Financing Activities:			
Redemption of Debenture (96 / 100 × 40,000)		(38,400)	
Payment of interest		(14,400)	
Payment of dividend		(46,000)	
Net cash from Financing activities			(98,800)
Net change in Cash and Cash equivalent for the year			Nil
Add : Cash at the beginning of the year			1,80,000
Cash at the end of the year			1,80,000

(1) Machinery Account

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Balance b/d	1,04,000	By Bank - Sale proceeds	8,000
" Bank - Purchase (Bat. Fig.)	60,000	"Depreciation fund	12,000
		" Adj. P/L A/c - loss on sale	4,000
		By Balance c/d	1,40,000
	1,64,000		1,64,000

(2) Depreciation Fund Account

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Machinery A/c	12,000	By Balance b/d	80,000
To Balance c/d	88,000	" Adj. P / L A/c - Depreciation	20,000
	1,00,000		1,00,000

(3) Investment Account

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Balance b/d	2,20,000	By Bank	72,000
		By Balance c/d	1,48,000
	2,20,000		2,20,000

(4) Adjusted Profit and Loss Account

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Machinery A/c - loss on sale	4,000	By Balance b/d	32,000
"Depreciation Fund - Depreciation	20,000	" 8% Debenture - Profit on cancellation	1,600
"Dividend	46,000	By Operating profit (Bal. figure)	96,800

" Interest (1,80,000 x 8/100);	14,400		
To Balance c/d	46,000		
	1,30,400		1,30,400

Note: There is no need to make any adjustment entry for bad debt as it has already been written off.

—— Space to write important points for revision ——

2018 - Dec [3] (a) Following are the summarized Balance Sheets of Beta Ltd.

Liabilities	31.03.17 ₹	31.03.18 ₹	Assets	31.03.17 ₹	31.03.18 ₹
Equity Share Capital (₹ 10)	4,00,000	5,00,000	Land & Building	4,00,000	3,80,000
General Reserve	1,00,000	1,20,000	Plant and Machinery	3,00,000	3,38,000
Profit & Loss (Cr.)	61,000	61,200	Inventory	2,00,000	1,48,000
Bank Loan	1,40,000	_	Trade Receivable	1,60,000	1,28,400
Trade Payable	3,00,000	2,70,400	Cash in hand	1,000	1,200
Provision for Taxation	60,000	70,000	Cash at Bank	-	16,000
			Goodwill	-	10,000
	10,61,000	**10,21,600**		**10,61,000**	**10,21,600**

Additional Information:

(i) Dividend paid during the year ₹ 46,000.

(ii) Net profit for the year ₹ 1,32,200.

(iii) Depreciation written-off on building ₹ 20,000 and on machinery ₹ 28,000.

(iv) Income tax paid during the year ₹ 56,000.

(v) The following assets of another company were purchased for a consideration of ₹ 1,00,000 and paid in shares.
Assets were: Inventory ₹ 40,000 and Machinery ₹ 50,000.

(vi) Further machinery was purchased for ₹ 50,000 during the year. There was a sale of Machinery.

You are required to prepare a Cash Flow Statement as per AS 3.

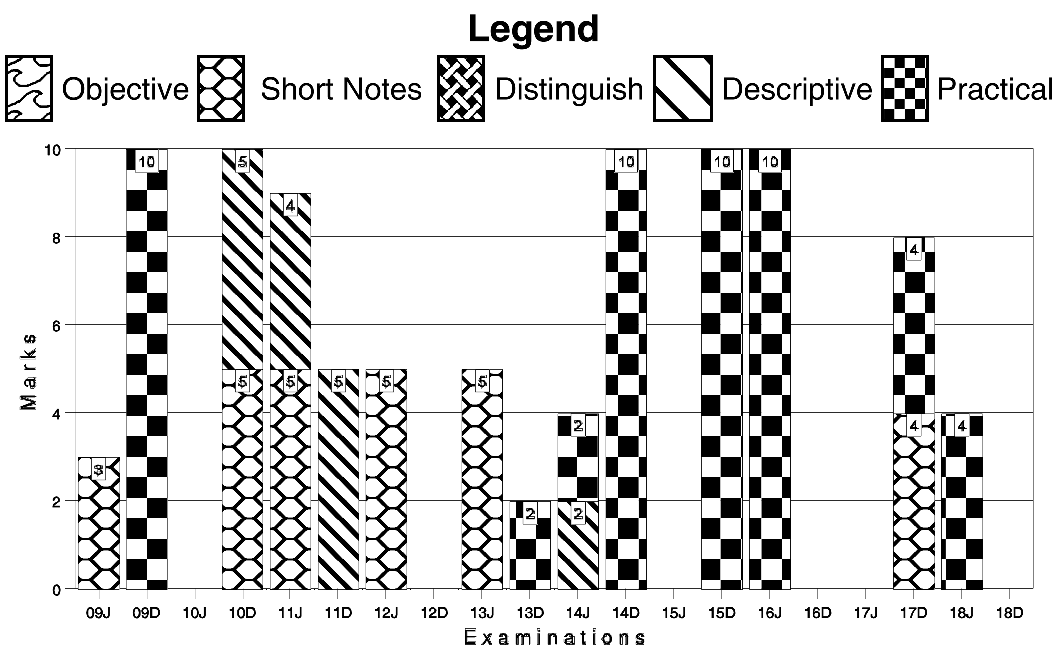
(9 marks)

4A ACCOUNTS OF BANKING COMPANY

THIS CHAPTER INCLUDES

- Important Provisions of Banking Regulation Act, 1949
- Bank's Book Keeping System
- Books of Accounts
- Final Accounts of Bank
- Performing & Non-Performing Assets
- Rebate on Bills Discounted

Marks of Objective, Short Notes, Distinguish Between, Descriptive & Practical Questions



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CHAPTER AT A GLANCE

<table>
<tr><th>S. No.</th><th>Topic</th><th colspan="2">Important Highlights</th></tr>
<tr><td>1.</td><td>"Non-Performing Assets" (NPA)</td><td colspan="2">The interest and / or instalment of principal in respect of such an Advance has remained due for a specified period of time. The identification of NPA is done on the basis of the position as on the balance Sheet date.</td></tr>
<tr><td>2.</td><td>Time Limits</td><td colspan="2">An Advance / Asset will be treated as NPA considering the following time limits-</td></tr>
<tr><td></td><td></td><td>Nature</td><td>When termed as NPA</td></tr>
<tr><td></td><td></td><td>Term Loan</td><td>Interest and / or Instalment of principal has remained overdue for a period exceeding 90 days.</td></tr>
<tr><td></td><td></td><td>Overdraft / Cash Credit</td><td>The account has remained "Out-of-order" for a period exceeding 90 days.</td></tr>
<tr><td></td><td></td><td>Bill Purchased & Discounted</td><td>The bill remains overdue for a period exceeding 90 days.</td></tr>
<tr><td></td><td></td><td>Agricultural Advances</td><td>The instalment of principal or interest thereon remains overdue for:
• Short Duration Crops - Two Crop Seasons
• Long Duration Crops - One Crop Seasons</td></tr>
</table>

3.	**Classification of Assets**	The bank have to classify their advances as follows: 1. **Standard Assets:** Standards Assets is one which do not pose any problems and which do not carry more than normal risk attached to the business. They are not NPAs. 2. **Sub-Standard Assets:** Substandard Assets are those which have remained an NPA for a period not exceeding 12 Months. 3. **Doubtful Assets:** An assets would be classified as doubtful if it remained in the sub-standard category for 12 Months. 4. **Loss Assets:** A loss assets is one where loss has been identified by the bank or Internal / External Auditors or by the RBI Inspection.

SHORT NOTES

2009 - June [8] Write short note on:

(c) Statutory Reserve in case of Bank; **(3 marks)**

Answer:

Statutory Reserve in case of Banks:

Every banking company incorporated in India shall create a reserve fund and transfer to least 25% of the annual profit as disclosed in the Profit and Loss Account before any dividend is declared.

Any appropriation out of reserve fund must be intimated to RBI within 21 days from the day such appropriation, explaining the circumstances relating thereto.

—— Space to write important points for revision ——

2010 - Dec [8] Write short note on:

(a) Non - Banking Assets **(5 marks)**

Answer

Non- banking assets :

A Bank cannot acquire certain assets but it can always lend against the security of such assets. This means that sometimes, in case of failure on the part of the loanee to repay the loans, the bank may have to take possession of such assets. In that case, the assets will be shown in the balance sheet as “ Non- banking Assets”. These must be disposed of within seven years. Income from or profit/loss on sale such assets has be separately shows in profit and loss account of the bank.

—— Space to write important points for revision ——

2011 - June [8] Write short note on :

(d) Rebate on Bills discounted. **(5 marks)**

Answer

Rebate on Bills Discounted

When a bank discounted bill, bills discounted and purchased A/c. is debited with the full value of the bill and current A/c. (Customers) is credited with the net proceeds and interest and Discount A/c. is credited with the amount of total discount of the bill. Discount represents the interest on bill value for the unexpired period of the bill (difference between the date of maturity and date of discounting). It sometimes happen that on the closing day, the bill in question has not matured and then the interest relating to next period should be carried forward.

—— Space to write important points for revision ——

2012 - June [8] Write short note on:

(d) Liquidity norms of Banking Companies; **(5 marks)**

Answer:

Liquidity Norms of banking Companies under Section 24 of banking Regulation Act.

Banking Companies have to maintain sufficient liquid assets in the Normal courses of business. In order to safeguard the interest of depositors and to prevent banks from overextending their resources, liquidity norms have been settled and given statutory recognition. Every banking company has to maintain in cash, gold or unencumbered approved securities, an amount not less than 25% of its demand and time liabilities in India. However, this percentage is changed by the Reserve Bank of India from time to time considering the general economic conditions. This is in addition to the average daily balance which a scheduled bank is required to maintain under **Section 42** of the Reserve bank of India Act and in case of other banking companies, the cash reserve required to be maintained under Section 18 of the Banking Regulation Act.

—— Space to write important points for revision ——

2013 - June [8] Write short note:

(b) Rebate on Bills Discounted; **(5 marks)**

Answer:

At the time of discounting the bill total among of discount (difference between face value and discounted amount) is credited to interest and discounted by a bank. Discount represents the interest on bill value for the unexpired period of the bill, It may sometime happen that on the closing day of the accounting year, the bill in question has not matured. At the time of preparing final accounts, the interest relating to next accounting period must be carried forward by passing the following entry:

Interest and Discount A/c. Dr.

To Rebate on Bills Discounted Account.

—— Space to write important points for revision ——

2017 - Dec [5] Write short note:

(c) Provisioning Arrangements for Non-Performing Assets **(4 marks)**

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 upto 1 year	25
For Doubtful > 1 year and upto 3 years	40
For Doubtful > 3 years	100

Space to write important points for revision

DISTINGUISH BETWEEN

2008 - Dec [5] (b) Distinguish between Statutory Reserve and Cash Reserve in respect of Banking Companies. **(5 marks)**

Answer:

Statutory Reserve:

Banking companies incorporated in India shall create a reserve fund and transfer to it atleast 25% of its annual profit as disclosed in the profit and loss account before any dividend is declared.

Where a banking company appropriates any sum or sums from the Reserve Fund or Share Premium Account, it shall report the fact to the Reserve Bank explaining circumstance relating to such appropriations within 21 days from the date of such appropriation.

Cash Reserve:

Every banking company not being a scheduled bank, has to maintain a Cash Reserve (CRR) of atleast 4% of the total of its demand and time liabilities or as specified by Reserve Bank of India, from time to time.

Space to write important points for revision

DESCRIPTIVE QUESTIONS

2010 - Dec [4] (b) Describe how the classification of investments is done by a Banking Company. **(5 marks)**

Answer:

The investment portfolio of a Bank would normally consist of both approved securities (Predominantly government securities) and other securities (shares, debentures, bonds etc.). Banks are required to classify their entire investment portfolio into three categories.

(i) **Held-to-maturity**	Securities acquired by bank with the intention to hold them upto maturity should be classified as 'held-to-maturity'.
(ii) **Held-for-maturity**	Securities required by bank with the intention to trade by taking advantage of short term price interest rate movements should be classified as held-for-maturity/trading.
(iii) **Available-for-sale**	Securities which do not fall within the above two categories should be classified as available-for-sale.

Space to write important points for revision

2011 - June [4] (d) State the main characteristics of the Book keeping system of Banks. **(4 marks)**

Answer:

Main characteristics of a Bank's Book-Keeping system.

(i) **Voucher posting**	Entries in the personal ledger are made directly from vouchers instead of being posted from the books of prime entry.

(ii) **Voucher summary sheets**	The vouchers entered into different personal ledgers each day are summarized on summary sheets, totals of which are posted to the control accounts of the general ledger.
(iii) **Daily trial balance**	The general ledger trial balance is extracted and agreed every day.
(iv) **Continuous checks**	All entries are checked by persons other than those who have made the entries.
(v) **Control accounts**	A trial balance of the detailed personal ledgers is prepared periodically, usually every two weeks, agreed with general ledger control accounts.
(vi) **Double voucher system**	Two vouchers are prepared for every transaction not involving cash- one debit voucher and another credit voucher.

—— Space to write important points for revision ——

2011 - Dec [5] (b) Discuss some important provisions of the Banking Regulation Act, 1949 regarding disposal of Non-Banking Assets u/s 9 of the Act. **(5 marks)**

Answer:

- Not with standing anything contained in **Section 6** which specifies the various forms of business in which a Banking company may engage in addition to the business of Banking, no Banking company shall hold any immovable property howsoever acquired, except such as is required for its own use, for any period exceeding seven years from the acquisition thereof or from commencement of the Act, whichever is later, or any extension of such period as in section provided; and such property shall be disposed of within such period or extended period, as the case may be.

- Provided that the Banking company may, within the period of seven years as aforesaid; deal or trade in any such property for the purpose of facilitating the disposal thereof. Provided further that Reserve Bank may in any particular case extend the aforesaid period of seven years by such period not exceeding five years, where it is satisfied that such extension would be in the interest of the depositors of the Banking company.

—— Space to write important points for revision ——

2014 - June [3] (b) Describe the principal accounting policies for a Banking Company in respect of foreign exchange transactions.

(2 marks) ***[CMAIG - I]***

Answer:

Transactions involving Foreign Exchange

(a) Monetary assets and liabilities have been translated at the exchange rates, prevailing at the close of the year. Non-monetary assets have been carried in the books at the historical cost.

(b) Income and expenditure items in respect of Indian branches have been translated at the exchange rates, ruling on the date of the transaction and respect of overseas branches at the exchange rates prevailing at the close of the year.

(c) Profit or loss on pending forward contracts has been accounted for.

—— Space to write important points for revision ——

PRACTICAL QUESTIONS

2009 - Dec [2] (a) From the following information, prepare the Profit and Loss Account of German Bank Ltd. for the year ending 31st March, 2009:

	₹
Interest on Loans	2,56,000
Interest on Fixed Deposits	2,75,000
Commission	5,200
Establishment Expenses	54,000

Discount on Bills discounted	1,46,000
Interest on Cash Credit	2,23,000
Interest on Current Accounts	42,000
Rates and Taxes	18,000
Interest on Overdrafts	1,54,000
Directors' Fees	3,000
Auditor's Fees	1,200
Interest on Savings Bank Deposits	68,000
Postage and Telegrams	1,400
Printing and Stationery	2,900
Sundry Charges	1,700
Income from Investments	2,000
Profit on Sale of Investment	4,000

Bad Debts to be written off amounted to ₹ 40,000. Provision for taxation may be made @ 55%. **(10 marks)**

Answer:

Profit and Loss Account
for the year ending 31st March,2009

I.	**Income:**		
	Interest Earned		781.00
	Other Income		9.20
			760.20
II.	**Expenditure:**		
	Interest Expended		385.00
	Operating Expenses		82.20
	Provisions & Contingencies		195.65
			662.85
	Profit/Loss:		
III.	Net Profit/Loss (-) for the year		127.35
	Profit/Loss (-) brought forward		---
			127.35
	Appropriation		
IV.	Transfer to Statutory Reserve		31.84
	(25% of 127.35 Balance Carried		101.88
	over to Balance Sheet		**133.72**

Schedule - 13 : Interest Earned

I.	Interest on Advances on	779.00
II.	Discount on Bills	2.00
	Income on Sale of Investments	**781.00**

Schedule - 14 : Other Income

I. Commission, Exchange and Brokerage	5.20
II. Profit on Sale of Investments	4.00
	9.20

Schedule - 15 : Interest Extended

I. Interest on Deposit	385.00
	385.00

Schedule - 16 : Operating Expenses

I. Payment to and Provision for employees (Establishment)	54.00
II. Rent, Taxes and Lighting	18.00
III. Printing and Stationary	2.90
IV. Directors Fees, Allowances and Expenses	3.00
V. Auditors Fees and Expenses	1.20
VI. Postage, Telegrams, Telephones etc.	1.40
VII. Other Expenditure (Sundry Charges)	1.70
	82.20

Note:

1. Calculation of Interest and Discount for Schedule No.13

Interest on Loans	*256*
Interest on Cash Credit	*223*
Interest on Overdrafts	*154*
Discount on Bills Discounted	*146*
	779

2. Calculation of Interest on Deposits for Schedule No.15

Interest on Fixed Deposits	*275*
Interest on Current Accounts	*42*
Interest on Savings Bank Deposits A/c	*68*
	385

2013 - Dec [1] {C} Answer the following questions (give workings wherever required):

(vi) New Bank Ltd. informs you the following:

(a)	Bill discount commission (unadjusted)	₹ 21,00,000
(b)	Rebate on bills discounted as1+65 on 01.04.2014	₹ 2,43,000
(c)	Rebate on bills discounted as on 31.03.2015	₹ 2,18,000

Compute the discount to be credited to the profit and loss account of the Bank for the year ended 31.03.2015. **(2 marks)** ***[CMAIG - I]***

Answer:

New Bank Ltd.
Rebate on Bills Discounted A/c

Date	Particulars	Amount ₹	Date	Particulars	Amount ₹
31.03.2015	To P& L A/c (Balancing Fig.)	21,25,000	01.04.2014	By Balance b/d	2,43,000
31.03.2015	To Balance c/d	2,18,000	31.03.2015	By Sundry Parties	21,00,000
		23,43,000			23,43,000

Space to write important points for revision

2014 - June [1] {C} Answer the following questions (give workings):

(vii) Sahookar Bank Ltd. had extended the following credit lines to a Small Scale Industry, which had not paid any interest since March 2011:

Balance outstanding out off term loan on 31.03.2015	₹ 45 Lakhs
DICGC Cover	40%
Securities held	₹ 20 Lakhs
Realizable value of securities	₹ 18 Lakhs

You are required to compute the necessary provision to be made for the year ended 31st March, 2015. **(2 marks)** ***[CMAIG - I]***

Answer:

	₹ (in lakhs)
Outstanding balance of tern loan	45.0
Less: Value of security held (subject to reliable value)	18.0
Unsecured portion	27.0
Less: DICGC cover (40%)	10.8
Balance	16.2
Provision (16.2 + 18) =	34.2

Space to write important points for revision

2014 - Dec [1] Answer the following question (Give workings):

(j) A loan account remains out of order as on date of Balance Sheet of MODERN Bank. The account has been classified as Doubtful asset (upto 1 year). Details of the account are as under:

Outstanding	₹ 6,73,000
ECGC Coverage	25% (limited to ₹ 1,00,000)
Value of security held	₹ 1,50,000

Compute the necessary provision to be made by the Bank in respect of this particular account. **(2 marks)** ***[CMAIG - I]***

Answer:

Computation of Provision

	₹
Doubtful Assets (upto 1 year)	6,73,000
Less: Value of security	1,50,000
	5,23,000
Less: ECGC coverage (limited to ₹ 1 lakh)	1,00,000
Unsecured portion	4,23,000
Provision on secured portion @ 25% on 1,50,000	37,500
Provision on unsecured portion @ 100% on 4,23,000	4,23,000
Total provision	4,60,500

Space to write important points for revision

2014 - Dec [7] Answer the question:

(a) Some of the items in the Trial Balance of CANHC Bank Limited as on March 31, 2012 were as follows:

	₹		₹
Loans and Advances	71,50,000	Printing and Stationary	5,000
Current Accounts		Interest on Saving Bank	75,000
(including Overdrafts of ₹	66,00,000	Deposits	5,000
15,00,000)		Auditor's Fees	
Bills Discounted and		Interest on Overdrafts	95,000
Purchased	19,20,000	Provision for Doubtful Debts,	
Interest on Fixed Deposits	1,55,000	April 1, 2011	42,000
Interest on Loans	2,25,000	Bad Debts	21,000
Discount (subject to	2,01,000	Provision for Income tax,	
unexpired discount		April 1, 2011	66,000
₹ 30,000)	1,05,000	Income tax paid for 2011-	54,000
Interest on Cash Credits	47,000	2012	
Commission earned			
Loss on investment	34,000		
Salaries and Allowances	82,000		

Required: Prepare the Profit and Loss Account of the Bank maintaining the provision for Income tax at ₹ 84,000 and Provision for Doubtful Debts at ₹ 52,000 for the year ended March 31, 2012. **(8 marks)** ***[CMAIG - I]***

Answer:

CANHC Bank Limited

Profit & Loss A/c for year ended 31.03.2012

Particulars	**Schedule No.**	**Year ended 31.03.2012 Amount (₹) (₹ '000)**
I. Income:		
Interest earned	13	596
Other income	14	13
		609

II.	**Expenditure:**		
	Int. expended	15	230
	Operating exp.	16	92
	Provision & contingencies (72 + 31)		103
	Total		425
III.	**Profit or Loss**:		
	Net Profit for the year		184
	P/L brought forward		—
			184
IV.	**Appropriations:**		
	Transfer to statutory reserve @ 25%		46
	Balance carried over to Balance-sheet		138
	Total		184

Schedule 13
Interest earned

Interest/discount	596
(225 + 201 + 105 + 95 - 30)	
Interest on investments	—
Interest on balance with RBI & other banks	—
	596

Schedule 14
Other Income

Commission, exchange brokerage	47
(-) loss on investment	34
	13

Schedule 15
Interest expended

Interest on deposits	(155 + 75)	230
Interest on RBI /other bank borrowings		
		230

Schedule 16
Operating Expenses

Salaries & allowances	82
Printing & Stationery	5
Auditor fees	5
	92

Provision for Doubtful debts A/c

Dr. **Cr.**

Particulars	Amount	Particulars	Amount
To Bad debts	21	By Balance b/d	42
To Balance c/d	52	By P/L (B.f.)	31
	73		73

Provision for taxation

Particulars	Amount ₹	Particulars	Amount ₹
To Bank	54	By Balance b/d	66
To Balance c/d	84	By P/L (B.f.)	72
	138		138

Space to write important points for revision

2015 - Dec [1] Answer the following questions (Give workings):
(i) INDIAN BANK provides the following particulars:

Sl. No.	Date of Bill	Amount of Bill (₹)	Period	Rate of Discount
(i)	15.01.2015	90,000	5 Months	8%
(ii)	10.02.2015	60,000	4 Months	9%

Required:
Calculate the Rebate on Bills Discounted as on 31st March, 2015.

(2 marks) ***[CMAIG - I]***

Answer:

Rebate on Bills Discounted

	Due date	**Days after**	**Discount**	₹
90,000	18.6.15	79	8%	1,558
60,000	13.6.15	74	9%	1,095
				2,653

Space to write important points for revision

2015 - Dec [7] Answer the question.

(b) The following is an extract from Trial Balance of VAISHNAVI BANK LTD. as at 31st March, 2015.

	₹	₹
Bills discounted	9,00,000	
Rebate on Bills discounted (as on 1st April, 2014)		44,320
Discount Received		2,11,416

An analysis of the Bills discounted and held on 31.03.2015 is as follows:

Sl. No.	Date of Bills	Amount (₹)	Period	Rate of Discount
(i)	5.01.2015	2,50,000	5 months	10%
(ii)	10.02.2015	1,50,000	4 months	9%
(iii)	25.02.2015	2,00,000	4 months	9%
(iv)	20.03.2015	3,00,000	3 months	8%

You are required to:

(i) Calculate the amount of discount on bills to be credited to Profit and Loss Account for the year ended 31st March, 2015.

(ii) Show the necessary Journal Entries in this respect.

(6 + 2 = 8 marks) ***[CMAIG - I]***

Answer:

Rebate on bills discounted

	Due date	**Days after 31.3.15**	**Discount rate**	₹
2,50,000	8.6.15	69	10%	4,726
1,50,000	13.6.15	74	9%	2,740
2,00,000	28.6.15	89	9%	4,389
3,00,000	23.6.15	84	8%	5,523
				17,378

Rebate on bills discounted A/c	Dr.	44,320	
To Discount on bills A/c			44,320
Bills A/c	Dr.	9,00,000	
To Discount A/c			2,11,416
To Client A/c			6,88,584
Discount on bills A/c	Dr.	17,378	
To Rebate on bills discounted A/c			17,378
Discount on bills A/c	Dr.	2,38,361	
To P/L			2,38,361

Space to write important points for revision

2016 - June [7] (a) The following details are extracted from the books of HEAVEN BANK LTD., a Commercial Bank as on 31st March, 2016:

	(Amount in ₹ lakh)
Interest and discount received	390
Interest paid on deposits	204
Issued and subscribed capital	100
Salaries and allowances	20
Directors fee and allowances	3
Rent and taxes paid	9
Postage and telegrams	6

Statutory reserve fund	80
Commission, exchange and brokerage	20
Profit on Exchange Transaction	7
Profit on sale of investments	21
Depreciation on bank's properties	3
Law charges	4
Audit fee	1

The following further information is given:

(i) A customer to whom a sum of ₹ 100 lakhs has been advanced, has become insolvent and it is expected only 50% can be recovered from his estate.

(ii) There were also other debts for which a provision of ₹ 15 lakh was found necessary by the auditors.

(iii) Rebate on bills discounted on 31.03.2015 was ₹ 1,20,000 and 31.03.2016 was ₹ 1,60,000.

(iv) Provided ₹ 65 lakh for Income Tax.

(v) The directors desire to declare 10% dividend.

(vi) Provide 25% for Statutory Reserve.

(vii) Profit & Loss Account as on 31.03.2015 was NIL.

Required:

Prepare Profit & Loss Account of Heaven Bank Ltd. for the year ended March 31, 2016.

(Notes/Schedules to Profit & Loss Account need not form part of the answer)

(10 marks) ***[CMAIG - I]***

Answer :

Heaven Bank Ltd.

Profit & Loss A/c for the year ended 31.3.2016

I.	**Income**:		
	Interest earned	13	389.60
	Other Income	14	48.00
	Total		437.60

II.	**Expenditure**:		
	Interest expended	15	204.00
	Operating expenses	16	46.00
	Provisions & contingencies (65 + 50 + 15)		130.00
	Total		**380.00**
III.	**Profits/Losses**:		
	Net profit for the year		57.60
	Profit brought forward		Nil
	Total		**57.60**
IV.	**Appropriations**:		
	Transfer to statutory reserve		14.40
	Proposed dividend		10.00
	Balance c/f to B/s		33.20
	Total		**57.60**

Schedule - 13 Interest earned:

Interest	390.00
Add: Rebate on 31.3.2015	1.20
Less: Rebate on 31.3.2016	1.60
	389.60

Schedule - 14 Other Income:

Commission, exchange & brokerage	20.00
Profit on sale of inv.	21.00
Profit on exchange transaction	7.00
	48.00

Schedule - 16 Operating Expenses:

Payment to & Prov. for employees	20.00
Rent & taxes	9.00
Depreciation	3.00
Director's fees	3.00

Auditor's fees	1.00
Law charges	4.00
Postage & telegram	6.00
Total	46.00

Shareholder's share: 5% of 92 = 4.6

—— Space to write important points for revision ——

2017 - Dec [3] (b) From the following information for a Bank calculate the amount of discount to be transferred to the Statement of Profit and Loss.

(i) Rebate on Bills Discounted (as on 01.04.2016) ₹ 28,000. Discount Received ₹ 1,02,000.

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

Amount of Bill (₹)	Rate of Discount	Due Date (including grace days)
65,000	13% p.a.	June 14, 2017
1,50,000	15% p.a.	July 19, 2017
4,30,000	12% p.a.	August 10, 2017

Also pass the necessary journal entry for the unexpired discount as on 31.03.2017. **(3 + 1 = 4 marks)**

Answer:

Calculation for rebate on bill discounted

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

Amount to be credited to P/L = 28000 + 102000 - 27178 = ₹ 102822.

Journal Entry:

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

—— Space to write important points for revision ——

2018 - June [3] (b) Given below are details of interest on advance of a Commercial Bank as on 31.3.2017:

Particulars	Interest Earned	Interest Received
	(₹ **in Crore**)	(₹ **in Crore**)
Performing Assets		
Term Loan	120	80
Cash Credit and Overdraft	750	620
Bills Purchased and Discounted	150	150
Non-Performing Assets		
Term Loan	75	5
Cash Credit and Overdraft	150	12
Bills Purchased and Discounted	100	20

Find out the income to be recognized for the year ended 31st March, 2017. **(4 marks)**

Answer:

As per RBI Circular, Interest on non - performing assets are considered on Cash Basis whereas interest on performing assets are considered on Accrual Basis.

Statement Showing the Recognition of Income

(₹ in Crore)

Particulars	Amount (₹)	Amount (₹)
1. Interest on Term Loans		
(i) Performing Assets	120	
(ii) Non-performing Assets	5	
		125
2. Interest on Cash Credit and Overdraft		
(i) Performing Assets	750	
(ii) Non-performing Assets	12	
		762

3. Interest on Bills Purchased and Discounted		
(i) Performing Assets	150	
(ii) Non-performing Assets	20	
-		170
Income to be recognized		1057

Space to write important points for revision

Repeatedly Asked Questions		
No.	**Question**	**Frequency**
1	Write short notes Rebate on Bill Discount. 11 - June [8] (d), 13 - June [8] (b)	2 Times

Table Showing Marks of Compulsory Questions										
Year	**14 J**	**14 D**	**15 J**	**15 D**	**16 J**	**16 D**	**17 J**	**17 D**	**18 J**	**18 D**
Practical	2									
Total	2									

4B ACCOUNTS OF ELECTRICITY COMPANY

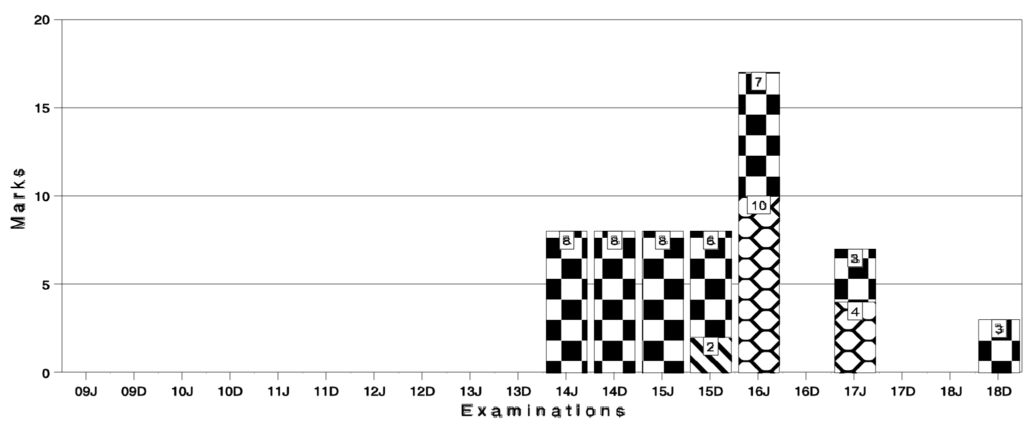
THIS CHAPTER INCLUDES

- The Electricity Act, 2003
- Central Electricity Authority
- Central Electricity Regulatory Commission (CERC)
- State Electricity Commission (SEC)
- Accounting of Security Deposit
- Accounting of Service Line Cum Development (SLD) Charges under Accounting
- Accounting for Depreciation
- Debt-Equity Ratio
- Interest on Loan Capital
- Return on Equity
- Optimised Depreciated Replacement Cost

Marks of Objective, Short Notes, Distinguish Between, Descriptive & Practical Questions

Legend

Objective Short Notes Distinguish Descriptive Practical



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CHAPTER AT A GLANCE

S. No.	Topic	Important Highlights
1.	**Electricity Act, 2003**	The Act has been enacted to replace: • Indian Electricity Act, 1910 • The Electricity Supply Act, 1948 • The Electricity Rules, 1956 • The Electricity Regulatory Commissions Act, 1988
2.	**Objective of "Electricity Act, 2003"**	1. To consolidate the laws relating to generation, transmission, distribution, trading and use of electricity. 2. For taking measure conducive to development of electricity industry, and promoting competition therein. 3. Protecting interest of consumers and supply of electricity to all areas. 4. Rationalization of electricity tariff. 5. Ensuring transparent policies regarding Subsidies. 6. Constitution of Central Electricity Authority, Regulatory Commissions and Establishment of Appellate Tribunal.
3.	**Main features of the Electricity Act, 2003**	(i) The activities like generation, transmission and distribution of power have been separately identified. (ii) The Act de-licenses power generation completely (except for hydro power projects, over a certain size).

		(iii) 10% of the power supplied by suppliers and distributors to the consumers has to be generated using renewable and non-conventional sources of energy. (iv) Setting up State Electricity Regulatory Commission (SERC) made mandatory. (v) Appellate Tribunal to hear appeals against the decision of the CERC and SERCs. (vi) Ombudsman scheme for consumers' grievance redressal.
4.	**Various Regulatory/Authorities under the Electricity Act**	1. **Central Electricity Authority:** Central Electricity Authority (CEA) shall exercise such functions and perform such duties as are assigned to it under the electricity Act. 2. **"Appropriate Commission"** means: (a) Central Electricity Regulatory Commission (CERC) referred u/s 76(1), or, (b) State Electricity Regulatory Commission (SERC) referred u/s 82, or, (c) Joint commission referred u/s 83. 3. **Central Electricity Regulatory Commission (CERC):** (a) There shall be a Commission to be known as the Central Electricity Regulatory Commission (CERC) to exercise the powers conferred on, and discharge the functions assigned to, it under this Act. (b) CERC has jurisdiction over Generating Companies owned or controlled by the Central Government and those

Generating Companies who have entered into or otherwise have a composite scheme for generation and sale in more than one state.

4. **State Electricity Regulatory Commission (SERC):**
   (a) Every State Government shall, within 6 months from the appointed date, by Notification constitute for the purpose of this Act, a Commission for the State to be known as the (name of the state) Electricity Regulatory Commission (…SERC).
   (b) State SERC's have jurisdiction over Generating Stations within the State boundaries, except those under the CERC's jurisdiction.
5. **Joint Commission:**
   (a) By two or more Governments of States, or
   (b) By the Central Government, in respect of one or more Union Territories, and one or more Governments of States,
   and shall be in force for such period and shall be subject to renewal for each further period, if any, as may be stipulated in the agreement.
   The Joint Commission shall determine Tariff in respect of the Participating States or Union Territories separately and independently.
6. **Central Advisory Committee (CAC) and State Advisory Committee:**
   The CERC/SERC may, by notification, establish from a specified date, a

		Committee to be known as Central Advisory Committee (CAC) / State Advisory Committee (SAC) respectively. The objects of CAC / SAC shall be to advise the CERC / SERC on: • Major questions of policy, • Matter relating to quality, continuity and extent of service provided by the Licensees, • Compliance by the Licensees with the conditions and requirements of their License, • Protection of consumer interest, • Electricity supply and overall standards of performance by utilities.

SHORT NOTES

2016 - June [9] Write short notes on following:

(b) Main features of the Electricity Act. - 2003 **(5 marks)** ***[CMAIG - I]***

(d) Average Revenue Per User (APRU) **(5 marks)** ***[CMAIG - I]***

Answer :

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

(i) The activities like generation, transmission and distribution of power have been separately identified.

(ii) The Act de-licenses power generation completely (except for hydro power projects, over a certain size).

(iii) 10% of the power supplied by suppliers and distributors to the consumers has to be generated using renewable and non-conventional sources of energy.

(iv) Setting up State Electricity Regulatory Commission (SERC) made mandatory.

(v) Appellate Tribunal to hear appeals against the decision of the CERC and SERCs.
(vi) Ombudsman Scheme for consumer's grievance redressal.
(vii) Provision for private licensees in transmission and entry in distribution through an independent network.
(viii) Metering of all electricity supplied made obligatory.
(ix) Provision relating to theft of electricity made more strict.

(d) ARPU:

- The Average Revenue Per User (ARPU) or subscriber is an indication of the net recurring revenue per subscriber per month earned by the telecom operator.
- This is calculated by dividing the monthly net revenue by the average subscriber base. ARPU includes monthly rentals, airtime/call charges, VAS charges and all other charges as reduced by pass through.
- ARPU does not include non-recurring revenues like handset sales, installation fees, revenue from roaming services from other networks, etc. Due to a large variation between prepaid and postpaid services, the ARPU is calculated separately for both these services. ARPU for prepaid services is generally lower (approximately 40% less) as compared to post-paid services bringing down the blended ARPU.
- For June 2005 and September 2005, the blended ARPU on an all India basis has fallen from ₹ 381 in June 2005 to ₹ 374 in September 2005. It is interesting to note that the Indian telecom industry has witnessed a continuous fall of ARPU on a quarter to quarter basis due to falling airtime rates.

—— Space to write important points for revision ——

2017 - June [5] Write short note :
(c) Treatment of Service Line Cum Development Charges **(4 marks)**

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.

Notes:

- Balance of Capital Service Line Contributions A/c at the end of the accounting period should be disclosed as Capital Reserve under the head 'Reserves and Surplus' as it is not refundable to consumers.
- Balance of Capital Service Line Contributions A/c at the end of the accounting period should be disclosed as Capital Reserve under the head 'Reserves and Surplus' wherein the amount transferred to Income Statement is shown as deduction. The amount transferred matches proportionately against depreciation charged on total cost of such asset in the Statement of Profit and Loss.

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

—— Space to write important points for revision ——

DESCRIPTIVE QUESTIONS

2015 - Dec [7] (c) Answer the question.

(ii) State the justifications/reasons for which an immediate shift to the Optimized Depreciated Replacement Cost (ODRC) Method is not recommended. (**2 marks**) ***[CMAIG - I]***

Answer:

An immediate shift to the optimized Depreciated Replacement cost (ODRC) method is not recommended due to

– Problems in producing a detailed asset register.
– Absence of norms for standard lives of assets.
– Absence of construction cost estimates.
– Lack of data on future load growth.

—— Space to write important points for revision ——

PRACTICAL QUESTIONS

2014 - June [2] (b) The following information and details are provided to you by the Mahi Electricity Supply Company for the year ending 31st March, 2014:

	₹
8% Investments of the reserve fund	2,10,00,000
8% Investments of the contingencies reserve	1,90,00,000
14% Debentures	1,80,00,000
Development Reserve	15,60,000
Loan from Electricity Board	3,50,00,000
Capital Base	6,57,25,000
RBI rate of the relevant date	8%
Profit before debenture interest	1,14,65,300

You are required to calculate the reasonable return and show the disposal of surplus. **(8 marks)** ***[CMAIG - I]***

Answer:

Reasonable Return

Capital Base × (Bank Rate + 2%)	
i.e. 6,57,25,000 × 10%	65,72,500
+ Income from reserve fund investment	16,80,000

+ Intt. income from debentures @ ½%	90,000
+ Interest Income from Loan from Electricity Board @ ½%	1,75,000
+ Interest Income from Development Reserve @ ½%	7,800
Reasonable Return	85,25,300
Disposal of Surplus	
Profit	1,14,65,300
Less: Debenture interest	25,20,000
	89,45,300
Less: Reasonable Return	85,25,300
Surplus	4,20,000
Disposal	
1/3 (being less than 5% of reasonable return) at the disposal of the company of the balance	1,40,000
½ to TDCR	1,40,000
½ to consumer's benefit A/c	1,40,000
	4,20,000

Space to write important points for revision

2014 - Dec [7] (c) The Mettur Electricity Company Ltd. decides to replace one of its old plants with a modern one with a larger capacity. The plant when installed in 1950 cost the company ₹ 48,00,000, the components of materials, labour and overhead being in the ratio of 5:3:2.

It is ascertained that the cost of materials and labour have gone up by 40% and 80% respectively.

The proportion of overheads to total costs is expected to remain the same as before.

The cost of the new plant as per improved design is ₹ 1,20,00,000 and in addition, materials recovered from the old plant of a value ₹ 4,80,000 have been used in the construction of the new plant. The old plant was scrapped and sold for ₹ 15,00,000.

The accounts of the company are maintained under Double Account System. Indicate how much would be capitalised and the amount that would be charged to revenue. Show journal entries and prepare necessary ledger accounts. **(8 marks)** ***[CMAIG - I]***

Answer:

Working Note:

	₹
(i) Computation of total actual cost of new plant: Cost of new plant (as given)	1,20,00,000
Add: Value of materials of old plant used in construction of new Plant	4,80,000
	1,24,80,000
(ii) Split-up of cost of old Plant when acquired in 1950:	
Materials $\left(48,00,000 \times \frac{5}{10}\right)$	24,00,000
Labour $\left(48,00,000 \times \frac{3}{10}\right)$	14,40,000
Overheads $\left(48,00,000 \times \frac{2}{10}\right)$	9,60,000
	48,00,000

Percentage of overheads to total cost $= \frac{9,60,000}{48,00,000} \times 100$ = 20% or

Percentage of overheads to combined cost of material and labour

$$= \frac{9,60,000}{38,00,000} \times 100 = 25\%$$

Current Cost of Replacement :

(i)	Materials is (Increase by 40% over ₹ 24,00,000) (i.e., ₹ 24,00,000 + 40% increase ₹ 9,60,000)	33,60,000
	Labour (increased by 80% over ₹ 14,40,000) (i.e., ₹ 14,40,000 + 80% increase ₹ 11,52,000)	25,92,000
	Overheads (25% of combined cost of materials and Labour i.e., 25% of (₹ 33,60,000 + 25,92,000)	14,88,000
		74,40,000

(ii)	Computation of amount of replacement to be capitalized:		
	Total actual cost of new Plant		1,24,80,000
Less:	Estimated present cost of replacement		74,40,000
	Amount to be capitalised		50,40,000
(iii)	Computation of amount of replacement to be charged to Revenue A/c:		
	Estimated present cost of replacement		74,40,000
Less:	Value of old material used in construction of new plant	4,80,000	
	Amount realized on sale of old Plant	15,00,000	19,80,000
Change to Revenue			54,60,000
(iv)	Computation of actual amount of Cash spent on replacement :		
	Total actual cost of new Plant		1,24,80,000
Less:	Value of old materials used in construction of new Plant		4,80,000
			1,20,00,000

Journal Entries

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
1	Replacement A/c	Dr.		74,40,000	
	Plant A/c (Bal. Fig.)	Dr.		45,60,000	
	To Bank A/c [W.N. (iv)]				1,20,00,000
2	Bank A/c	Dr.		15,00,000	
	To Replacement A/c				15,00,000
3	Plant A/c	Dr.		4,80,000	
	To Replacement A/c				4,80,000
4	Revenue A/c	Dr.		54,60,000	
	To Replacement				54,60,000

Plant A/c

Particulars	₹	**Particulars**	₹
To Balance b/d	48,00,000	By Balance c/d	98,40,000
To Bank A/c	45,60,000		
To Replacement A/c	4,80,000		
	98,40,000		98,40,000

Replacement A/c

Particulars	₹	**Particulars**	₹
To Bank A/c	74,40,000	By Bank A/c	15,00,000
		By Plant A/c	4,80,000
		By Revenue A/c (Bal. Fig.)	54,60,000
	74,40,000		74,40,000

Space to write important points for revision

2015 - June [7] Answer the question:

(c) The following balances are extracted from the records of NARMODA ELECTRICITY CO. LTD. for the year ended March 31, 2015.

Particulars	(₹ in Lakh)	**Particulars**	(₹ in Lakh)
Balance as on1st April, 2014:		Expenses of Management	14,400
Land	1,80,000	Cost of distribution	6,000
Machinery	7,20,000	Depreciation	24,000
Mains	2,40,000	Sale of energy for lighting	80,000
Share Capital - Ordinary Shares	6,58,800	Sale of energy for Power	76,000
Debentures	2,40,000	Meter Rent	6,000

Expenditure during the year:		Interest on Debentures	12,000
Land	6,000	Interim Dividend	24,000
Machinery	6,000	Net Revenue Account as on	34,200
Mains	61,200	01.01.2014	
Sundry Creditors	1,200	Depreciation Fund	3,00,000
Cost of Generation	42,000	**Sundry Debtors:**	
Rent, Rates and Taxes	6,000	For Energy Supplied	48,000
		Others	600
		Cash Balance	6,000

You are required to prepare:

(i) Revenue Account and

(ii) Net Revenue Account for the year ended March 31, 2015

(iii) General Balance Sheet as at 31.03.2015.

(3 + 2 + 3 = 8 marks) ***[CMAIG - I]***

(Note: Schedules/Note to Balance Sheet are not required)

Answer:

NARMODA ELECTRICITY CO. LTD.
Revenue Account Year ended 31st March, 2015

Dr. **Cr.**

Particulars	**₹ in lakh**	**Particulars**	**₹ in lakh**
Expenses of management	14,400	By Sale of energy for lighting	80,000
Cost of distribution	6,000		
Depreciation	24,000	By Sale of energy for power	76,000
Cost of generation	42,000		
Rent rates and taxes	6,000	By Meter rent	6,000
To net revenue a/c	69,600		
	1,62,000		1,62,000

Dr. Net Revenue A/c for the year ended 31st March, 2015 Cr.

Particulars	₹ in lakh	Particulars	₹ in lakh
Interest on deb. Dividend	12,000 24,000	By Balance from last year's a/c	34,200
Bal. Carried to general b/s	67,800	By Bal. b/f revenue A/c	69,600
	1,03,800		1,03,800

General Balance Sheet as on 31st March, 2015

Liabilities	₹ in lakh	Assets		₹ in lakh
Capital Account		Capital Account:		
Amount received	8,98,800	Amount expended on works		12,13,200
Sundry Creditors	1,200	Sundry Debtors		
Net revenue A/c balance	67,800	For Energy supplied	48,000	
Depreciation fund A/c	3,00,000	Other	600	48,600
		Cash balance		6,000
	12,67,800			12,67,800

Working:

(1) Amount received : 6,58,800 + 2,40,000 = 8,98,800

(2) Amount expended on works
₹ (1,80,000 + 7,20,000 + 2,40,000 + 6,000 + 6,000 + 61,200) - ₹ 12,13,200

—— Space to write important points for revision ——

2015 - Dec [7] Answer the question.

(c) (i) From the following information of VIDYUT ELECTRICITY CO. LTD., an Electricity generation Project, CALCULATE:

(1) Depreciation and

(2) Advance Against Depreciation upto the year 2014-15 as per Regulation 21 of the Central Electricity Regulatory Commission (Terms and Conditions of Tariff) Regulations 2004.

- Date of Commercial Operation of COD : 1st April, 2012
- Approved Opening Capital Cost as on 1st April, 2012 : ₹ 10,00,000
- Weighted average Rate of Depreciation : 5.20%
- Details of allowed Additional Capital, Repayment of loan and Weighted Average Rate of Interest on Loan are as follows:

(Amount in ₹)

Year	2012-13	2013-14	2014-15
Additional Capital Expenditure (allowed)	70,000	20,000	15,000
Repayment of Loan	60,000	70,000	70,000
Weighted Average Rate of Interest on Loan	7.50%	7.60%	7.80%

(3 + 3 = 6 marks) ***[CMAIG - I]***

Answer:

Computation of Depreciation:

Particulars	**1st year 2012-13**	**2nd year 2013-14**	**3rd year 2014-15**
Opening capital cost (A)	10,00,000	10,70,000	10,90,000
Additional capital cost (B)	70,000	20,000	15,000
Closing capital cost (A+B) (C)	10,70,000	10,90,000	11,05,000
Average capital cost (A+C/2)	10,35,000	10,80,000	10,97,500
weighted average rate of depreciation	5.20%	5.20%	5.20%
Annualised depreciation	53,820	56,160	57,070
Advance against depreciation	6,180	13,840	12,930
Total Depreciation	**60,000**	**70,000**	**70,000**

Computation of advance against depreciation:

Particulars	2012-13	2013-14	2014-15
Repayment of loan (A)	60,000	70,000	70,000
Depreciation (B)	53,820	56,160	57,070
Difference (A-B) (C)	6,180	13,840	12,930
cumulative payment of loan (D)	60,000	1,30,000	2,00,000
cumulative Dep(E)	53,820	1,09,980	1,67,050
Difference (D-E) (F)	6,180	20,020	32,950
Advance against depreciation (Min of c & f)	6,180	13,840	2,930

—— Space to write important points for revision ——

2016 - June [1] {C} (d) Answer the following question.

(v) GREAT POWER LTD. received ₹ 2,00,000 as Security Deposit from its consumers on 1st July 2015. R.B.I interest rate as on 1st April 2015 was 8%.

Pass the Journal Entries in the book of Great Power Ltd. for the year ended March 31,2016. **(2 marks)** ***[CMAIG - I]***

Answer :

In the books of Great Power Ltd.

1, July 2015	Bank A/c To Security Deposit A/c (Being Security Deposit received)	Dr.	2,00,000	2,00,000
31st March 2016	Interest expense A/c To Interest accrued on Security Deposit A/c (Being provision for interest accrued on Security Deposit made)	Dr.	12,000	12,000
	Interest accrued on Security Deposit A/c To Sales Turnover A/c (Being Adjustment of Interest accrued in consumer's bill)	Dr.	12,000	12,000

—— Space to write important points for revision ——

2016 - June [7] (b) The following information are abstracted from the records of EVERGREEN POWER LTD.

- The name of the power station: EVERGREEN POWER LTD.
- Date of Commercial Operation of COD = 1st April, 2012
- Approved Opening Capital Cost as on 1st April, 2012 = ₹ 75,00,000
- Details of allowed additional Capital Expenditure during the years are as follows:

	(Amount in ₹)			
Year ended March 31,	2013	2014	2015	2016
Additional Capital Expenditure (Allowed)	5,00,000	1,50,000	1,00,000	50,000

You are required to calculate Return on Equity for 2012-13 to 2015-16 years as per Regulation 21 of the Central Electricity Regulatory Commission (Terms and Conditions of Tariff) Regulations 2004. **(5 marks)** ***[CMAIG - I]***

Answer:

Computation of Return of Equity:

Particulars	**2013**	**2014**	**2015**	**2016**
Opening Equity (30%) (A)	22,50,000	24,00,000	24,45,000	24,75,000
Additional Equity (30% (B)	1,50,000	45,000	30,000	15,000
Closing Equity (A + B) (c)	24,00,000	24,45,000	24,75,000	24,90,000
Average Equity (A + C)/2 (D)	23,25,000	24,22,500	24,60,000	24,82,500
Return on Equity (D × 14%)	3,25,500	3,39,150	3,44,400	3,47,550

Space to write important points for revision

2017 - June [3] (b) 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 COD = 1st April, 2016
(ii) Approved Opening Capital Cost as on 1st April, 2016 = ₹ 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

(3 marks)

Answer:

Computation of Return on equity

	Particulars	1st Year	2nd Year	3rd Year	4th Year
(A)	Opening Equity (30%)	6,00,000	6,36,000	6,48,000	6,57,000
(B)	Additional Equity (30%)	36,000	12,000	9,000	4,500
(C)	Closing Equity	6,36,000	6,48,000	6,57,000	6,61,500
(D)	Average Equity [(A + C)/2]	6,18,000	6,42,000	6,52,500	6,59,250
(E)	Return on Equity (D × 14%)	86,520	89,880	91,350	92,295

—— Space to write important points for revision ——

2018 - Dec [3] (b) From the following information calculate return on equity as per Regulation 21 of the Central Electricity Regulatory Commission (Terms and Conditions of Tariff) Regulation 2004:

(i) Date of commercial operation of COD = 01.04.2014

(ii) Approved opening capital cost as on 01.04.2014 = ₹ 30,00,000

(iii) Details of allowed additional capital expenditure:

Year	1	2	3	4
Additional Capital Expenditure (₹)	2,00,000	60,000	40,000	20,000

(3 marks)

Table Showing Marks of Compulsory Questions

Year	13 D	14 J	14 D	15 J	15 D	16 J	16 D	17 J	17 D	18 J
Practical						2				
Total						2				

4C ACCOUNTS OF INSURANCE COMPANY

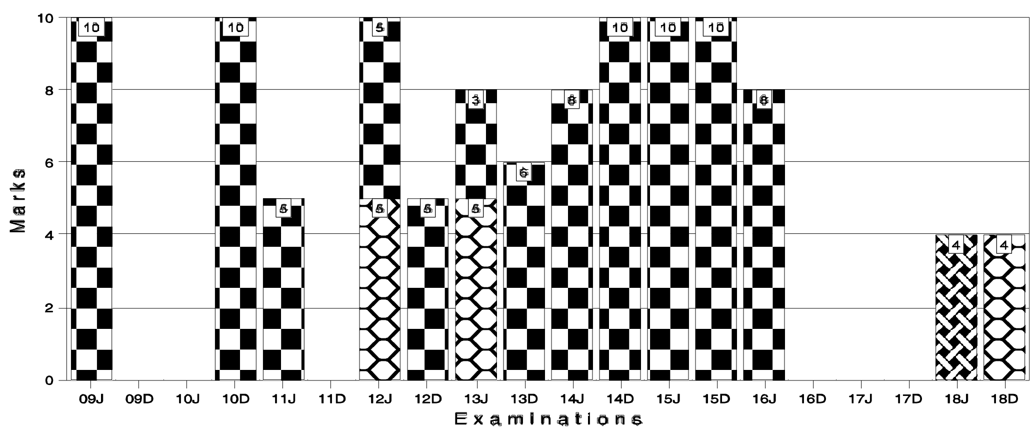
THIS CHAPTER INCLUDES

• Types of Policies • Principles of Insurance • Life & Non-Life Insurance • Important Provisions of - The Insurance Act 1938	• IRDA Regulation • Books of Accounts • Financial Statements • General Insurance

Marks of Objective, Short Notes, Distinguish Between, Descriptive & Practical Questions

Legend

Objective Short Notes Distinguish Descriptive Practical



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CHAPTER AT A GLANCE

S. No.	Topic	Important Highlights
1.	**Introduction**	Several people exposed to a particular type of risk contribute small amounts called premiums to an insurance fund from which the unfortunates who actually suffer the risk are compensated. Insurance business is essentially a way of averaging the risks.
2.	**Types of Policies**	Depending on the type of risk, there are several types of insurance policies. **Risks of fire** are covered by **fire policies**. **Marine risks** of goods, vessels and freights of goods are covered by **marine insurance policies**. Losses of theft are covered by **Burglary insurance**.
3.	**Principles of Insurance**	**(i) Principle of indemnity:** Insurance is a contract of indemnity. The insurer is called indemnifier and the insured is the indemnified. In a contract of indemnity, only those who suffer loss are compensated to the extent of actual loss suffered by them. One cannot make profit by insuring his risks. **(ii) Principle of uberrimae fidei:** Under ordinary law of contract there is no positive duty to tell the whole truth in relation to the subject-matter of the contract.

4.	**Books required to be maintained by Insurance Companies**	1. The registrar of policies. This book contains the following particulars in respect of each policy issued: (a) The name and address of the policyholder; (b) The date when the policy was effected; and (c) A record of any assignment of the policy. 2. The register of claims. This book should contain the following particulars in respect of each claim: (a) The date of claim; (b) The name and address of the claimant; (c) The date on which the claim was discharged; and (d) In the case of a claim which is rejected, the date of rejection and the ground for rejection. 3. The register of licensed insurance agents. This book should contain the following particulars in respect of each agent: (a) Name and address of every insurance agent appointed; (b) The date of appointment; and (c) The date on which appointment ceased, if any.
5.	**Annuity Business**	Life insurance companies also do annuity business. Annuity refers to fixed annual payment made by the insurance company to the insured on his attaining a specified age. The insured deposits lump sum amount by way of consideration for the annuity granted.

6.	**Surrender Value**	In the case of life policy, the policy normally has value only when it matures. But to facilitate the promotion of business, insurance companies assign value to the policy on the basis of the premiums paid. Insurance companies will be prepared to pay such value on the surrender of the policy by a needy policy holder desiring to realize the policy.
7.	**Paid-up Policy**	A policy holder, who has difficulty in paying the premium, may be allowed an option to get the policy paid-up. In such a case, the policyholder is relieved from the obligation of paying off the rest of premium, but he will not get the full value of policy which is calculated as follows: $\text{Paid-up value} = \text{Sum assured} \times \frac{\text{No. of Premiums paid}}{\text{Total number of premiums payable}}$
8.	**Re-insurance**	Re-insurance means the transfer of a part of risk by the insurer. This is particularly done when the amount of insurance is very high and when it is very difficult to bear the entire risk by a single insurer, a part of the risk is to be insured with some other insurance companies.
9.	**Life Assurance Fund**	This represents the excess of revenue receipts over revenue expenditure relating to life business. The fund is available to meet the aggregate liability on all policies outstanding. Revenue Account is prepared every year to ascertain the balance of life insurance fund at the end of the year.

SHORT NOTES

2008 - Dec [8] Write note on :

(a) Re-insurance **(3 marks)**

Answer :

Re-insurance

If an insurer finds that a particular risk is too heavy for his capacity to bear, he may re-insure a part of the risk with another insurer. Such an arrangement between two insurers is called reinsurance. The first insurer, in that event, parts with a proportionate share of the premium with the second insurer. On maturity of the claim, both the insurers shares the claim, in agreed ratio.

—— Space to write important points for revision ——

2012 - June [8] Write short note on:

(a) Surrender value of policy; **(5 marks)**

Answer :

In the case of life policy, the policy normally has value only when it matures. But to facilitate promotion of business insurance companies assign value to the policy on the basis of the premium paid. Insurance companies will be prepared to pay such value on the surrender of the policy by a needy policy holder desiring to realise the policy. Therefore the value is referred to as 'surrender value'. Surrender value is similar to claims paid. Thus surrender value is the amount the policy holder will get from the life insurance company if he decides to exit the policy before maturity.

—— Space to write important points for revision ——

2013 - June [8] Write Short Note :

(c) Commission on Reinsurance ceded/accepted;

(5 marks)

Answer :

When insurance company gets re-insurance business if has to pay commission to some other companies. This commission is called "Commission on Reinsurance accepted" and is shown as an expenses in the revenue account. When an insurance company passed on a part of business to some other companies then the company (which gives business) gets commission from the company to whom such business is given. This commission is called "Commission on reinsurance Ceded" and is an income to the company surrendering the business. It appears as an income in the Revenue account.

—— Space to write important points for revision ——

2018 - Dec [5] Write short note on :

(b) Re-insurance **(4 marks)**

DISTINGUISH BETWEEN

2018 - June [5] (c) Distinguish between Life and Non-Life Insurance**.**

(4 marks)

Answer:

There are certain basic differences between life policies and other types of policies. These are listed below:

(i) Human life cannot be valued exactly. Therefore each insured is permitted to insure his life for a specified sum, depending on his capacity to pay premiums. This is also one form of investment and the policy amount depends on his investment decision. In the event of the policy maturing, the insurer must pay the policy amount, as actual loss cannot be determined. This is not the case with other policies. Other policies are contracts of indemnity. Therefore, notwithstanding the amount for which the policy is taken, the insurer would pay (reimburse) only the actual loss suffered or the liability incurred.

(ii) Life insurance contracts are long-term contracts. Once a policy is taken, premiums have to be paid for number of years till maturity and the policy amount is paid on maturity. Of course, a life policy can be surrendered after certain number of years and the insured is paid a proportion of the premiums paid known as surrender value. In the case of other policies, they are for a short period of one year although the policy can be renewed year after year.

(iii) Life insurance is known also by another term 'assurance' since the insured gets an assured sum. Other policies are known as insurance.

(iv) The determination of profit is by different methods for life and general insurance business. In the case of life business, periodically actuaries estimate the liability under existing policies. On that basis, a valuation Balance Sheet is prepared to determine the profit. In the case of general insurance business, a portion of the premium is carried forward as a provision for unexpired liability and the balance net of claims and expenses is taken as profit (or loss).

—— Space to write important points for revision ——

DESCRIPTIVE QUESTIONS

2008 - Dec [1] {C} (e) What is meant by Reversionary Bonus?

(3 marks)

Answer :

In the case of life policies with profits, policyholders are given the right to participate in the profits of the business. After nationalization policyholders are given 95% of profits of LIC by way of bonus. Bonus can be paid in cash adjusted against the future premiums due from the policyholders or it can be paid on maturity of the policy, together with the policy amount. Bonus paid at the end along with the policy amount is called reversionary bonus.

—— Space to write important points for revision ——

PRACTICAL QUESTIONS

2009 - June [3] (a) The following balances have been extracted from the books of Star Insurance Co. Ltd. for the year ending 31st December, 2006:

	₹
Amount of Life Assurance at the beginning of the year	12,56,450
Claims by death	93,584
Claims by maturity	77,136
Premia	1,68,457
Expenses of management	23,912
Commission	29,233
Consideration for annuities	8,496
Interest, dividends and rents	41,969
Income-tax paid on profit	2,448
Surrenders	17,414
Annuities	23,536
Bonus paid in cash	7,560
Bonus paid in reduction of premium	2,800
Preliminary expenses	480
Claims admitted but not paid at the end of the year	64,027
Annuities due but not paid	17,904
Capital paid up	4,80,000
Government Securities	13,52,712
Sundry Assets	4,54,488
Investment Reserve	48,000

Prepare the Revenue Account and the Balance Sheet after taking into account the following :

		₹
(i)	Claims covered under re- insurance	8,000
(ii)	Further claims intimated	6,400
(iii)	Further bonus utilised in reduction of premium	1,200

(iv)	Interest accrued	12,320
(v)	Premium outstanding	5,920
(vi)	Bonus surrendered	4,000

(10 marks)

Answer:

Star Insurance Co. Ltd.

Revenue Account for the year ending 31st December, 2006

Particulars		₹	**Particulars**		₹
Claims less reinsurance			Balance of Fund at the beginning of the year		12,56,450
By death	93,584		Premia	1,68,457	
Add further Claim			Add Outstanding	5,920	1,74,377
Intimated	6,400		Consideration for.		
	99,984		Annuities granted		
			Interest, dividends		
By maturity	77,136		and rents	41,969	
	1,77,120		*Add* accrued int.	12,320	54,289
Less: Reinsurance	8,000	1,69,120	Fines for getting lapsed		NIL
Surrender's	17,414		Policies revised		NIL
Bonus surrendered	4,000	21,414	Other Receipts		NIL
Annuities		23,536			
Bonus (paid in cash)		7,560			
Bonus in consideration of premium Expenses of management		NIL			
Paid	23,912				
Commission	29,233	53,145			
Income-tax on profits		2,448			
Dividend and Other items		NIL			
Balance of Fund at the end of the year to be transferred to Balance Sheet		12,16,389			
		14,93,612			14,93,612

Star Insurance Co. Ltd
Balance Sheet as at 31st December, 2006

Liabilities		₹	Assets		₹
Share Capital			Loans		NIL
Issued and Paid up		4,80,000	Investments:		
Reserve and Profit and Loss			Government Securities		13,52,712
balances:			Accrued Interests		12,320
Investment Reserve		48,000			
Life Assurance Fund		12,16,389	Outstanding Premium	5,920	
Amount due to Other			*Less:* Bonus Surrendered	1,200	4,720
Persons		Nil	Outstanding Dividends, ent, etc		NIL
Other Liabilities			Amount due from Other Insurers:		
Outstanding claims	64,027		Reinsurance claims		8,000
Claims intimated	6,400		Sundry Debtors & Bills receivable		Nil
Annuities due but Not paid	17,904	88,331	Sundry Assets		4,54,488
			Other Items, if any:		
			Preliminary expenses		480
		18,32,720			18,32,720

—— Space to write important points for revision ——

2010 - Dec [6] (a) Credential General Insurance Co. supplies you the following information. You are asked to show the amount of claim as it would appear in the Revenue Account for the year ended 31.3.2010.

		Direct business ₹	Indirect business ₹
Claims paid during the year:		90,10,000	12,40,000
Claims payable -	1.4.09	15,08,500	1,55,000
	31.3.10	17,25,000	65,500

Claims received :		—	3,60,000
Claims receivable -	1.04.09	—	95,000
	31.3.10	—	1,90,500
Expenses of the management - (included ₹ 61,500 as Surveyor's fees and ₹ 78,300 as legal expenses for settlement of claims)			4,10,000

(10 marks)

Answer:

Credential General Insurance Co.

(Abstract showing the amount of claims)

Claim less insurance		(fig in ₹)
Paid during the year	1,00,23,800	
Add: Outstanding claims at the end of the year	16,00,000	
	1,16,23,800	
Less: Outstanding claims at the beginning of the year	15,68,500	1,00,55,300

Working:

1. Claims paid during the year:

Direct business	90,10,000	
Re-Insurance	12,40,000	1,02,50,000
Add: Surveyor's fees	61,500	
Legal expenses	72,300	1,33,800
		1,03,83,800
Less: Claims received from Re-insurance		3,60,000
		1,00,23,800

2. Claims outstanding on 31-3-10:

Direct business	17,25,000	
Re-insurance	65,500	17,90,500
Less: Claims receivable from Re-insurance		1,90,500
		16,00,000

3.	Claims outstanding on 1.4.09:		
	Direct business	15,08,500	
	Re-insurance	1,55,000	16,63,500
	Less: Claims receivable from Re-insurance		95,000
			15,68,500

—— Space to write important points for revision ——

2011 - June [7] (b) The Revenue Account of Sunlife Insurance Company shows the Life Insurance Fund on 31.3.2011 at ₹ 75,20,400 before taking into account the following items :

(i) Claim covered under re-insurance - ₹ 17,000
(ii) Bonus utilized in reduction of life insurance premium - ₹ 6,300
(iii) Interest accrued on securities - ₹ 13,240
(iv) Outstanding premium - ₹ 10,180
(v) Claim intimated but not admitted - ₹ 32,400

Calculate the assurance fund considering the above omissions. **(5 marks)**

Answer:

(b)

			₹
Balance of Fund as on 31.03.2011			75,20,400
Add Bonus utilized in reduction		₹	
of premium		6,300	
Interest on securities		13,240	
Premium outstanding		10,180	29,720
			75,50,120
Less: Claims outstanding	32,400		
Less: Covered under re-ins.	17,000	15,400	
Add, bonus in reduction of premium		6,300	21,700
Balance of life Assurance Fund			75,28,420

—— Space to write important points for revision ——

2012 - June [7] (b) The Life Insurance Fund of Bharat Life Insurance Co. Ltd. was ₹ 50 lakhs on 31.03.2012. Its acturial valuation on 31.03.2012 disclosed a net liability of ₹ 42,50 lakhs. An interim bonus of ₹ 80,000 was paid to the policy holders during previous two years. It is now proposes to carry forward ₹ 1,50,000 and to divide the balance between policy holders and the shareholders.
Show the (a) Valuation Balance Sheet; (b) Net profit for the two-year period; and (c) Distribution of profits. **(5 marks)**

Answer :

Valuation Balance Sheet as on 31.3.2012

Particulars	₹	Assets	₹
Net liabilities Net profit	4,250 750	Life Insurance Fund	5,000
	5,000		5,000

Net profits for two year period.

Profit as per valuation balance sheet	7,50,000
Add: Interim bonus paid	80,000
Net Profit	8,30,000

Distribution of profits:

Net profits	8,30,000
Less: Amount proposed for carry forward	1,50,000
	6,80,000
Share of policy holders - 95% of 6,80,000 =	6,46,000
Less: Interim bonus	80,000
Amount due to policy holders	5,66,000
Share of shareholders (5% of 6,80,000) =	34,000

—— Space to write important points for revision ——

2012 - Dec [5] (b) The Revenue Account of a Life Insurance Company shows the Life Assurance Fund on 31.03.2012 at ₹ 75,00,000 before taking into account the following items:

A.	Claims covered Under Re-insurance	₹ 3,15,000
B.	Income Tax on the above	₹ 35,000
C.	Bonus in reduction of Premium	₹ 4,25,000
D.	Dividend from Investment	₹ 3,20,000
E.	Claims intimated but not yet admitted	₹ 8,15,000
F.	Outstanding Premium	₹ 25,000

Compute the Life Insurance Fund on 31.03.2012 after taking into account the above omission. **(5 marks)**

Answer :

Statement showing Life Insurance Fund as on 31.03.2012

Particulars		Amount (₹)	Amount (₹)
Balance of Fund on 31.03.2012			75,00,000
Add: Bonus Utilised in reduction on Premium		4,25,000	
Dividend from Investment		3,20,000	
		25,000	7,70,000
			82,70,000
Premium Outstanding			
Less: Claims Intimated but not admitted	8,15,000		
Claims covered under Re-insurance	3,15,000	5,00,000	
Income Tax		35,000	
Bonus Utilised in reduction on Premium		4,25,00	9,60,000
Balance of Life Insurance Fund			73,10,000

Space to write important points for revision

2013 - June [7] (a) BISLA Life Insurance Company furnishes you the following information:

Life Insurance fund on 31.03.2012	1,40,00,000
Net Liability on 31.03.2012 as per Actuarial Valuation	1,20,00,000
Interim Bonus paid to Policy holders during Intervaluation Period	2,50,000

You are required to prepare:
(a) Valuation Balance Sheet
(b) Statement of Net Profit for the Valuation Period. **(3 marks)**

Answer :

Bisla Life Insurance Co.
Valuation Balance Sheet as on 31.03.2012

Particulars	₹	Particulars	₹
To Net Liability as per Actuarial valuation	1,20,00,000	By Life Insurance Fund	1,40,00,000
To Surplus	20,00,000		
	1,40,00,000		1,40,00,000

Statement Showing Net Profit for the valuation period

Particulars	₹
Surplus as per Valuation Balance Sheet	20,00,000
Add: Interim Bonus Paid	2,50,000
Net Profit	**22,50,000**

Space to write important points for revision

2013 - Dec [1] {C} Answer the following questions (give workings wherever required):

(v) Fact General Insurance Company informs you that the claims outstanding on 01.04.2012 was ₹ 5,20,000 and claims paid during the financial year 2012-13 was ₹ 64,50,000. The claims outstanding as on 31.03.2013 was ₹ 5,60,000 and claims recoverable from re-insures being ₹ 1,90,000. Calculate the amount of claims incurred which is to be charged to its revenue account. **(2 marks)** ***[CMAIG - I]***

Answer:

Fact General Insurance Co. Ltd.
Claims incurred (Net)

	₹
Claims paid	64,50,000
Add: Claims outstanding at the end of the year	5,60,000
	70,10,000

Less: Claims outstanding at the beginning of the year	5,20,000
	64,90,000
Less: Recoverable from re-insures as on 31.03.2013	1,90,000
	63,00,000

Space to write important points for revision

2013 - Dec [6] (c) The Revenue Account of a life insurance company shows the life assurance fund on 31st March, 2013 at ₹ 60,20,000 before taking into account the following items:

(i) Claims covered under re-insurance ₹ 1,20,000.
(ii) Bonus utilized in reduction of life insurance premium ₹ 45,000.
(iii) Interest accrued on securities ₹ 82,600.
(iv) Outstanding premium ₹ 60,000.
(v) Claims intimated but not admitted ₹ 3,00,000.

What is the life assurance fund after taking into account the above omissions? **(4 marks)** ***[CMAIG - I]***

Answer:

Statement showing Life Assurance Fund as at 31st March, 2013

Particulars	Amount (₹)	Amount (₹)	Amount (₹)
Balance of fund as on 31st March, 2013			60,20,000
Add: Interest on securities		82,600	
Premium outstanding		60,000	1,42,600
			61,62,600
Less: Claim outstanding	3,00,000		
Less: Covered under Re-insurance	1,20,000	1,80,000	
Bonus in reduction of Premium		45,000	2,25,000
Balance of (correct) Life Assurance Fund			**59,37,600**

Note: *Bonus is nothing but the share of profit which is payable by the insurance company to the policyholders and Bonus in reduction of premium is applied to reduce further premium.*

Space to write important points for revision

2014 - June [8] (b) A Life Insurance Company gets its valuation made once in every two years. Its life assurance fund on 31st Dec. 2012 stood at ₹ 55,55,000 before providing for ₹ 55,000 being the shareholders' dividend for 2012. Its actuarial valuation on 31st Dec. 2012 disclose a net liability of ₹ 35,00,000. An interim bonus of ₹ 1,00,000 was paid to the policyholders during the previous two years.

You are required to show :

(i) Valuation Balance Sheet.

(ii) New Profit for the period.

(iii) The Distribution of the surplus. **(8 marks)** ***[CMAIG - I]***

Answer:

(i) **Preparation of Valuation Balance Sheet**:

Particulars	**Amount ₹**
Life Assurance Fund as on 31.12.2012	55,55,000
Less: Dividend for the year 2012	55,000
	55,00,000

.... Co. Ltd.

Valuation Balance Sheet as at 31st December, 2012

Liabilities	**₹**	**Assets**	**₹**
Net Liabilities a per Actuarial Valuation as at 31.12.2012 Surplus	35,00,000 20,00,000	Life Assurance Fund as per Balance Sheet	55,00,000
	55,00,000		55,00,000

(ii) **Net Profit for the Period:**

Particulars	**Amount ₹**
Surplus (as per Valuation Balance Sheet)	20,00,000
Add: Interim bonus for the period	1,00,000
Therefore, Net profit for the period	21,00,000

(iii) **Distribution of the surplus:**

Particulars	Amount ₹
Net Profit (Calculated as above)	21,00,000
Policyholders' shares 95% (i.e., ₹ 21,00,000 × 95 / 100) *Less:* Payment of Interim Bonus	19,95,000 1,00,000
Reversionary Bonus to be declared	18,95,000
Shareholders' share only @ 5% (i.e., ₹ 21,00,000 × 5 / 100)	1,05,000

—— Space to write important points for revision ——

2014 - Dec [1] Answer the following question (Give workings):

(i) Human Life Insurance Company provides the following information:

Life insurance Fund on 31st March, 2014 ₹ 155 Lakhs

Net liability on 31st March as per actuarial valuation ₹ 132 Lakhs

Interim Bonus paid to Policy holders during inter valuation period ₹ 11 Lakhs

Prepare Valuation Balance Sheet. **(2 marks)** ***[CMAIG - I]***

Answer:

Valuation Balance Sheet **(₹ in lakhs)**

Particulars	Amount	Particulars	Amount
To Net liability on 31st March as per actuarial valuation	132	By Life Insurance Fund	155
To Surplus	23		
	155		155

—— Space to write important points for revision ——

2014 - Dec [7] (b) Following information are provided by the Rashtriya Beema Company for the year ended 31st March, 2014:

(i) On 1st April, 2013. The unexpired risks reserve was in respect of marine insurance business ₹ 52.50 crores; in respect of fire insurance business ₹ 55 crores and in respect of miscellaneous insurance business ₹ 12.50 crores.

(ii) It is the practice of the company to create reserve at 100% of net premium income in respect of marine insurance policies and at 50% of net premium in respect of fire and miscellaneous insurance policies.

(iii) During the year 2013-2014 the following business was conducted:

(₹ in crores)

Particulars	Marine	Fire	Miscellaneous
Premium collected from:	₹	₹	₹
1. Insured in respect of policies issued	57	125	30
2. Other insurance companies in respect of risks undertaken	17.5	12.5	10
Premium paid/payable to other insurance companies on business ceded	21.50	16.50	8.50

You are required:

(i) Pass necessary journal entries relating to unexpired risks reserve.

(ii) Show unexpired risks reserve account (in columnar form) for the year ended 31st March, 2014. **(8 marks)** ***[CMAIG - I]***

Answer:

Books of Rashtriya Beema Company
Journal

Date	**Particulars**	**(₹ in crores)**	**(₹ in crores)**
31.03.14	Marine Revenue A/c Dr. To Unexpired Risks Reserve A/c [Provision made for unexpired risks reserve on marine business is (53-52.50)]	0.5	0.5
31.03.14	Fire Revenue A/c Dr. To Unexpired Risks Reserve A/c [Unexpired risks reserve made for fire business is (60.5-55)]	5.5	5.5

31.03.14	Miscellaneous Revenue A/c To Unexpired Risks Reserve A/c [Unexpired Risks Reserve made for Miscellaneous business is (15.75-12.50)]	3.25	3.25

Unexpired Risk Reserve A/c

Dr. **Cr.**

Date	Particulars	Marine	Fire	Misc.	Date	Particulars	Marine	Fire	Misc.
31.3.14	To Revenue A/c	52.5	55.00	12.50	1.4.13	By Balance b/d	52.5	55.00	12.50
31.3.14	To Balance c/d	53.0	60.50	15.75	31.3.14	By Revenue A/c	53.0	60.50	15.75
		105.5	115.50	28.25			105.5	115.50	28.25

Space to write important points for revision

2015 - June [1] Answer the question:

(i) GRIZA LIFE INSURANCE CO. LTD. furnishes the following information:

Life Insurance fund as on 31.03.2014	₹ 26,56,000
Net Liability on 31.3.2014 as per actuarial valuation	₹ 10,34,000
Interim Bonus paid to Policy holders during intervaluation period	₹ 1,23,800
Amount proposed to carry forward amount of	₹ 2,55,000

What is the amount of share of Shareholders? **(2 marks)** ***[CMAIG - I]***

Answer:

In the Books of Griza Life Insurance Co. Ltd.

Valuation Balance Sheet as on 31st March, 2014

Particulars	**Amount ₹**	**Particulars**	**Amount ₹**
To Net liability	10,34,000	By Life Assurance Fund	26,56,000
To Net Profit	16,22,000		
	26,56,000		26,56,000

Net profit as per Valuation Balance Sheet = 16,22,000

Add: Interim Bonus paid = 1,23,800

Net Profit = 17,45,800

Distribution of the profits

Net Profit	= 17,45,800
Less: Amount proposed to be carried forward	= 2,55,000
Balance	= 14,90,800
Share of policyholders (95% of 14,90,800)	= 14,16,260
Less: Interim bonus paid	= 1,23,800
Amount due to policyholders	= 12,92,460
Share of Shareholders (5% of 14,90,800)	= 74,540

—— Space to write important points for revision ——

2015 - June [7] Answer the question:

(b) LONG LIFE ASSURANCE CO. LTD. furnishes you the following information:

	₹
Life Assurance Fund on 31.03.2015	90,00,000
The interim bonus paid during the previous two-years period to Policy holders	1,50,000
Net Liability as per periodical Actuarial Valuation	75,00,000
Surplus brought forward from the previous valuation	9,00,000

The directors of the Company proposed to carry forward ₹ 10,00,000 and to divide the balance between the Policy holders and Shareholders. You are required to show:

(i) The valuation Balance Sheet as on 31.3.2015

(ii) The Net profit for the two years (valuation period)

(iii) The distribution of the surplus (Profit)

(2 + 3 + 3 = 8 marks) ***[CMAIG - I]***

Answer:

LONG LIFE ASSURANCE CO. LTD.
Valuation Balance Sheet as at March 31, 2015

Particulars	Amount ₹	Particulars	Amount ₹
Net liability as per actuarial valuation	75,00,000	Life Assurance Fund	90,00,000
Surplus (Balancing Figure)	15,00,000		
	90,00,000		90,00,000

Statement showing net profit for the valuation period

Net profit for valuation period: (As per valuation Balance Sheet)

A.	Surplus as per valuation balance sheet	15,00,000
B.	Add: Interim Bonus distributed	1,50,000
C.	Less: Surplus in the beginning	(9,00,000)
D.	Net profit for the valuation period	7,50,000

Distribution of Surplus

A.	Total surplus	16,50,000
B.	Less: Surplus to be carried forward	10,00,000
		6,50,000
C.	Shareholders (5% of ₹ 6,50,000)	32,500
D.	Policy holders (95% of ₹ 6,50,000)	6,17,500
E.	Less: Interim bonus already distributed	1,50,000
F.	Bonus still due to Policy holders	4,67,500

—— Space to write important points for revision ——

2015 - Dec [1] Answer the following question (Give workings):

(j) The Revenue Account of HEAVEN LIFE INSURANCE LTD. shows the Life Assurance Fund on 31st March, 2015 at ₹ 42,08,400 before taking into account the following items:

	₹
Claims covered under re-insurance	12,000
Claims intimated but not admitted	22,050
Premium Outstanding	8,110

What is the Balance of Life Assurance Fund? **(2 marks)** ***[CMAIG - I]***

Answer:

Balance of funds as on 31.3.2015	=	42,08,400
Add:		
Premium o/s	=	8,110
Less:		42,16,510

Claims o/s	22,050	
Claims covered under re-insurance	12,000	34,050
Balance of life assurance fund		41,82,460

—— Space to write important points for revision ——

2015 - Dec [7] Answer the question.

(a) The following details are extracted from the Books of HEAVEN FIRE INSURANCE CO. LTD. for the year ended March 31, 2015.

(Amount in ₹ Lakh)

Particulars	
Claims Paid	440
Legal expenses regarding claim	9
Premiums received	1,200
Re-insurance Premiums paid	90
Commission	250
Expenses of Management	150
Provision against unexpired risk on 1st April, 2014	480
Claims unpaid on 1st April, 2014	40
Claims unpaid on 31.03.2015	70

Create Reserve for Unexpired Risk @ 40%

Required:

Prepare the Revenue Account as per IRDA Regulations for the year ended March 31, 2015. **(8 marks)** ***[CMAIG - I]***

Answer:

Heaven Fire Insurance Co. Ltd.

Revenue A/c for the year ending 31st March, 2015.

Particulars	**Sed. No**	**₹**
Premium received (Net)	1	1,110
change in provision for unexpired		36
Income from Investments risk		1,146
Total (A)		

Claim incurred	2	479
Commission		250
Management expenses		150
Total (B)		879
Operating loss (A-B)		267

Schedule - 1 Premium Earned

Premium earned	1,200
Less: Premium ended on reinsurance	90
Net premium	1,110

Schedule - 2 Claims incurred

Claims paid	440
Add: O/S claims as on 31.3.15	70
Less: O/S claims as on 31.3.14	(40)
	470
Add: Legal expenses regarding claim	9
	479

Space to write important points for revision

2016 - June [1] {C} (d) Answer the following question.

(ii) SUKHAM LIFE INSURANCE CO. furnishes the following information:

(₹ in Lakhs)

Particulars	Amount (₹)
Life Insurance fund on 31.03.2016	650
Net liability on 31.03.2016 as per actuarial valuation	510
Interim bonus paid to policy holders during inter-valuation period	35

You are required to prepare the valuation Balance Sheet as on 31.03.2016. **(2 marks)** ***[CMAIG - I]***

Answer :

Sukham Life Insurance Co.:
Valuation Balance Sheet as on 31.3.2016

Liabilities	Amount	Assets	Amount
To Net Liability as per actuarial Valuation	510	By Life Insurance fund	650
To Surplus	140		
	650		**650**

Space to write important points for revision

2016 - June [8] (b) SUN LIFE INSURANCE CO. LTD. provides the following information:

	(Amount in ₹ Lakh)
Balance of Life Assurance Fund as on 1st April, 2015	502
Interim bonus paid in the valuation period	80
Balance of Revenue Amount for the year ended 31st March 2016	700
Net liability as per Actuarial Valuation as on 31st March 2016	490

You are required to prepare:

(i) Valuation Balance Sheet and

(ii) Profit Distribution Statement-for the year ended 31st March, 2016.

(3 + 3 = 6 marks) ***[CMAIG - I]***

Answer:

In the Books of Sun Life Insurance Co. Ltd.

(i) **Valuation Balance Sheet as on 31st March, 2016**

(₹ in lakhs)

Liabilities	**Amount ₹**	**Assets**	**Amount ₹**
To Net liability	490	By Life Assurance Fund	700
To Net Profit	210		
	700		700

(ii) **Profit Distribution Statement:**

Profit as per Valuation Balance Sheet	=	210	
Add: Interim Bonus	=	80	
Net Profit	=	290	
Distribution:			
Net Profit	=	290	
Policy Shareholder's Shares @ 95%	=	275.5	
Less: Interim bonus	=	80	
Amount due to policyholders	=	195.5	
Shareholders Share @ 5% of 290 lakhs			14.50

Space to write important points for revision

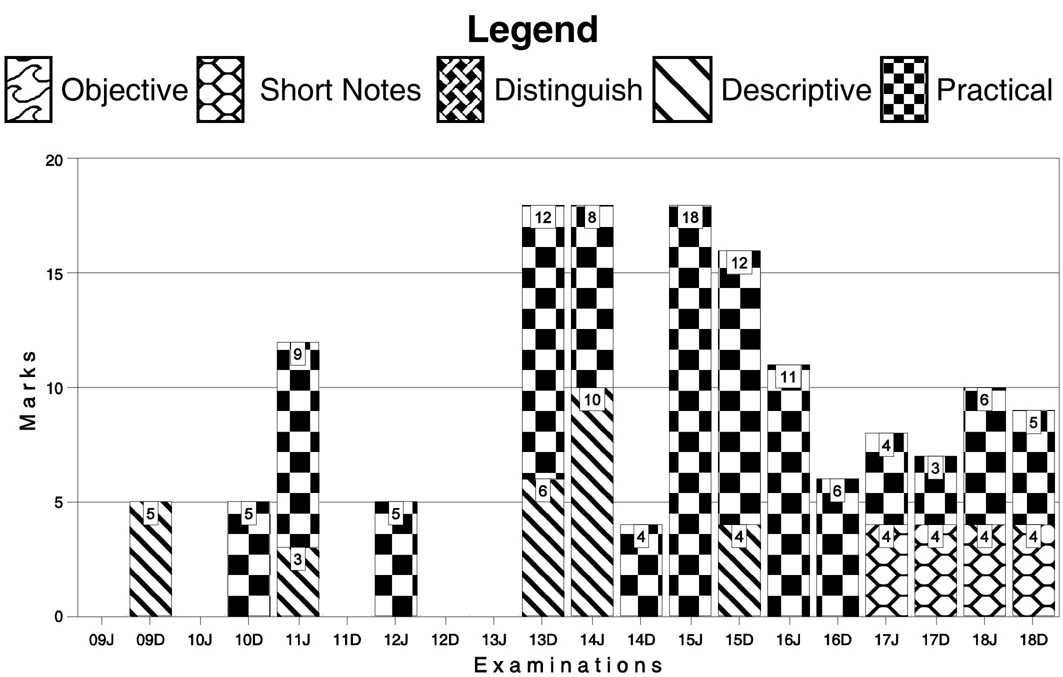
Repeatedly Asked Questions		
No.	**Question**	**Frequency**
1	Write short notes Re-insurance. 08 - Dec [8] (a), 18 - Dec [5] (b)	2 Times

Table Showing Marks of Compulsory Questions										
Year	**14 J**	**14 D**	**15 J**	**15 D**	**16 J**	**16 D**	**17 J**	**17 D**	**18 J**	**18 D**
Practical					2					
Total					2					

5 ACCOUNTING STANDARDS

THIS CHAPTER INCLUDES	
• AS - 11; • AS - 12; • AS - 15; • AS - 16;	• AS - 17; • AS - 18; • AS - 19.

Marks of Objective, Short Notes, Distinguish Between, Descriptive & Practical Questions



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CHAPTER AT A GLANCE

S. No.	Topic	Important Highlights
1.	**AS 11: Accounting for the effects of changes in foreign exchange rates**	The statement applies mandatorily in respect of: (a) Accounting for transaction in foreign currencies (b) Translating the financial statements of foreign branches for inclusion in the financial statements of the reporting enterprise.
2.	**AS 12: Accounting for government grants**	Government refers to Union/State, Govt. Agencies and similar bodies - Local, National or International. Grants also include subsidies, cash incentive, and duty drawback either in cash or kind/benefits to an enterprise on recognition of compliance in the past or future compliance with condition attached to it.
3.	**AS 15: Accounting for employee benefits**	The statement applies to benefit usually comprising of Provident Fund, Superannuation/ Pension Fund, Gratuity, Leave encashment or retirement, Post retirement health and welfare schemes and other benefits provided by an employer to employees either in pursuance of legal requirement or otherwise, but does not extend to employers' obligation which cannot be reasonably estimated (e.g. ex-gratia ad-hoc on retirement).

4.	**AS 16: Borrowing costs**	Borrowing costs are interests and other costs incurred by an enterprise in connection with the borrowing of funds. A qualifying asset is an asset that necessarily takes substantial period of time to get ready for its intended use or sale.
5.	**AS 17: Segment reporting**	In India, disclosures of disaggregated information are required as per Schedule III to the **Companies Act, 2013.** A manufacturing company is required to disclose value and quantities of opening and closing stock of goods produced by each class of goods. Also it has to disclose quantitative information about licensed and installed capacities and actual production by each class of goods.
6.	**AS 18: Accounting standard related party disclosures**	Generally business transactions between related parties lose the feature and character of the arms length transactions. Related party relationship affects the volume and decision of business of one enterprise for the benefit of the other enterprise one. Hence, it is necessary to disclose the related transaction for proper understanding of financial performance and financial position of an enterprise. **Related Party** 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.

7.	**AS 19: Accounting for leases**	Lease is an arrangement by which the "Lessor" gives the right to use an asset for given period of time to the "Lessee" on rent. It involves two parties, a Lessor and a Lessee and an asset which is to be leased. The Lessor, who owns the asset, agrees to allow to the Lessee to use it for a specified period of time in return for periodic rent payments. **Types of lease** **(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 situations, the lease transactions are called Finance Lease. **(ii) Operating Lease:** It is a lease which does not transfer substantially all the risk and reward incidental to ownership. **Applicability** The Accounting Standard is not applicable to following types of lease: • Lease agreement to explore natural resources such as oil, gas, timber, metal and other mineral rights. • Licensing agreements for motion picture film, video recording, plays, manuscripts, patents and other rights. • Lease agreement to use land.

SHORT NOTES

2017 - June [5] Write short note:

(a) Recognition of Govt. grants related to specific fixed assets. **(4 marks)**

Answer

Recognition of Govt. grants related to specific fixed assets:

Grants received specifically for fixed asset is disclosed in the financial statement either

(i) by way of deduction from the gross block of the asset concerned, thus grant is recognized in Profit and Loss Account through reduced depreciation (in case of funding of specific asset Cost entirely, the asset should be stated at a nominal value in Balance Sheet); or

(ii) the grant treated as deferred revenue income and charged off on a systematic and rational basis over the useful life of the asset, until appropriated disclosed as —Deferred Govt. grant under Reserves and Surplus in the Balance Sheet (grants relating to depreciable assets should be credited to Capital Reserve and suitably credited to Profit and Loss Account to offset the cost charged to income).

—— Space to write important points for revision ——

2017 - Dec [5] Write short note:

(a) Operating Lease and Finance Lease **(4 marks)**

Answer:

Operating Lease and Finance Lease

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.

A finance lease is a lease that transfers substantially all the risks and rewards incidental to ownership of an asset. Title may or may not eventually be transferred.

An operating lease is a lease other than a finance lease.

As per AS 19, a lease is classified as a finance lease if it transfers substantially all the risks and rewards incidental to ownership. A lease is classified as an operating lease if it does not transfer substantially all the risks and rewards incidental to ownership.

—— Space to write important points for revision ——

2018 - June [5] Write short notes:

(a) Geographical Segment as per AS-17 **(4 marks)**

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 risk and returns that are different from those of components operating in other economic environments. Factors that should be considered in identifying geographical segments include:

(i) Similarity of economic and political conditions;
(ii) Relationships between operations in different geographical areas;
(iii) Proximity of operations;
(iv) Special risks associated with operations in a particular area;
(v) Exchange control regulations; and
(vi) The underlying currency risks.

—— Space to write important points for revision ——

2018 - Dec [5] Write short note:

(a) Related Party as per AS 18 **(4 marks)**

DESCRIPTIVE QUESTIONS

2009 - Dec [3] (b) What is sale & lease back? Enumerate accounting treatment of sale & lease back under AS 19. **(5 marks)**

Answer :

A sale and lease back transaction includes the sale of an asset by vendor and leasing of the same asset back to the vender. The seller gets the right to use the same asset as also increasing its liquidity position. It is like eating the cake and having it too. The benefit of depreciation is available to the buyer.

Accounting Treatment:	
1. **If lease back is financial lease**	Any profit or loss of sale proceeds over the carrying amount should not be immediately recognized as profit or loss in the financial statement of seller lessee. It should be deferred and amortised over lease term in proportion to the depreciation of leased assets.
2. If lease back is operating lease	Any profit or loss is recognized immediately when sale price is equal to fair value. If sale price is 'below' fair value: Profit - recognize profit immediately. Loss - recognize loss immediately if not compensated by future lease payment. Loss - defer and amortise loss if loss is compensated by future lease payment.

—— Space to write important points for revision ——

2011 - June [6] (b) Lakshmi Bank has followed the policies for retirement benefits as under:

(i) Contribution to pension fund is made based on actuarial valuation at the year end in respect of employees who have opted for pension scheme.

(ii) Contribution to the gratuity fund is made based on actuarial valuation at the year end.

(iii) Leave encashment is accounted for on "PAY-AS-YOU-GO" method.

Comment whether the policy followed by Bank in the above cases are in accordance with AS-15. **(3 marks)**

Answer :

(i) As the contribution to Pension Fund is made on actuarial basis every year, therefore, the policy is as per AS15.

(ii) As the contribution is being made on annual basis to gratuity fund on actuarial basis, the policy is in accordance with AS - 15.

(iii) As regard leave encashment, which is accounted for on PAY-AS-YOU-GO basis, it is not in accordance with AS - 15. It should be accounted for on actual basis.

—— Space to write important points for revision ——

2012 - Dec [2] (b) What do you mean by “Fellow Subsidiary” in the context of Related Party Disclosure (As per AS-18)? **(2 marks)** ***[CMAFG - IV]***

Meaning:

(i) As per AS-18, a Company is considered to be a Fellow Subsidiary of another company, if both the companies are subsidiaries of the same holding company.

(ii) Say, A Ltd. is holding 60 % shares of B Ltd. and A Ltd. also holds 55 % shares in C Ltd. Then B Ltd. and C Ltd. are the subsidiaries of A Ltd., i.e., A Ltd. is the holding company of both B Ltd. and C Ltd. In this given Example, B Ltd. and C Ltd., are “Fellow Subsidiaries” of each other.

—— Space to write important points for revision ——

2013 - Dec [1] {C} Answer the following:

(a) State the disclosure requirements under AS-12. **(2 marks)**

Answer:

Disclosure under AS-12

(a) The accounting policy adopted for Government Grants including, method of presentation in the financial statement.

(b) The nature and extent of Govt. grants recognized in the financial statements, including grants of non-monetary assets given at a concessional rate or free of cost.

—— Space to write important points for revision ——

2013 - Dec [2] (a) (i) What are the disclosure requirements for an enterprise as per AS-11? **(4 marks)**

Answer:

Disclosure under AS -11:

An enterprise should disclose:

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

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

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

(iv) Foreign currency risk management policy.

—— Space to write important points for revision ——

2014 - June [1] {C} Answer the following:

(b) State the types of lease to which AS-19 are not applicable. **(2 marks)**

Answer:

The Accounting Standard AS-19 is not applicable to the following types of Lease:

(i) Lease agreement to explore natural resources such as oil, gas, timber, metal and other material rights;

(ii) Licensing agreements for motion picture film, video recording, Plays, manuscripts, patents and other rights;

(iii) Lease agreement to use land.

—— Space to write important points for revision ——

2014 - June [2] (b) (i) State the disclosure requirements under AS-15. **(3 marks)**

(ii) What are the components of pension expenses for defined benefit pension plan? **(5 marks)**

Answer:

(i) Disclosure under AS-15:

(a) In view of the varying practices, adequate disclosure of method of accounting for an understanding of the significance of such costs to an employer.

(b) Disclosure separately made for statutory compliance or otherwise the retirement benefit costs are treated as an element of employee remuneration without specific disclosure.

(c) Financial statements should disclose whether actuarial valuation is made at the end of the accounting period or earlier (in which case the date of actuarial valuation and the method used for accrual period if not based on actuary report).

Answer:

(ii) The components of pension expenses for defined pension plan are:

(i) Current service cost;

(ii) Interest cost;

(iii) Actuarial gains and losses;

(iv) Past service cost;

(v) The effect of any curtailment re-settlements;

(vi) Effect of recognition of over funding (assets) of defined benefit plan at lower of over funding amount and present value of any economic benefit plan at lower of over funding amount and present value of any economic benefit available in the plan or reduction in future contribution to the plan;

(vii) Excepted return on any plan assets or any reimbursement rights.

—— Space to write important points for revision ——

2015 - Dec [2] Answer the question:

(a) (i) What are disclosure requirements under AS-11? **(4 marks)**

Answer:

Disclosure under AS -11: An enterprise should disclose:

(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.

—— Space to write important points for revision ——

PRACTICAL QUESTIONS

2008 - Dec [4] (a) The following information relate to company AKG Ltd.

	Exchange rate
Goods purchased on 25.02.2007 for US $ 1,00,000	₹ 44.50
Exchange rate on 31.03.2007	₹ 45.00
Date of actual payment 05.06.2007	₹ 45.40

Required:

Calculate the loss/gain for the financial years 2006-07 and 2007-08 as per AS-11 **(2 marks)**

Answer :

As per AS – 11 all foreign currency transactions are to be recorded by applying the exchange rate at the date of transaction. So, goods purchased on 25.02.2007 and corresponding creditor account would be recorded at the rate of ₹ 44.50 = US $1, i.e at ₹ 44,50,000.

At the balance sheet date all monetary items should be reported, as per AS– 11, using the rate on the date of closing the accounts. So, the amount resulting in exchange loss of ₹50,000 [₹ 45,00,000 – ₹ 44,50,000] has to be debited in Profit and Loss Account for 2006 – 07.

Further, exchange difference on settlement on 05-06-2007 on this monetary item as a loss of ₹40,000 [₹ 45,40,000 - ₹ 45,00,000] will be debited in Profit and Loss Account for the year 2007-08.

—— Space to write important points for revision ——

2008 - Dec [7] (b) Softex Ltd. acquired an equipment on lease from Simplex Ltd. (Lessor) on April 1, 2008 for 3 years. Its useful life is 5 years. Both the cost and the fair market value of the equipment are ₹ 6,00,000. The amount (annual lease payment) will be paid in three instalments at end of each year. Simplex Ltd. will get back the equipment upon termination of the lease. However, Softex Ltd. is given an option to retain the equipment at a nominal value at the end of the lease period. The unguaranteed residual value at the end of 3 years is ₹ 80,000.

The internal rate of return (IRR) of the investment is 10%:

[$PVIFA_{10\%.3\ yrs}$ = 2.4868; $PVIF_{10\%.\ 3\ yr.}$ = 0.7513].

Required:

(i) State with reason whether the lease constitute a finance lease. **(3 marks)**

(ii) Calculate unearned finance income keeping in view the relevant Accounting Standard (AS. 19). **(2 marks)**

Answer :

(i) The IRR of the investment is 10% (given).

Investment in lease is ₹6,00,000.

So, from the lessor's point of view, PV of minimum lease payment (MLP) + unguaranteed residual value = ₹6,00,000.

Now, PV of unguaranteed residual value = ₹80,000 × 0.7513 = ₹ 60,104.

PV of MLP is then ₹6,00,000 - ₹60,104 = ₹5,39,896.

The fact that……………..

1. the PV of MLP at the beginning of the lease period substantially. (₹5,39,896 ₹6,00,000 or 90% approx.) covers the initial fair value.
2. the lease period covers major part (60%) of the life of the asset, and
3. the lessee is given the option to retain (buy) the equipment for a nominal value at the end of the lease period…..makes the lease a finance lease.

Answer:

(ii) Unearned Finance Income:

Annual lease payment = ₹ 5,39,896÷2.4868 = ₹ 2,17,104.71.

	₹
Gross investment in lease : ₹ 2,17,104.71 × 3 =	6,51,314
Add : Unguaranteed residual value	80,000
	7,31,314
(Less) PV of Gross investment in lease	(6,00,000)
Unearned Finance Income	₹1,31,314

—— Space to write important points for revision ——

2009 - Dec [6] (b) PARASH LTD. had the following borrowings during a year in respect of capital expansion :

Plant	Cost of Assets (₹)	Remarks
Plant–M	100 lakh	No specific borrowings
Plant–N	125 lakh	Bank loan of ₹ 65 lakh at 10%
Plant–X	175 lakh	9% Debentures of ₹ 125 lakh were issued

In addition to the specific borrowings stated above the company had obtained term loans from two Banks :

(1) ₹ 100 lakh at 10% from Corporation Bank and

(2) ₹ 110 lakh at 11.5% from State Bank of India to meet its capital expansion requirements.

Required :

Determine the amount of borrowings costs to be capitalized in each of the above plants as per AS-16. **(6 marks)** ***[CMAFG - IV]***

Answer:

PARASH LTD.

1. Computation of actual borrowing costs incurred during the year.

Sources	Loan Amount (₹ in lakh)	Interest Rate	Interest Amount (₹ in lakh)
Bank Loan	65.00	10%	6.50
9% Debentures	125.00	9%	11.25
Term Loan from Corporation Bank	100.00	10%	10.00

Term Loan from State bank of India	110.00	11.25%	12.65
	400.00		40.40
Specific Borrowing included in above	190.00		17.75

2. Weighted Average Capitalization Rate for General Borrowings

$$= \frac{\text{Total Interest} - \text{Interest on Specific Borrowings}}{\text{Total Borrowings} - \text{Specific Borrowings}}$$

$$= \left(\frac{40.40 - 17.75}{400 - 190}\right) = \frac{22.65}{210} = 10.79\%$$

3. Capitalization of Borrowings costs under AS-16 will be as under :

Plant	Borrowing	Loan Amount	Interest Rate (%)	Interest Amount	Cost of Assets	
M	General	100	10.79	10.79		110.79
N	Specific	65	10.00	6.50	71.50	
	General	60	10.79	6.47	66.47	137.97
X	Specific	125	9.00	11.25	136.25	
	General	50	10.79	5.39	55.39	191.64
		400		40.40		440.40

Note: *The amount of borrowings costs capitalized should not exceed the actual interest Cost.*

Space to write important points for revision

2010 - Dec [7] Answer the following question:

(c) AB Ltd. has set up its business in a designated backward area which entitles the company to receive from the Govt. of India a subsidy of 25% of the cost of investment. Having fulfilled all the conditions under the scheme, the company in its investment of ₹ 80 crores in capital assets, received ₹ 20 crores from the Govt. in February, 2010 in the accounting period 2009-10. The company wants to treat this receipt as an item of revenue and thereby reduce the losses in P. & L. A/c for the year ended 31.3.2010.

Do you think the treatment is justified? Answer with reference to relevant AS. **(5 marks)**

Answer :

As per para 10 of AS-12 'Accounting for Govt. Grants', when the Govt, grants are of the nature of promoters' contribution., i.e., they are given with reference to the total investment in an undertaking or by way of the contribution towards its total capital out lay (for example, central investment subsidy scheme) and no repayment is ordinarily expected in respect thereof, the grants are treated as capital reserve which can neither be distributed as dividend nor considered as deferred income.

In the instant case, the subsidy received is neither in relation to specific fixed asset nor in relation to revenue, Thus it is inappropriate to recognise Govt. grants in the profit and loss statement, since they are not earned but represent an incentive provided by Govt. without related costs. The correct treatment is to credit the subsidy to Capital Reserve. Therefore, the accounting treatment followed by the company is not proper.

—— Space to write important points for revision ——

2011 - June [7] (a) A Ltd. Leased a machinery to B Ltd. on the following terms:

Fair value of the machinery ₹ 20 lakhs, Lease terms 5 years, Lease Rental per annum ₹ 5 lakhs, Guaranteed Residual value ₹ 1 lakh, Expected Residual value ₹ 2 lakhs, Internal Rate of Return 15%.

Depreciation is provided on straight line method @ 10% per annum. Ascertain unearned financial income and necessary entries may be passed in the books of the Lessee in the First year. **(9 marks)**

Answer :

Computation of Unearned Finance Income

As per AS 19 on Leases, unearned finance income is the difference between (a) the gross investment in the lease and (b) the present value of minimum lease payments under a finance lease from the standpoint of the lessor; and any unguaranteed residual value accruing to the lessor, at the interest rate implicit in the lease;

Where;

(a) Gross Investment in the lease is the aggregate of (i) minimum lease payments from the stand point of the lessor and (ii) any unguaranteed residual value accruing to the lessor.

Gross Investment = Minimum lease payment + Unguaranteed residual value

= (Total lease rent + Guaranteed residual value) + Unguaranteed residual value

= [(₹ 5,00,000 × 5 years) + ₹ 1,00,000] + ₹ 1,00,000

= ₹ 27,00,000…………..(a)

(b) Table showing present value of (i) Minimum lease payments (MLP) and (ii) Unguaranteed residual value (URV).

Year	MLP inclusive of URV ₹	Internal rate of return (Discount factor 15%)	Present value ₹	
1.	5,00,000	0.8696	4.34,800	
2.	5,00,000	0.7561	3.78,050	
3.	5,00,000	0.6575	3.28,750	
4.	5,00,000	0.5718	2.85,900	
5.	5,00,000	0.4972	2.48,600	
	1,00,000	0.4972	.49,720	
	(guaranteed residual value)		17.25,820	(i)
	1,00,000	0.4972	.49,720	(ii)
	(unguaranteed residual value)	(i) + (ii)	17.75,540	(b)

Unearned Finance Income = (a) – (b)

= ₹ 27,00,000 – ₹ 17,25,540

= ₹ 9,74,460

Journal Entries in the books of B Ltd.

	₹	₹
At the inception of lease Machinery account Dr. To A Ltd's account (Note 1) (Being lease of machinery recorded at present value of MLP)	17,25,820 (Note 1)	17,25,820
At the end of the first year of lease Dr. Finance charges account (Refer Working Note) To A Ltd's account (Being the finance charges for first year due)	2,58,873	2,58,873
A Ltd's account Dr. To Bank account (Being the lease rent paid to the lessor which includes outstanding liability of ₹ 2,41,127 and finance charge of ₹ 2,58,873)	5,00,000	5,00,000
Depreciation account Dr. To Machinery account (Being the depreciation provided @ 10% p.a. on straight line method)	1,72,582	1,72,582
Profit and loss account Dr. To Depreciation account To Finance charges account (Being the depreciation and finance charges transferred to profit and loss account)	4,31,455	1,72,582 2,58,873

Note: 1 Working Note:

Table showing apportionment of lease payments by B. Ltd. between the finance charges and the reduction of outstanding liability.

Year	Outstanding liability (opening balance) ₹	Lease rent ₹	Finance charge ₹	Reduction in outstanding liability ₹	Outstanding liability (closing balance) ₹
1	17,25,820	5,00,000	2,58,873	2,41,127	14,84,693
2	14,84,693	5,00,000	2,22,704	2,77,296	12,07,397
3	12,07,397	5,00,000	1,81,110	3,18,890	8,88,507
4	8,88,507	5,00,000	1,33,276	3,66,724	5,21,783
5	5,21,783	5,00,000	78,267	5,21,783	1,00,050*
			8,74,230	17,25,820	

*The difference between this figure and guaranteed residual value (₹ 1,00,000) is due to approximation in computing the interest rate implicit in the lease.

—— Space to write important points for revision ——

2012 - June [2] (a) As on 1st April, 2011 the Fair Value of Plan Assets was ₹ 1,00,000 in respect of a pension plan of X Ltd. On 30th September, 2011 the plan paid out benefits of ₹ 20,000 and received inward contributions of ₹ 50,000. On 31st March, 2012 the fair value of plan assets was ₹ 1,50,000 and present value of the defined benefit obligation was ₹ 1,48,000. Actuarial losses on the obligations for the year 2011-12 were ₹ 1,000. On 1st April, 2011 the company made the following estimates, based on its market studies, understanding and prevailing prices:

Interest & Dividend Income, after tax payable by the fund	9.50%
Realized and unrealized gains on Plan Assets (after tax)	2.00%
Fund Administrative Costs	(1.25%)
Expected Rate of Return	10.25%

Required: Find the Expected & Actual Returns on Plan Assets for the year 2011-12 **(5 marks)**

Answer:

A. Closing Balance of Fair Value of Plan Assets	₹ 1,50,000
B. *Add :* Benefit Paid	₹ 20,000

C. *Less* : Contributions Received	(₹ 50,000)
D. *Less* : Opening Balance of Fair Value of Plan Assets	₹ 1,00,000
E. Actual Return on Plan Assets	₹ 20,000

A. Return on Opening Balance of Fair Value of Plan Assets [₹ 1,00,000 × 10.25% ×12/12]	₹10,250
B. Return on Net Contributions Received [Contributions - Benefits paid] [(₹ 50,000 - ₹ 20,000) × 5%]	₹ 1,500
C. Expected Return on Plan Assets	₹ 11,750

Note : *Equivalent Half Yearly Compounding Interest Rate*

$$= \sqrt{(1 + \text{EXPECTED RATE OF RETURN})} - 1$$

$$= \sqrt{(1 + .1025)} - 1 = .05 \text{ or } 5\%$$

Space to write important points for revision

2013 - Dec [2] (a) (ii) The following details are provided by an Import House:

Particulars	Exchange rate 1 Us Dollar =
Goods purchased on 24th August, 2012 Us Dollar 2,00,000	₹ 47.10
Exchange rate on 31st March, 2013	₹ 54.20
Exchange rate on date of actual payment on 25th May, 2013	₹ 56.30

Calculate gain or loss for the financial years 2012-13 and 2013-14 and its accounting treatment. **(4 marks)**

(b) Kovid Limited has taken a Machinery on Lease from Krishna Limited. The following information are provided by Kovid Limited:

Lease Term	5 years
Fair value at inception of Lease	₹ 20 Lakhs
Lease Rent	₹ 5 Lakhs per annum payable at the end of the year
Expected Residual value	₹ 3 Lakhs
Guaranteed Residual value	₹ 2 Lakhs
Implicit Interest rate	15.5% per annum

You are required to prepare Lease Rent Account and Lease Liability Account in the Books of Kovid Limited. (The present value of Re. 1 at Discount rate of 15.5% are 0.8658, 0.7496, 0.6490, 0.5619 and 0.4865 for year 1 to year 5 respectively.) **(8 marks)**

Answer:

(a) (ii) As per AS-11, all foreign currency transactions should be recorded by applying the exchange rate at the date of transaction. Therefore, goods purchased on 24th August, 2012 and corresponding creditor would be recorded at ₹ 47.10.

= 2,00,000 x 47.10 = ₹ 94,20,000

As per As-11, at the balance sheet date all monetary items should be reported using the closing rate. Therefore, the creditors of US $ 2,00,000 outstanding on 31st March, 2013 will be reported as:

= 2,00,000 x 54.20 = ₹ 1,08,40,000

Exchange loss ₹ 14,20,000 (1,08,40,000 - 94,20,000) should be debited in profit and loss account for 2012-13.

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

= 2,00,000 x 56.30 = 1,12,60,000 - 1,08,40,000 = ₹4,20,000

₹ 4,20,000 should be debited to profit or loss for the year 2013-14.

Answer:

(b) Present value of minimum lease payment

Year	MLP (₹)	Discount factor @ 15.5%	PV (₹)
1	5,00,000	0.8658	4,32,900
2	5,00,000	0.7496	3,74,800
3	5,00,000	0.6490	3,24,500
4	5,00,000	0.5619	2,80,950
5	7,00,000 [including ₹ 2,00,000]	0.4865	3,40,550
	27,00,000		17,53,700

Present value of minimum lease payment (₹ 17,53,700) is less than fair value at the inception of lease (₹ 20,00,000) so the leased asset and liability should be recognized at ₹ 17,53,700.

Apportionment of finance lease
Rate of Interest 15.5%

Year	Liability (₹)	MLP (₹)	Finance Charge (₹)	Principal Amount of reduction (₹)
0	17,53,700	–	–	–
1	15,25,524	5,00,000	2,71,824	2,28,176
2	12,61,980	5,00,000	2,36,456	2,63,544
3	9,57,587	5,00,000	1,95,607	3,04,393
4	6,06,013	5,00,000	1,48,426	3,51,574
5	–	7,00,000	93,932	6,06,068

Books of Kovid Limited
Lease Rent Account

Year	Particulars	Amount (₹)	Particulars	Amount (₹)
1st Year	To Bank A/c	5,00,000	By Finance Charges A/c	2,71,824
			By Lease Liability A/c	2,28,176
		5,00,000		5,00,000

2nd Year	To Bank A/c	5,00,000	By Finance Charges A/c	2,36,456
			By Lease Liability A/c	2,63,544
		5,00,000		5,00,000
3rd Year	To Bank A/c	5,00,000	By Finance Charges A/c	1,95,607
			By Lease Liability A/c	3,04,393
		5,00,000		5,00,000
4th Year	To Bank A/c	5,00,000	By Finance Charges A/c	1,48,426
			By Lease Liability A/c	3,51,574
		5,00,000		5,00,000
5th Year	To Bank A/c	7,00,000	By Finance Charges A/c	93,932
			By Lease Liability A/c	6,06,068
		7,00,000		7,00,000

Lease Liability Account (less or A/c)

Year	Particulars	Amount (₹)	Particulars	Amount (₹)
1st Year	To Lease Rent A/c	2,28,176	By Fixed Assets A/c	17,53,700
	To Balance c/d	15,25,524		
		17,53,700		17,53,700
2nd Year	To Lease Rent A/c	2,63,544	By Balance b/d	15,25,524
	To Balance c/d	12,61,980		
		15,25,524		15,25,524
3rd Year	To Lease Rent A/c	3,04,393	By Balance b/d	12,61,980
	To Balance c/d	9,57,587		
		12,61,980		12,61,980
4th Year	To Lease Rent A/c	3,51,574	By Balance b/d	9,57,587
	To Balance c/d	6,06,013		
		9,57,587		9,57,587
5th Year	To Lease Rent A/c	6,06,013	By Balance b/d	6,06,013
		60,60,013		6,06,013

2014 - June [2] (a) (i) Jayakrishna Mills Ltd., runs a modern wheat flour mill. The CFO has prepared the draft accounts, duly considering the mandatory accounting standards. Following note appears: “The company purchased on 15.6.2013, a special purpose machinery for ₹ 75 lakhs. It received a State Government grant for 10% of the price. The machine has an effective life of 10 years”.
What is the proper method of accounting treatment for the above?
(4 marks)

(ii) Springlily Ltd. borrowed US $ 6,00,000 on 31.12.2013 which will be repaid (settled) as on 30.6.2014. The company prepares its financial statements ending on 31.3.2014.
Rate of exchange between reporting currency (Rupee) and foreign currency (US $) on different dates are as under:

31.12.2013	1 US $ = ₹ 64.00
31.03.2014	1 US $ = ₹ 64.50
30.06.2014	1 US $ = ₹ 64.75

State the aspects to be noted while preparing the financial statements due to the applicable AS. How should the difference in exchange rates be treated? **(4 marks)**

Answer:

(i) AS-12 prescribes two methods in accounting treatment of Government grants for specific fixed assets.
Method I: Government grants related to depreciable fixed assets to be treated as deferred income which is to be recognized in the Profit and Loss Account in proportion in which depreciation on those assets is charged over the useful life of the asset.
The deferred income pending its apportionment to Profit and Loss Account to be disclosed in the balance sheet separately with a suitable description, e.g. Deferred Government Grants, to be shown after “Reserves & Surplus” but before “ Secured Loans”.
Method II: Grants received specifically for Fixed Asset may be disclosed in the financial statement by way of deduction from the gross block of the asset concerned, thus grant is recognised in P/L Account through reduced depreciation.

In this case machinery will be recognised at ₹ 67.5 lakhs i.e. after deduction of ₹7.5 lakhs Govt. Grants and depreciation will be calculated on that ₹ 67.5 lakhs.

Answer:

(ii) As per AS-11, all foreign currency transactions should be recorded by applying the exchange rate at the date of transaction. Therefore, amount borrowed on 31.12.2013 and corresponding lender would be recorded at ₹ 64.00

= 6,00,000 x 64.00 = 3,84,00,000

As per AS-11, at the balance sheet date all monetary items should be reported using the closing rate. Therefore, the lenders of US $ 6,00,000 outstanding on 31.3.14 will be reported as:

= 6,00,000 x 64.50 = 3,87,00,000.

Exchange loss ₹ 3,00,000 = (3,87,00,000– 3,84,00,000) should be debited in profit and loss account for 2013-14.

As per AS-11, exchange difference on settlement on monetary items should be transferred to profit and loss account as gain or loss thereof: 6,00,000 x 64.75 = 3,88,50,000 – 3,87,00,000 = ₹ 1,50,000 should be debited to profit or loss for the year 2014-15.

—— Space to write important points for revision ——

2014 - Dec [1] Answer the questions:

(b) During the year 2013-14, Purvi Limited received a grant from the Government of India amounting to ₹ 35 lakh towards purchase of a piece of land for ₹ 140 lakh.

You are required to show the accounting treatment of the above transaction in the books of Purvi Limited, as per AS-12.

(c) Chandra Limited purchased a machinery of ₹ 10,00,000 from Machinery Mart. The consideration was paid in the form of fully paid up equity shares of ₹ 10 each at 60% premium. Pass necessary journal entries in the books of Chandra Ltd. **(2 marks each)**

Answer:

(b) As per AS-12, accounting for Government Grants related to non-depreciable assets should be credited to capital reserve.

Thus, in the Books of Purvi Limited: (₹ In Lakhs)

Accounting entries:		₹	₹
(i) On Purchase of Land			
Land A/c	Dr.	140	
To Bank A/c			140
(ii) On receipt of Govt. Grant			
Bank A/c	Dr.	35	
To Capital Reserve A/c			35

Answer:

(c)

Journal of Chandra Ltd.

Particulars		**Dr.** (₹)	**Cr.** (₹)
Machinery A/c	Dr.	10,00,000	
To Machinery Mart			10,00,000
Machinery Mart	Dr.	10,00,000	
To E. S. Capital A/c			6,25,000
To Securities Premium A/c			3,75,000

Space to write important points for revision

2015 - June [1] Answer the questions:

(e) Rukmani Limited purchased a plant for US \$ 2,50,000 on 1st March, 2015, payable after three months. Company entered into a forward contract for three months @ ₹ 54.10 per dollar. Exchange rate per dollar on 1st March, 2015 was ₹ 53.74. Compute amount of profit or loss on forward contract as per AS-11. How will you recognise the same in the books of the company? **(2 marks)**

Answer:

Forward Premium = (54.10 - 53.74) × 2,50,000
= ₹ 90,000

As per AS- 11 this should be expended over the tenor of contract i.e. three months (01.03.2015 to 31.05.2015).

—— Space to write important points for revision ——

2015 - June [2] Answer any **two** question:

(a) Makkhu Limited leased a machine to Gunu Limited on the following terms:

(i)	Fair value of the machine	₹ 72 lakhs
(ii)	Lease term	5 years
(iii)	Lease rental per annum	₹ 12 lakhs
(iv)	Guaranteed residual value	₹ 2.40 lakhs
(v)	Expected residual value	₹ 4.50 lakhs
(vi)	Internal rate of return	15%

Discounted rates at 15% for ₹ 1, 1st year to 5th year are 0.8696, 0.7561, 0.6575, 0.5718 and 0.4972 respectively.

Ascertain Unearned Finance Income. **(8 marks)**

(b)(i) As on 1st April, 2014, the fair value of plan assets was ₹ 2,00,000 in respect of a pension plan of Sagar Limited. The plan paid out benefits of ₹ 25,000 and received inward contributions of ₹ 55,000. On 31st March, 2015, the fair value of plan assets was ₹ 3,00,000 and acturial losses on the Defined Benefit Obligations for the year 2014-15 were ₹ 30,000. On 1st April, 2014, the company made the following estimates, based on its market studies, understanding and prevailing prices:

Interest and Dividend income, after tax payable by the fund 11.25% p.a. Realised and unrealised gains on plan assets (after tax) 3% p.a. Fund administrative costs 4% p.a. Calculate Net Acturial gains/losses for the year 2014-15. **(5 marks)**

(ii) Patta Ltd. purchased a piece of Land for ₹ 25,00,000 for which it received a grant from the State Government amounting to ₹ 6,00,000. How will you treat Government grant in the accounts as per AS-12? Also pass the necessary journal entries of the above in the books of the company. **(3 marks)**

Answer:

As per AS-19 on leases, unearned finance income is the difference between (a) the gross investment in the lease and (b) the present value of minimum lease payment under the finance lease from the stand point of the lessor, and any unguaranteed residual value accruing to the lessor, at the interest rate implicit in the lease.

where:

(a) **Gross investments in the lease is the aggregate of:**

(i) minimum lease payments from the stand point of the lessor and

(ii) any unguaranteed residual value accruing to the lessor.

Gross investment = Minimum Lease Payments + Unguaranteed Residual Value

= Total lease rent + Guaranteed Residual Value (GRV) + Unguaranteed Residual Value (URV)

= $(12,00,000 \times 5) + 2,40,000 + 2,10,000$

= 64,50,000 (a)

(b) Table showing present value of (1) Minimum Lease Payments (MLPs) and Unguaranteed Residual Value (URV):

Year	MLP inclusive of URV (₹)	Internal Return of Return (discount factor @ 15%)	Present Value
1	12,00,000	0.8696	10,43,520
2	12,00,000	0.7561	09,07,320
3	12,00,000	0.6575	7,89,000
4	12,00,000	0.5718	6,86,160

5	12,00,000	0.4972	5,96,640
	2,40,000 (GRV)	0.4972	1,19,328
	62,40,000		41,41,968 (i)
	2,10,000 (URV)	0.4972	1,04,412 (ii)
Total	64,50,000	(i) + (ii)	42,46,380 (b)

Unearned finance income = (a) - (b)
= 64,50,000 - 42,46,380
= 22,03,620

Answer:

(b) (i)

A.	Closing Balance of Fair Value of Plan Assets	₹ 3,00,000
B.	Add Benefits Paid	₹ 25,000
C.	*Less:* Contribution Received	(₹ 55,000)
D.	*Less:* Opening Balance of Fair Value of Plant Assets	(₹ 2,00,000)
E.	Actual Return on Plan Assets	₹ 70,000
F.	Expected Return on Plan Assets [₹ 2,00,000 × 10.25% × 12/12] + [(₹ 55,000 – ₹ 25,000) × 5%]	₹ 22,000
G.	**Actual Gains on Plan Assets [E-F]**	₹ 48,000
H.	Acturial losses on the obligations	₹ 30,000
I.	**Net Acturial Gains [G+H]**	₹ 18,000
	Working Notes:	
	1. Expected Rate of Return = 11.25% + 3% – 4% = 10.25% 2. Equivalent Half Yearly Compounding Interest Rate = $\sqrt{1 + \text{Expected Rate of Return}} - 1 = \sqrt{1 + (0.1025)} - 1$ = 0.05 or 5%	

	3. **Assumptions:** (a) All Contributions are received and Benefits are paid in middle of the year (b) Expected Rate of Return is compounded half yearly.	

(ii) Grant related to non depreciable Fixed Assets. (AS-12) Grant is shown as deduction from the gross value of assets in arriving at its book value when grant is equal to the cost of asset, the asset should be shown in the balance sheet at nominal value.

Journal Entries in the books of Patta Limited

I	At the time of Purchase of Land Land A/c Dr. To Bank A/c (Being Land purchased for ₹ 25,00,000)	25,00,000	25,00,000
II	At the time of Receiving of Govt. Grant Bank A/c Dr. To Land A/c (Being Grant received from State Govt.)	6,00,000	6,00,000

Space to write important points for revision

2015 - Dec [1] Answer the questions:

(a) Shiva Limited has received a grant of ₹ 15 crores from the Government for setting up a manufacturing unit in a backward area. Out of this grant, the company distributed ₹ 4 crores as dividend. Also, Shiva Limited received land free of cost from the State Government but it has not recorded it at all in the books as no money has been spent. In the light of AS-12 examine, whether the treatment of both the grants is correct. **(2 marks)**

(b) GANGOTRI LTD. reports the following information regarding Pension Plan assets.

	(₹)
Fair market value of Plan Assets as on 31.03.2015	17,00,000
Fair market value of Plan Assets as on 01.04.2014	16,00,000
Benefit payments to Retirees	1,80,000
Employer contribution	1,50,000

Calculate the Actual Return on Plan Assets as per AS-15. **(2 marks)**

Answer:

(a) As per AS -12 "Accounting for Government Grants," when Government Grant is received for a specific purpose, it should be utilized for the same. So, the Grant received for setting up a manufacturing unit is not available for distribution of dividend.

In the case, even if the company has not spent money for the acquisition of land, land should be recorded in the books of accounts at a nominal value. The treatment of both the elements in the treatment of the grant is incorrect as per AS -12.

(b)

Particulars	**(₹)**
Fair market value of Plan assets as on 31.03.2015	17,00,000
Less: Fair market value of Plan assets as on 01.04.2014	(16,00,000)
	1,00,000
Add: Benefit payment to Retirees	1,80,000
Less: Employer Contributions	(1,50,000)
Actual Return on Plan Assets	1,30,000

—— Space to write important points for revision ——

2015 - Dec [2] Answer the questions:

(c) Classify the following into either Operating or Financial Lease (briefly give your reasoning):

1. Lessee has option to purchase the asset at lower than fair value, at the end of lease term. It is certain that the lessee will exercise the option.

2. Economic life of the asset is 7 years, lease term is 6 years, but asset is not acquired at the end of lease term.
3. Economic life of the asset is 6 years, lease term is 2 years, but the asset is of special nature and has been procured only for use of the lessee.
4. Present value of minimum lease payment = X. Fair value of the asset = Y. **(8 marks)**

Answer:

1. Finance lease if it becomes certain at the inception of lease itself that the option will be exercised by the lease that also at a price which is lower than its expected fair value.
2. Finance lease, since a substantial portion of the life of the asset is covered by lease term.
3. Finance lease since the asset is procured only for the use of lessee.
4. Finance lease since at the beginning of the lease term, present value of minimum lease rental covers substantially the initial fair value of the leased asset. Where X is minimum lease rental and Y is initial fair value.

—— Space to write important points for revision ——

2016 - June [4] (b) X Ltd. has leased equipment over its useful life that costs ₹ 7,46,55,100 for a three year lease period. After the lease term the asset would revert to the Lessor. You are informed that:

(i) The estimated unguaranteed residual value would be ₹ 1 lakh only.
(ii) The annual lease payments have been structured in such a way that the sum of their present values together with that of the residual value of the asset will equal the cost thereof.
(iii) Implicit interest rate is 10%.

You are required to ascertain the annual lease payment and the unearned finance income P.V. factor @ 10% for years 1 to 3 are 0.909, 0.826 and 0.751 respectively. **(6 marks)**

Answer:

Calculation of lease rental:

⇒ Cost of Assets
= Present value of lease rental + Present value of residual valued

⇒ 7,46,55,100 = 2.486x + .751 × 1,00,000

⇒ 7,46,55,100 - 75,100 = 2.486x

⇒ $\frac{7,45,80,000}{2.486}$ = x

⇒ x = 3,00,00,000

Calculation of Unearned Financial Income:

⇒ Gross investment — Net investment

⇒ [(3,00,00,000 × 3) + 1,00,000] - 7,46,55,100

⇒ 9,01,00,000 — 7,46,55,100

⇒ 1,54,44,900

—— Space to write important points for revision ——

2016 - June [6] (b) The fair value of plan assets at the beginning and at the end of the year was ₹ 3,800 and ₹ 4,300 respectively. The employer's contribution to the plan during the year was ₹ 300. Benefit payments to retirees were ₹ 400.

Calculate the actual return to the plan assets. **(5 marks)**

Answer:

Particulars	**Amount** (₹)
Fair value of plan asset at the beginning of the year	3,800
Add: Employer's Contribution	300
Add: Actual Return	?
Less: Benefit Payments	(400)
Fair value of plan assets at the end of the year	4,300

Actual = Fair value at the closing of the year – Fair value of the plan assets at the opening of the year – Employer's Contribution + Benefit payments = (₹ 4,300 – ₹ 3,800 - ₹ 300 + ₹ 400) = ₹ 600.

—— Space to write important points for revision ——

2016 - Dec [1] Answer the following questions:

(a) ROLTA Ltd. reports the following information regarding Pension Plan Assets:

Particulars	**Amount** (₹)
Fair market value of Pension Plan assets as on 01.04.2015	6,00,000
Fair market value of Pension Plan assets as on 31.03.2016	9,00,000
Actual Return	1,95,000
Benefit payments of Retirees	1,50,000

Calculate the Employer's Contribution to the Pension Plan assets during the year 2015-16 as per AS-15.

(c) The following information relate to ZOOM Ltd.

Imported Raw materials on 25.02.2015 for US $ 10,000;

Exchange Rate on 25.02.2015 ₹ 60 per US $;

Exchange Rate on 31.03.2015 ₹ 60.50 per US $;

Date of Actual payment for import: 15.06.2015;

Exchange Rate on 15.06.2015 ₹ 61 per US $;

Calculate the (Loss)/Gain for the financial year 2015-16 (as per AS-11).

(e) ATIMA LTD. purchased a fixed asset for ₹ 45 Lakh on 05.04.2015. The company received a grant from the Government of West Bengal during the year amounting to ₹ 18 Lakh.

Show the accounting treatment of the above if it is non-depreciable asset as per AS-12. **(2 marks each)**

Answer:

(a) Employer's contribution to plan assets during the year 2015-16:

Fair value of plan assets (end of year) - Fair value of plan assets (beginning of year) + benefit payments - Actual return of plan

= (9,00,000 - 6,00,000 + 1,50,000 - 1,95,000) = ₹ 2,55,000.

(c) As per AS-11 outstanding liability for creditors as on 31.03.2015 will be reported (10,000 x 60.50) = ₹ 6,05,000. Hence (loss) /Gain for the year 2015-16 will be 10,000 × (61 - 60.50) = (₹ 5,000)

(e) As per AS-12 accounting for Government Grants related to non-depreciable assets should be credited to Capital Reserve.

Accounting entries:

(i) On purchase of Fixed Asset

	(₹ in Lakh)	
Fixed Asset A/c Dr.	45.00	
To Bank A/c		45.00

(ii) On receipt of Government Grant

	(₹ in Lakh)	
Bank A/c Dr.	18.00	
To Capital Reserve / Fixed Assets A/c		18.00

—— Space to write important points for revision ——

2017 - June [2] (b) M Ltd. sold machinery having WDV of ₹ 200 Lakhs to N Ltd. for ₹ 250 Lakhs and the same machinery was leased back by N Ltd. to M Ltd. The lease back is an operating lease. Comment on the accounting treatment as per AS 19 in the following circumstances:

(i) Fair value is ₹ 230 Lakhs and sale price is ₹ 250 Lakhs

(ii) Fair value is ₹ 175 Lakhs and sale price is ₹ 195 Lakhs **(4 marks)**

Answer:

(i) Profit of ₹ 30 Lakhs (230 Lakhs - 200 Lakhs) to be immediately recognised in its books and balance profit of ₹ 20 Lakhs (250 Lakhs - 230 Lakhs) is to be amortised/deferred over lease period.

(ii) Loss of ₹ 25 Lakhs (200 Lakhs - 175 Lakhs) to be immediately recognised by M Ltd. in its books and profit of ₹ 20 Lakhs (195 Lakhs - 175 Lakhs) should be amortised/deferred over lease period.

—— Space to write important points for revision ——

2017 - Dec [2] (b) Z Ltd. sold goods to a US Company for US $ 50000 on 10.02.2017 and realized the due on 30.06.2017. Z Ltd. closes the books of accounts on 31st March. Exchange rates were as follows:

Date	Rate
10.02.2017	65.40
31.03.2017	66.00
30.06.2017	65.80

Calculate the exchange loss/gain the reporting date and on the settlement date and comment on their treatment as per AS 11. **(3 marks)**

Answer:

As per AS 11, transactions such as purchase, sales etc. are to be recorded in the books of accounts at the exchange rate prevailing on the date of transaction. Any exchange gain/ loss arising subsequently is to be transferred to Income Statement.

Value of the goods sold = $ 50000

Exchange rate on the date of transaction = ₹ 65.40/$

So sales to be recorded in the books = 50000×65.40 = ₹ 3,270.000

Exchange rate on the date of reporting (31.03.17) = ₹ 66.00/$

Value of the receivables on 31.03.17 = 5000 × 66 = ₹ 3,300,000

Exchange gain on 31.03.2017 = (33,00,000 – 32,70,000) = ₹ 30,000, to be credited to P/L A/c.

Exchange rate on the date of settlement (30.06.17) = ₹ 65.80/$

Exchange loss on 30.06.17 = 50000×(66.00 – 65.80) = ₹ 10,000 to be debited to P/L A/c.

—— Space to write important points for revision ——

2018 - June [2] (b) M/s. Ayush Ltd. began construction of a new building on 1st January, 2017. It obtained ₹ 3,00,000 lakh special loan to finance the construction of the building on 1st January ,2017 at an interest rate of 12% p.a. The company's other outstanding two non-specific loans were:

Amount	Rate of Interest
₹ 6,00,000	11% p.a.
₹ 11,00,000	13% p.a.

The expenditure that were made on the building project were as follows:

	Amount (₹)
January, 2017	3,00,000
April, 2017	3,50,000
July, 2017	5,50,000
December, 2017	1,50,000

Building was completed on 31st December, 2017. Following the principles prescribed in AS 16 on 'Borrowing Cost', calculate the amount of interest to be capitalized and pass one Journal entry for capitalizing the cost and borrowing in respect of the building. **(6 marks)**

Answer:

(i) **Computation of average accumulated expenses:**

	₹
₹ 3,00,000 X 12 / 12	3,00,000
₹ 3,50,000 X 9 / 12	2,62,500
₹ 5,50,000 X 6 / 12	2,75,000
₹ 1,50,000 X 1 / 12	12,500
₹ 13,50,000	8,50,000

(ii) **Calculation of average interest rate other than for specific borrowings:**

Amount of loan (₹)	**Rate of interest**	**Amount of interest (₹)**
6,00,000	11 %	= 66,000
11,00,000	13%	=1,43,000
17,00,000		2,09,000
Weighted average rate of interest	$\frac{2,09,000}{17,00,000} \times 100$	= 12.29%

(iii) **Interest amount to be capitalized:**

Particulars	**₹**
Specific borrowings (₹ 3,00,000 × 12%)	= 36,000
Non-specific borrowings [` 5,50,000 (₹ 8,50,000 - ₹ 3,00,000) × 12.29%]	= 67,595
Amount of interest to be capitalized	= 1,03,595

(iv) **Computation of actual interest costs incurred during the year:**

Particulars	**Amount (₹)**
₹ 3,00,000 × 12%	36,000
₹ 6,00,000 × 11%	66,000
₹ 11,00,000 × 13%	1,43,000
	2,45,000

Amount to be capitalized is ₹ 13,50,000 + ₹ 1,03,595 i.e. ₹ 14,53,595 which is not more than ₹ 2,45,000.

(v)

Journal Entry

Date	**Particulars**	**Dr. (₹)**	**Cr.(₹)**
31.12.2017	Building Account (13,50,000 +1,03,595) Dr. To Bank Account (Being amount of cost of building and borrowing cost thereon capitalized)	14,53,595	14,53,595

Space to write important points for revision

2018 - Dec [2] (b) An enterprise operates through six segments, namely, A, B, C, D, E and F. The relevant information about these segments are given in the following table (amounts in ₹.' 000):

	A	B	C	D	E	F	Total (segment)
1. Segment Revenue							
(a) External Sales	-	550	250	150	50	50	1050
(b) Inter Segment Sales	100	100	50	200	-	50	500
2. Segment Results-Profit/ (Loss)	(90)	25	(5)	(15)	5	10	-
3. Segment Assets	30	50	10	20	10	5	

Identify the reportable segments under (i) segment revenue criterion, (ii) segment result criterion and (iii) segment asset criterion as per AS17.

(5 marks)

Table Showing Marks of Compulsory Questions										
Year	**14 J**	**14 D**	**15 J**	**15 D**	**16 J**	**16 D**	**17 J**	**17 D**	**18 J**	**18 D**
Descriptive	2									
Total	2									

5A OBJECTIVE QUESTIONS

2008 - Dec [1] {C} (a) Indicate with reasons/working the correct answer, out of the four as given, in each of the following cases:

(ii) The fair values of Pension plan assets of Milestones Ltd. at the beginning and the end of the year 2007-08 were ₹ 2,80,000 and ₹ 3,08,600 respectively. The employer's contribution to the plan during the year was ₹ 29,000. If benefit payments made to the retirees are ₹ 32,000, the actual return on Pension plan assets for the year will be (as per AS-15):

A. ₹ 25,600
B. ₹ 31,600
C. ₹ 32,600
D. None of A, B and C

(vi) In a cash flow statement there is no place for

A. Issue of equity shares
B. Issue of bonus shares
C. Conversion of debt to equity
D. Both B and C above **(2 × 2 = 4 marks)**

Answer :

(a) (ii) AS -15 defines "Actual return" as the difference in values of the assets on opening and closing dates (+) benefit payments (-) employer's contribution to the pension plan during a period.

So, the actual return = ₹ (3,08,600 – 2,80,000 +32,000 -29,000) = ₹ 31,600

Correct answer is B

(vi) Neither an issue of bonus shares nor a conversion of debt to equity involves the use of cash and cash equivalents. These transactions are excluded from a cash flow statement, they should be disclosed in the financial statements.

—— Space to write important points for revision ——

2008 - Dec [2] (a) For the given abbreviations name the terms in full.

(i) ICAI
(ii) AS
(iii) IAS
(iv) US GAAP
(v) IFRS **(1× 5 = 5 marks)**

Answer :

	Abbreviation	**Full term**
(i)	ICAI	Institute of Chartered Accountant of India
(ii)	AS	Accounting Standards (of India)
(iii)	IAS	International Accounting Standards
(iv)	USGAAP	Generally Accepted Accounting Standards of United States of America
(v)	IFRS	International Financial Reporting Standard

—— Space to write important points for revision ——

2009 - June [1] {C} (a) In each of the cases given below one out of four answers is correct. Indicate the correct answer (= 1 mark) and give your workings/reasons briefly (= 1 mark).

(viii) An external user of financial statement of a company is
(a) Director
(b) Partner
(c) Supplier
(d) Officer
each of whom has some relationship with the company. **(2 marks)**

(b) Choose the most appropriate one from the stated options and write it down (only indicate by A, B, C, D as you think correct).

(iii) RAINBOW LTD. has different distinguishable segments One of them is engaged in providing an individual product and it is subject to risk and returns. Such segment is known as
(a) Business Segment;
(b) Geographical Segment;
(c) Reportable Segment;
(d) Primary Segment.

(iv) As per AS-11 exchange differences arising on repayment of fixed asset-linked liabilities should be adjusted to
(a) Profit & Loss Account;
(b) Fixed Asset Account;
(c) Revaluation Reserve;
(d) None of the above. **(1 × 2 = 2 marks)**

(c) State which of the following statements is T (= true) or F (= false):
(iv) Government grant receivable as compensation for expenses or losses incurred in previous accounting period is an Extraordinary item to be disclosed separately in Profit & Loss Account of the Company. **(1 mark)**

Answer :

(a) (viii) 'C'; Suppliers.

Directors, Partners of the company and its officers are not "external" persons. The Companies Act provides that Directors and partners (as shareholders) shall be provided with copies of the Companies Financial Statements. These persons as well as officers of the company have much economic interest in the well being of the company for which they need to look into the financial statements. **Suppliers are external persons and their sake in the company is not that much.**

Answer:

(b) (iii) – A
(iv) – A

Answer:

(c) (iv) – T

—— Space to write important points for revision ——

2009 - Dec [1] {C} (a) In each of the cases given below are out of four answers is correct. Indicate the correct answers (= 1 mark) and give your workings/reasons briefly (= 1 mark).

(i) M. K. Leasing Company expects a minimum yield of 10% on its investment in the leasing business. It proposes to lease a machine costing ₹ 5,00,000 for ten years. If yearly lease payments are received in advance, the lease rental to be charged by the company for the lease will be [Given PVIFA (10%, 9 years = 5.759)]

A. ₹ 81,372;
B. ₹ 73,975;
C. ₹ 72,370;
D. None of (A), (B), (C).

(vii) XYZ Co. Ltd. proposed a dividend of 20%. The net profit of the company is ₹ 1,20,000. The called up equity share capital is ₹ 5,00,000 and the amount of calls in arrears is ₹ 30,000. What will be the amount of dividend payable ?

A. ₹ 1,00,000;
B. ₹ 94,000;
C. ₹ 24,000;
D. ₹ 1,06,000. **(2 × 3 = 6 marks)**

(b) Choose the most appropriate one from stated options and write it down (only indicate by A, B, C, D, as you think correct) :

(ii) As per AS-17, the revenue of the reportable segment must have at least the following percentage of total revenue of the enterprise :

A. 60%
B. 75%
C. 80%
D. 90%. **(1 mark)**

(c) State which of the following statements is True (= T) and False (=F) :

(ii) Recognising cost of retirement benefits only at the time payments are made to employees on or after retirement, is known as pay-as-you go.

(iii) Aria Corporation Ltd. had total turnover of ₹ 60 crores including inter division transfer of ₹ 14 crores. The company is liable to give segment reporting as per AS-17. **(1 × 2 = 2 marks)**

Answer :

(a) (i) B – 73,975

Lease Rental to be charged:

₹ 73,975.44 i.e. ₹ 73,975

(vii) B- ₹ 94,000/-

The amount of dividend payable will be ₹ 94,000/-

Answer:

(b) (ii) – B

Answer:

(c) (ii) – True

(iii) – False

—— Space to write important points for revision ——

2010 - June [1] {C} (a) In each of the cases given below, one out of four alternatives is correct. Indicate the correct answer (1 mark) and give your workings/reasons briefly (1 mark)

(iii) The fair value of Pension Plan Assets of ROLTA LTD. at the beginning and end of the year 2009-10 were ₹ 3 lakh and ₹ 4.50 lakh respectively. Benefit payment made to retirers were ₹ 75,000, what would be the employer's contribution to the Plan during the year, if the actual return on Pension Plan assets are ₹ 97,500? As per AS-15.

A. ₹ 97,500
B. 1,27,500
C. 1,50,000
D. Insufficient information

(v) STC LTD. had imported raw materials with US$ 1000 on 24.02.2009 when exchange rate was ₹ 46.60 per US$. The payment for imports was made on 15.6.2009 when exchange rate was ₹ 47.50 per US$. If the rate of exchange on 31.3.2009 is ₹ 47.00 per US$, the (Loss)/gain for the financial year 2009-10 will be (as per AS-11)

A. (₹ 500) Loss
B. ₹ 500 Gain
C. ₹ 400 Gain
D. None of (A), (B), (C)

(vi) GAYATHRI LTD. purchased 1000 shares in SAVITHA LTD. at ₹ 600 per share in 2008. There was a rights issue in 2009 at one shares for every two held at a price of ₹150 per share. If GAYATHRI LTD. subscribed to the rights what would be the carrying cost of 1500 shares?

A. ₹ 6,75,000
B. ₹ 6,50,000
C. ₹ 6,00,000
D. Insufficient information **(2 × 3 = 6 marks)**

(b) Choose the most appropriate one from the stated options and write it down (only indicate A, B, C, D as you think correct).

(v) Include the power of Audit Committee is/are

A. To investigate any activity within its terms of reference
B. To seek information from any employee
C. To obtain outside legal or other professional advice
D. All the above (A), (B), & (C) **(1 mark)**

Answer :

(a) (iii) B: ₹ 1,27,500

Employers contribution during the year 2009-10:

Fair value of assets (end of year) – Fair value of assets (beginning of the year)- Actual Return of plan + benefit payments = 4,50,000-3,00,000 – 97,500 + 75,000 = ₹ 1,27,500.

(v) A: (₹ 500) Loss

As per AS- 11 Outstanding Liability for creditors as on 31.3.2009 will be reported (1,000 × 47.00) = ₹ 47,000

Hence (Loss)/ Gain for year 2009-10 will be ₹(1,000 × 47.50 -47,000) = (₹500) Loss.

(vi) A; ₹ 6,75,000

Cost of original holding (1,000×500)	= ₹ 6,00,000
Amount paid for rights (500×150)	= ₹ 75,000
Carrying cost of 1,500 shares in SABITA Ltd.	= ₹ 6,75,000

Answer:

(b) (v) – D

2010 - Dec [1] {C} (a) In each of the cases given below, one out of four alternatives is correct. Indicate the correct answer(= 1 mark) and give your working/reasons briefly (= 1 mark):

(iii) VARTUAL LTD. acquired 1000 shares in ANKIT LTD. at a Cum-right price of ₹ 250 per share. Ankit Ltd. offered right shares of one for every two held at ₹ 125 per share. After the right issue the share price fell from ₹ 250 to ₹ 200 per share. If the rights were sold by vartual Ltd. at ₹ 70 per share, what would be the carrying cost of investment in Ankit Ltd. After the sale of rights ?
(A) ₹ 2,50,000;
(B) ₹ 2,15,000;
(C) ₹ 2,85,000;
(D) None of (A), (B) and (c).

(iv) The fair market values of Pension Plan assets of ASILEENA LTD. at the beginning of year 2009-10 was ₹ 7,00,000. The employer contribution to the plan and Benefit payments made to retire during the year were ₹ 1,00,000 and ₹ 40,000 respectively. If the actual return on pension Plan assets is ₹50,000, what would be the Fair market value of pension plan at end of year 2009-10 (As per-AS-15)?
(A) ₹ 8,00,000;
(B) ₹ 8,10,000;
(C) ₹ 8,30,000;
(D) Insufficient information. **(2 × 2 = 4 marks)**

(b) Choose the most appropriate one from the stated options and write it down (only indicate A, B, C, D as you think correct):

(iii) ARKUTI LTD. has different distinguishable segments—One of them is engaged in providing an individual product and it is subject to risk and returns. Such segment is known as:
(A) Business Segment;
(B) Reportable Segment;
(C) Geographical Segment;
(D) Primary Segment. **(1 mark)**

Answer :

(a) (iii) (D) None of(a) and (B) and (c).

(iv) (B) 8,10,000

Answer:

(b) (iii) A- Business Segment

—— Space to write important points for revision ——

2011 - June [1] {C} (a) In each of the cases given below, one out of four alternatives is correct. Indicate the correct answer (=1 mark) and give your workings/reasons briefly (=1 mark) :

(ii) RAJASTHALI & CO. purchased fixed assets costing ₹ 3,000 lakhs on 1.4.2010 and the same was fully financed by foreign currency loan (U.S. Dollars) payable in three annual equal instalments. Exchange rates were 1 Dollar = ₹ 40.00 and ₹ 42.50 as on 1.4.2010 and 31.03.2011 respectively. First instalment was paid on 31.03.2011. As per AS-11 (Revised)

(a) Exchange Difference of ₹ 187.50 lakhs should be charged to P&L A/c.

(b) Exchange Difference of ₹ 125 lakhs should be charged to P&L A/c.

(c) Exchange Difference of ₹ 187.5 lakhs should be added to Fixed Assets A/c.

(d) Exchange Difference of ₹ 125 lakhs should be added to Fixed Assets A/c.

(v) The Chief Accountant of PELF FIN STOCK Ltd. gives the following data regarding its six segments :

₹ In lakhs

Particulars	**M**	**N**	**O**	**P**	**Q**	**R**	**Total**
Segment Assets	50	25	10	5	5	5	100
Segment Results	-50	-140	80	10	-10	10	-100
Segment Revenue	200	320	200	90	90	100	1000

Reportable Segments As per AS-17 are:
(a) M, N, O, P, Q, R
(b) M, N, O, P, Q, only
(c) M, N, O, P only
(d) M, N, O, R only **(2 × 2 = 4 marks)**

Answer :

(a) (ii) A.

Foreign currency loan = $\frac{₹3,000 \text{ Lakhs}}{₹40}$ = 75 lakhs US Dollars

Exchange difference = 75 lakhs US Dollars × (42.50 – 40.00) = ₹ 187.50 lakhs

(Including exchange loss on payment of first installment). To be charged to Profit & Loss Account for the year.

(v) D.

As per para 27 of AS – 17 'Segment Reporting', a business segment or geographical segment should be identified as a reportable segment if :

(i) Its revenue from sales to external customers and from other transactions with other segments is 10% or more of the total revenue – external and internal of all segment; or
M, N, O, R have at least 10% of Total Segment Revenue.

(ii) Its segment result whether profit or loss is 10% or more of :
(1) The combined result of all segments in profit ; or
(2) The combined result of all segments in loss, whichever is greater in absolute amount; or M, N, O have at least 10% of Total Segment Result, (i.e. ₹ 200 lakhs)

(iii) Its segment assets are 10% or more of the total assets of all segments.
M, N, O have at least 10% of Total Segment Assets.

—— Space to write important points for revision ——

2011 - Dec [1] {C} (a) In each of the cases given below, one out of four alternatives is correct. Indicate the correct answer (= 1 mark) and give your workings/reasons briefly (= 1 mark):

(iv) PRARTHANA Ltd. is in engineering industry. The company received an actuarial valuation for the first time for its pension scheme which revealed a surplus of ₹ 6 lakhs. It contributes ₹ 5 lakhs annually for its pension schemes. The average remaining life of the employee is estimated to be 6 years. As per AS 15 (Revised)
   (a) Surplus of ₹ 6 lakhs in the pension scheme on its actuarial valuation is required to be credited to the Profit and Loss Statement for the current year.
   (b) Surplus of ₹ 6 lakhs can be spread over the next 2 years by reducing the annual contribution to ₹ 2 lakhs instead of ₹ 5 lakhs
   (c) Surplus of ₹ 6 lakhs is to be spread over the average remaining life of the employees of 6 years by crediting to the Profit and Loss Statement of each year.
   (d) None of these

(v) M/s. XYZ Ltd. has three segments namely X, Y, Z. The total assets of the Company are: Segment X ₹ 1.00 crore, Segment Y ₹ 3.00 crores and Segment Z ₹ 6.00 crores. Deferred tax assets included in the assets of each Segments are: X ₹ 0.50 crore, Y ₹ 0.40 crore and Z ₹ 0.30 crore. As per AS 17
   (a) X, Y and Z are reportable segments
   (b) Only X and Y are reportable segments
   (c) Only X and Z are reportable segments
   (d) Only Z and Y are reportable segments

(vi) NIKITA Limited wishes to obtain a machine costing ₹ 30 lakhs by way of lease. The effective life of the machine is 15 years, but the company requires it only for the first 5 years. It enters into an agreement with Ashok Ltd., for a lease rental for ₹ 3 lakhs p.a. payable in arrears and the implicit rate of interest is 15%. Treatment as per AS 19 in the books of Lessee
   (a) Lease payments should be recognized as an expense in the Statement of Profit and Loss on a straight line basis over the lease term
   (b) Finance Charges included in Lease payments should be recognized as an expense in the Statement of Profit and Loss

(c) Depreciation of ₹ 2,00,000 p.a. should be recognized as an expense in the Statement of Profit and Loss

(d) None of these **(2 × 3 = 6 marks)**

Answer :

(iv) **Correct option – A**

Explanation: According to para 92 of AS 15 (Revised) " Employee Benefits", actuarial gains and losses should be recognized immediately in the statement of profit and loss as income or expenses.

(v) **Correct option – D**

Explanation : According to AS 17 "Segment Reporting", Segment Assets do not include income tax assets. Therefore, the revised total assets are 8.8 crores [10 crores – (0.5+0.4+0.3)].

Segment X holds total assets of 0.5 crore (1 crore – 0.5 crore): Segment Y holds 2.6 crores (3 crores – 0.4 crores); and Segment Z holds 5.7 crores (6 crores – 0.3 crores).

Thus, only Z and Y hold more than 10% of the total assets and hence, only Y and Z are reportable segments.

(vi) **Correct option – A**

Explanation: The given lease agreement is an Operating Lease since:

(a) The present value of minimum lease payment amounts [₹ 10.8 lakhs (i.e. ₹ 3 lakh x 3.36)] is substantially less than the fair value of leased asset (i.e. ₹ 30 lakhs)

(b) The lease term (5 years) is substantially less than economic life of the asset (15 years).

As per AS 19 'Leases', a lease will be classified as Finance Lease if at the inception of the lease, the present value of minimum lease payment amounts to at least substantially equal to the fair value of leased asset.

Therefore, Lease payments under an Operating Lease should be recognized as an expense in the statement of profit and loss on a straight line basis over the lease term unless another systematic basis is more representative of the time pattern of the user's benefit.

2012 - June [1] {C} (a) In each of the cases given below, one out of four alternatives is correct. Indicate the correct answer (= 1 mark) and give your workings/reasons briefly (= 1 mark):

(i) RAJASTHALI Ltd. purchased Fixed Assets costing ₹ 6,000 lakhs on 1.4.2011 and the same was fully financed by Foreign Currency Loan (U.S. Dollars) payable in three annual equal instalments. Exchange rates were 1 Dollar = ₹ 40 and ₹ 42.50 as on 1.04.2011 and 31.03.2012 respectively. First instalment was paid on 31.03.2012. As per AS 11, Exchange Difference to be charged to P & L A/c for the year 2011-12 will be:
(A) ₹ 375 lakhs
(B) ₹ 250 lakhs
(C) Nil
(D) None of these

(iv) M/s XYZ Ltd. has three segments namely X, Y, Z. The total assets of the Company are: Segment X ₹ 2.00 crores, Segment Y ₹ 6.00 crores and Segment Z ₹ 12.00 crores. Deferred tax assets included in the assets of each Segments are X-₹ 1crore, Y-₹ 0.80 crores and Z-₹ 0.60 crores. The accountant contends that all the three Segments are reportable segments. As per AS 17:
(A) X, Y, and Z are reportable segments
(B) Only X and Y are reportable segments
(C) Only X and Z are reportable segments
(D) Only Y and Z are reportable segments

(ix) SRIJAN Ltd. wishes to obtain a machine costing ₹ 60 lakhs by way of lease. The effective life of the machine is 15 years, but the company requires it only for the first 5 years. It enters into an agreement with Ashok Ltd., for a lease rental for ₹ 6 lakhs p.a. payable in arrears and the implicit rate of interest is 15%. As per AS 19, what should be recognized as an expense in the Statement of Profit and Loss in the books of Lessee:
(A) Total Lease Payments
(B) Only Finance Charges included in Lease payments

(C) Depreciation of ₹ 4,00,000 p.a

(D) None of these **(2 × 3 = 6 marks)**

Answer:

(a) (i) A – ₹ 375

Foreign Currency Loan = ₹ 6,000 lakhs / ₹ 40 = 150 lakhs US Dollars

Exchange difference = 150 lakhs US Dollars × (42.50 – 40.00) = ₹ 375 lakhs

(including exchange loss on payment of first instalment)

Therefore, entire loss due to exchange differences amounting ₹ 375 lakhs should be charged to Profit and Loss Account for the year.

(iv) D- Only Y & Z are reportable segments.

According to AS 17 "Segment Reporting", Segment assets do not include income tax assets. Therefore, the revised total assets are 17.6 crores [20 crores – (1 + 0.8 + 0.6)]

Segment X holds total assets of 1 crore [2 crore- 1 crore]; Segment Y holds 5.2 crores (6 crores – 0.8 crores); and Segment Z holds 11.4 crores (12 crores – 0.6 crores)

Thus, only Y and Z hold more than 10% of the total assets and hence Only Y and Z are reportable segments.

(ix) A – Total lease payments.

The given lease agreement is an operating lease since:

(a) The present value of minimum lease payment amount [₹ 20.10 lakhs (i.e., ₹ 6 lakhs × 3.35)] is substantially less than the fair value of leased asset (i.e.,₹ 60 lakhs)

(b) The lease term (5 years) is substantially less than economic life of the asset (15 years) as per AS 19 "Leases," a lease will be classified as finance lease it at the inception of the lease, the present value of minimum lease payment amounts to at least substantially equal to the fair value of leased asset.

Therefore, Lease payments under an operating lease should be recognized as an expense in the statement of profit and loss on a straight line basis over the lease term unless another systematic basis is more representative of the time pattern of the user's benefit.

Note: *PVAF @ 15% for 5 years is 3.35*

—— Space to write important points for revision ——

2012 - Dec [1] {C} (a) In each of the cases given below, one out of four alternatives is correct. Indicate the correct answer (= 1 mark) and give your workings/reasons briefly (= 1 mark):

(ii) The fair value of Plan assets of ARIMA LTD. at beginning and end of the year 2011-2012 were ₹ 4,00,000 and ₹ 5,70,000 respectively. The employer's contribution to the plan during the year was ₹ 1,40,000. If benefit payments to retirees were ₹ 1,00,000, what would be the actual return on plan assets (as per AS-15)?

A. ₹ 1,50,000 lakhs
B. ₹ 1,30,000 lakhs
C. ₹ 1,20,000 lakhs
D. Insufficient Information

(iii) FICKLE LTD. has five business segments with operating profits and losses as shown below:

Segment	Operating Profit/(Loss) (₹ in lakh)
P	3
Q	(3)
R	20
X	(9)
Y	(20)

Reportable Segments as per AS-17 are

A. P, Q, R, X, Y
B. P, Q, R, Y
C. P, Q, R only
D. R, X, Y only

(iv) NANDITHA LTD. has imported $ 50,000 worth of goods from CHICAGO TRADERS of USA on 30.2.2012 when exchange rate was ₹ 54.60 per US $. The payment for imports was made on 30.6.2012 when exchange rate was ₹ 55.50 per US $. If the rate of exchange on 31.3.2012 is ₹ 55.00 per US $, the exchange difference to be charged/debited to Profit & Loss Account for the year 2012-13 as per AS-11 will be

A. ₹ 25,000
B. ₹ 45,000
C. ₹ 20,000
D. None of (A), (B) and (c) **(2 x 3 = 6 marks)**

(b) Choose the most appropriate one from the stated options and write it down (only indicate A, B, C, D as you think correct):

(v) SKY LTD. purchased a special machinery from Earth Ltd. for ₹ 50 Lakhs in consideration of 50,000 equity shares of ₹ 100 each of the company. Where this transaction will be reflected in the Cash Flow Statement as per AS-3?

A. Operating Activities
B. Financing Activities
C. Investing Activities
D. None of the above **(1 mark)**

Answer:

(a) (ii) **B: ₹ 1,30,000**

Actual Return = Fair value of assets (end of year) - Fair Value of assets (beginning of year) – Employer's contribution + benefit payments = (5,70,000 – 4,00,000 – 1,40,000 + 1,00,000) = ₹ 1,30,000.

(iii) **D: R, X, Y**

As per Para 27 of AS – 17 "Segment Reporting" a Business Segment or Geographical should be identified as a reportable segment If: Its segment results, where profit or loss is 10% or more of i) the combined result of all segment in profit; ii) The combined result of all segments in loss, whichever is greater, i.e., absolute amount.

Absolute in profit; ii) The combined result of all segment in loss, whichever is greater, i.e., absolute amount.
Absolute profits = (3 +20) Lakh = 23 Lakh
Absolute Losses = (3 + 9 +20) lakhs = 32 Lakh
Greater of these two absolute amounts are loses of ₹ 32 lakhs
10% of ₹ 32 = ₹ 3.20 Lakh
Reportable Segments are R, X, Y.

(iv) **A: ₹ 25,000**
As per AS-11, exchange difference on settlement on monetary items should be transferred to profit & Loss Account as gain or loss. Therefore (₹ 55.50 – ₹ 55.00) × $ 50,000 = ₹ 25,000 will be debited to profit & Loss Account for the year 2012-13.

Answer:

(b) (v) D

—— Space to write important points for revision ——

2013 - June [1] {C} (a) In each of the cases given below, one out of four alternatives is correct. Indicate the correct answer (= 1 mark) and give workings/reasons briefly in support of your answer (= 1 mark):

(iv) The fair values of Pension Plan Assets of ZOOM LTD. at the beginning and end of the year 2012-13 were ₹ 5,60,000 and ₹ 6,20,000 respectively. The actual return on Pension Plan Assets for the year was ₹ 63,000. If benefit payments made to the retirees are ₹ 64,000, the employer's contribution to the plan during the year as per AS-15 would be
(a) ₹ 52,000
(b) ₹ 61,000
(c) ₹ 65,000
(d) None of (a), (b), (c) **(2 marks)**

(b) Choose the most appropriate one from the stated options and write it down (only indicate a, b, c, d as you think correct).
(ii) As per AS-3 (Revised) Interest and Dividends received in the case of a manufacturing enterprise should be classified as cash flow from

(a) Operating activities
(b) Financing activities
(c) Investing activities
(d) Both (b) and (c)

(v) According to AS-11 (Revised) the difference between the forward rate and the exchange rate at the date of transaction should be
(a) Ignored
(b) Recognized as income or expense
(c) Adjusted to Shareholders' interests
(d) None of (a), (b), (c) **(1 x 2 = 2 marks)**

Answer:

(a) (iv) **B : ₹ 61,000**
As per AS - 15 the employer's Contribution
= the difference in values of the assets on opening and closing dates + benefit payments – Actual Return on plan.
= (6,20,000 – 5,60,000) + 64,000 – 63,000 ₹ 61,000

Answer:

(b) (ii) C
(v) B

—— Space to write important points for revision ——

2017 - June [1] (a) Choose the correct answer from the four alternatives given:

(i) Underwriting Agreements are of
(a) One type
(b) Two types
(c) Three types
(d) Four types

(ii) Segment Reporting is covered under
(a) AS 16
(b) AS 17
(c) AS 18
(d) AS 19

(iii) On redemption of Debentures, the amount lying in Debenture Redemption Reserve, which is no longer necessary to be retained, should be transferred to
   (a) Revaluation Reserve
   (b) Securities Premium Reserve
   (c) Capital Reserve
   (d) General Reserve

(iv) Rate of provisioning by a Bank for Advances doubtful for more than 1 year but less than 3 years is
   (a) 25%
   (b) 40%
   (c) 60%
   (d) 100%

(v) 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.

(vi) Which of the following items is not a part of cash flow from operating activities?
   (a) Collection from customers
   (b) Payment of outstanding wages
   (c) Payment to suppliers of machinery
   (d) Advances to foreign suppliers for raw materials

(1 × 6 = 6 marks)

(b) Match the following items in Column 'A' with items shown in Column 'B':

	Column 'A'		Column 'B'
1.	Grants Received from Government	A.	Capital Redemption Reserve
2.	Redemption of Debentures	B.	AS 15
3.	Issue of Bonus shares	C.	AS 12
4.	Defined benefit plans	D.	Sinking Fund

(1 × 4 = 4 marks)

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

(i) Exchange difference arising in respect of monetary items is to be recognized as income or expenditure during the year.

(ii) Capital Reserve is a Reserve which is available for distribution as Dividend.

(iii) Interest received by a finance company is a part of cash flow from investing activities.

(iv) Interest accrued and due should be shown under the head Other Current Liabilities in a Balance Sheet of a Company.

(1 × 4 = 4 marks)

Answer:

(a)

(i) (b) Two types
(ii) (b) AS 17
(iii) (d) General Reserve
(iv) (b) 40%
(v) (b) under Non-Current Liability
(vi) (c) Payment to suppliers of machinery

(b)

	Column 'A'		**Column 'B'**
(1)	Grant Received from Government	(C)	AS 12
(2)	Redemption of Debentures	(D)	Sinking Fund
(3)	Issue of Bonus Shares	(A)	Capital Redemption Reserve
(4)	Defined benefit plans	(B)	AS 15

(c)

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

2017 - Dec [1] (a) Choose the correct alternative:

(i) While preparing Cash Flow Statement of XY Ltd., a finance company, interest received on loans should be shown as
- (a) Cash Flow from Operating Activities
- (b) Cash Flow from Investing Activities
- (c) Cash Flow from Financing Activities
- (d) Cash and Cash Equivalent

(ii) As per Schedule III Current Maturities of Long Term Borrowings should be shown under
- (a) Current Assets in Balance Sheet
- (b) Non-current Liability in Balance Sheet
- (c) Current Liabilities in Balance Sheet
- (d) Other Expenses in Statement of Profit and Loss

(iii) Which of the following is not a criterion for selecting a reportable segment under AS 17?
- (a) 10% or more of aggregate revenue of all segment
- (b) 10% or more of aggregate assets of all segment
- (c) 10% or more of aggregate liabilities of all segment
- (d) 10% or more of aggregate profit or loss of all segment (higher of the two)

(iv) 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

(v) A Banking Company needs to transfer a minimum of ______ its profit to reserve fund.
- (a) 10%
- (b) 15%
- (c) 20%
- (d) 25%

(vi) 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 **(1 × 6 = 6 marks)**

2017 - Dec [1] (b) Match the following items in Column 'A' with items shown in Column 'B':

Column 'A'		Column 'B'	
1.	Guaranteed Residual Value (GRV)	A.	Capital Reserve
2.	Premium on Redemption of Preference shares	B.	AS 11
3.	Exchange Difference	C.	Securities Premium A/c
4.	Profit on reissue of forfeited shares	D.	AS 19

(1 × 4 = 4 marks)

2017 - Dec [1] (c) State whether the following statements are True or False:

(i) In case of an underwriting arrangement, marked applications are those applications that bear the stamp of the issuing company.
(ii) In case the leaseback is a finance lease, the sale proceeds in excess of the carrying amount should be immediately recognized in the Income Statement.
(iii) Issue of fully paid up bonus shares increases the total shareholders fund.
(iv) Interest and dividend received form a part of financing cash flow.

(1 × 4 = 4 marks)

Answer:

(a) (i) (A)
(ii) (C)
(iii) (C)
(iv) (D)
(v) (D)
(vi) (C)

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

(c) (i) (F)
(ii) (F)
(iii) (F)
(iv) (F)

—— Space to write important points for revision ——

2018 - June [1] (a) Choose the correct alternative:

(i) Premium on redemption of redeemable preference shares can be paid out of
(a) Capital Redemption Reserve Account
(b) Existing Shares Premium Account
(c) Proceed of fresh issue of shares
(d) All of the above

(ii) Which of the following is not a component of Cash Flow Statement?
(a) Cash payments to suppliers for goods and services
(b) Charging of Depreciation
(c) Cash advances and loans made to third parties
(d) Cash repayments of amounts borrowed

(iii) The Electricity Act, 2003 replaced which of the following three existing legislations?
(a) The Indian Electricity Act, 1910
(b) The Electricity (Supply) Act, 1948
(c) The Electricity Regulatory Commissions Act, 1998
(d) All of the above

(iv) General Ledger of a Banking Company does not contain
(a) Control Accounts of all personal ledgers
(b) Assets Accounts
(c) Contra Accounts
(d) Balance Sheet

(v) Which of the following is a principle of insurance?
(a) Principle of indemnity
(b) Insurable interest
(c) Principle of *uberrimae fidei*
(d) All of the above

(vi) Underwriting commission payable on the shares taken up by the promoters is
(a) 2.5%
(b) 2%
(c) 5%
(d) Nil **(1 × 6 = 6 marks)**

2018 - June [1] (b) Match the following items in Column 'A' with items shown in Column 'B':

	Column 'A'		Column 'B'
1.	Government Grants	A.	Capital Redemption Reserve
2.	Redemption of Debentures	B.	AS 16
3.	Un-guaranteed Residual Value	C.	AS 12
4	Borrowing Cost	D.	AS 19

(1 × 4 = 4 marks)

2018 - June [1] (c) State whether the following statements are True or False:

(i) Marked applications are those applications which bear the stamp of an underwriter.

(ii) In order to spread the risk of under- subscription, the principal underwriters may enter into subsidiary agreements with sub-leasees.

(iii) When debentures are issued at discount, it is prudent to write off the loss during the life of debentures.

(iv) Any surplus cash may be utilized by the company for buy-back and avoid the payment of dividend tax. **(1 × 4 = 4 marks)**

Answer:

(a) (i) (b)
(ii) (b)
(iii) (d)
(iv) (d)
(v) (d)
(vi) (d)

(b) 1. (c)
2. (a)
3. (d)
4. (b)

(c) (i) True
(ii) False
(iii) True
(iv) True

Space to write important points for revision

2018 - Dec [1] {C} (a) Choose the correct alternative:

(i) Which of the following reserves cannot be used for the purpose of issuing bonus shares?
  (a) Revaluation Reserve
  (b) Dividend Equalization Reserve
  (c) Capital Redemption Reserve
  (d) General Reserve

(ii) In Case of Life Insurance Business, Bonus may be of
  (a) One type
  (b) Two types
  (c) Three types
  (d) None of the above

(iii) Instalment of principal amount of long-term loan payable within next 12 months is shown under Balance Sheet of a company under the heading
  (a) Non-current Assets
  (b) Non-current Liabilities
  (c) Current Assets
  (d) Current Liabilities

(iv) 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 date of passing of special resolution .

(v) A banking company is required to maintain _______ provision on unsecured portion of doubtful advances.
(a) 25%
(b) 40%
(c) 50%
(d) 100%

(vi) Which of the following is correct?
(a) Debenture carries a fixed rate of dividend.
(b) A company limited by shares may issue irredeemable preference shares.
(c) Unmarked applications are those applications that bear the stamp of the underwriter.
(d) Except as provided in Section 54, a company shall not issue shares at a discount. **(1 × 6 = 6 marks)**

2018 - Dec [1] (b) Match the following items in **Column 'A'** with items shown in **Column 'B'**:

	Column 'A'		**Column 'B'**
(i)	Functional Currency	(a)	Electricity Company
(ii)	Surrender Value	(b)	AS 19
(iii)	Service Line Development Charges	(c)	AS 11
(iv)	Contingent Rent	(d)	Insurance Company
		(e)	No match found

(1 × 4 = 4 marks)

2018 - Dec [1] (c) State whether the following statements are *True* or *False*:

(i) The profit on forfeiture and re-issue of equity shares are credited to Capital Redemption Reserve.

(ii) As per Companies Act 2013, companies are not permitted to buy back their own shares out of securities premium.

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

(iv) Interest on loan is included in 'other operating expenses' under the Statement of Profit and Loss. **(1 × 4 = 4 marks)**

Section B

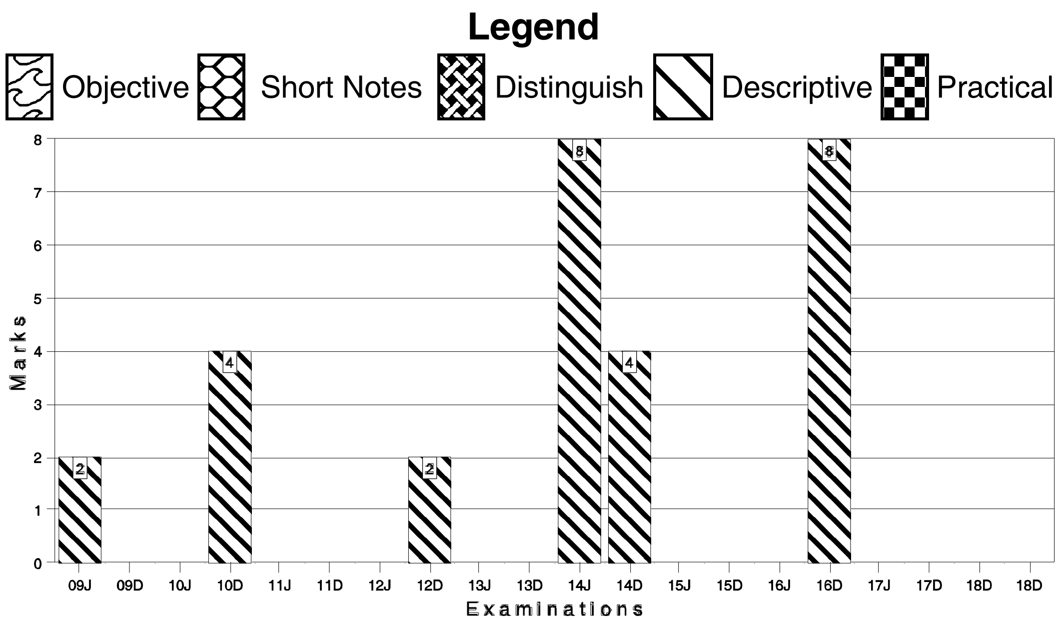
Auditing

6 AUDITING CONCEPTS

THIS CHAPTER INCLUDES

- Evolution of Auditing
- Definition
- Nature of Auditing
- Relationship and Distinction Between Auditing and Accounting
- Audit and Investigation
- Aspects to be Covered in Audit
- Objective of Auditing
- Basic Principles Governing an Audit
- Advantages of Audit
- Concept of True and Fair
- Concept of "Materiality" in Planning and Performing the Audit
- Disclosure of Accounting Policies

Marks of Objective, Short Notes, Distinguish Between, Descriptive & Practical Questions



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CHAPTER AT A GLANCE

S. No.	Topic	Important Highlights
1.	**Definitions of Auditing**	**Lawrence R. Dicksee-**'An audit is an examination of accounting records undertaken with a view to establishing whether they correctly and completely reflect the transactions to which they purport to relate.' **Taylor and Perry-** "Audit is defined as an investigation of some statements of figures involving examination of certain evidence, so as to enable an auditor to make a report on the statement.
2.	**Meaning**	(i) An intelligent and critical examination of the books of accounts of business. (ii) It is done by an independent qualified person. (iii) It is done with the help of vouchers, documents, information and explanations received from the clients. (iv) The auditor satisfies himself with the authenticity of the financial accounts prepared for a particular period.
3.	**Features of Auditing**	1. Audit is a systematic and scientific examination of the books of accounts of a business. 2. Audit is undertaken by an independent person or body of persons who are duly qualified for the job. 3. Audit is a verification of the results shown by the profit and loss account and the state of affairs as shown by the balance sheet. 4. Audit is a critical review of the system of accounting and internal control. 5. Audit is done with the help of vouchers, documents, information and explanations received from the authorities.

4.	**Objectives of Auditing**	The objectives of auditing may be classified into two parts: 1. The primary objective 2. The secondary or incidental objective.
5.	**Basic Principles Governing an Audit**	(i) Integrity objectivity and independence (ii) Confidentiality (iii) Skill and competence (iv) Work performed by others (v) Documentation (vi) Planning (vii) Audit evidence (viii) Accounting System and Internal Control (ix) Audit conclusions and reporting
6.	**True and Fair View**	1. The books of account have recorded all the business transaction correctly. 2. The books of account have been prepared according to the accepted principles of accountancy and have followed accounting standards issued by different regulatory bodies. 3. There are no errors and frauds present in the books of account. 4. The financial statements that have been prepared by the company are in conformity with the books of accounts and all mandatory provisions of Companies Act. 5. The books of accounts must disclose all material facts regarding revenue, expenses, assets and liabilities.
7.	**Advantages of an Independent Audit**	1. It safeguards the financial interest of persons who are not associated with the management of the entity, whether they are partners or shareholders. 2. It acts as a moral check on the employees from committing defalcations or embezzlement.

		3. Audited statements of account are helpful in setting liability for taxes, negotiating loans and for determining the purchase consideration for a business. 4. This are also use for settling trade disputes or higher wages or bonus as well as claims in respect of damage suffered by property, by fire or some other calamity. 5. Audited accounts are of great help in the settlement of accounts at the time of admission or death of partner. 6. Government may require audited and certificated statement before it gives assistance or issues a licence for a particular trade.
8.	**Materiality in Auditing**	Materiality can be defined as the magnitude of an omission or misstatement of accounting information that, in the light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or misstatement.

DESCRIPTIVE QUESTIONS

2009 - June [5] {C} Comment on the following statements based on legal provisions:

(e) Auditor's primary responsibility is to detect errors and frauds.

(2 marks)

Answer :

False: auditor's primary responsibility as per AAS-2 is to express an opinion on financial statements.

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2010 - Dec [7] (b) Explain the factors which act as guiding measures to the concept of materiality. **(4 marks)**

Answer :

The main factors to be considered for determining materiality of an item are:

(i) **Individually**	It may be determined individually. e.g., a payment of ₹ 1,000 may be material in a small business, but even ₹ 1 lac could be immaterial for a big business entity.
(ii) **Aggregate**	It may be determined in aggregate. e.g., total income from investment in mutual funds could be more material than looking into each individual investment.
(iii) **Legal Considerations**	It depends on the statutory or legal considerations. e.g., where the terms of appointment of a whole time director are not according to law, the remuneration paid to him is a material item even if the financial implication is not much.
(iv) **Legal Definition**	It may be defined or described in law itself. E.g., Schedule III requires separate disclosure of items of all expenses exceeding 1% of turnover or to write off capital assets purchased for less than ₹ 5000.
(v) **Relative overall impact**	It may depend on the relative degree of relevance to the overall accounts or the group, or class of transactions to which it pertains. E.g., short recoveries from debtors.
(vi) **Qualitative**	It may be qualitative and not often reckoned with respect to quantitative details alone. E.g., improper disclosure of an accounting policy in the Notes to the Annual Financial Statements may affect economic decisions.

(vii) **Insignificant quantity but special context**	It maybe of an insignificant quantity otherwise, but material in special circumstances. e.g., rounding off to the nearest rupee the fraction of 0.666 as 0.67 in computer software. It may be material in future due to cumulative effect even if insignificant now.

—— Space to write important points for revision ——

2012 - Dec [6] (f) Risk of non-detection of error is less than the risk of non-detection of fraud—Comment. **(2 marks)**

Answer :

Fraud is more difficult to detect than error. Fraud may be divided broadly into two classed:

(a) Defalcation, involving either misappropriation of money or goods.

(b) The fraudulent manipulation of accounts not involving defalcation.

This is so since fraud generally involves complicated, ticklish and carefully organized/perpetrated schemes to concede the same from the eyes of the Auditor and/or the management, such as forgery institutional failure of records transaction, cooking up the vouchers for expenses etc.

—— Space to write important points for revision ——

2014 - June [7] (a) (i) Bring out in a tabular form, the relationship between accounting and auditing. **(4 marks)**

(ii) State the aspects to be seen by an auditor to ensure that the statements audited project a true and fair view. **(4 marks)**

Answer:

(i) The relationship between accounting and auditing has been explained by Kell and Ziegler in "Modern Auditing" as follows:

Accounting	Auditing
(i) Analyze events and transactions.	Review client's internal control system.

(ii) Record and summarize data in accounting records.	Obtain and evaluate evidence on statement assertions.
(iii) Make financial statement assertions.	Determine fairness of state-ments in conformity with recog-nized accounting principles.
(iv) Prepare financial statements as per recognized accounting principles.	Prepare audit report on finding.
(v) Distribute Financial state-ments and Auditor's report to shareholders.	Deliver audit report to client.

(ii) (i) That the assets are neither undervalued or overvalued, according to the applicable accounting principles;

(ii) No material asset is omitted

(iii) The charges, if any, on assets are disclosed;

(iv) Material liability should not be omitted;

(v) The profit and loss account discloses all the matters required to be disclosed by Part II of Schedule III and the balance sheet has been prepared in accordance with Part I of Schedule III;

(vi) All unusual, exception or non-recurring items have been disclosed separately.

—— Space to write important points for revision ——

2014 - Dec [4] (a) Comment on the following:

(i) The concept of true and fair is a fundamental concept in Auditing. **(4 marks)**

Answer:

(a) (i) The main object of audit is to find out whether the financial statements prepared by a company show the true and fair view of the financial state of affairs of a company and if not then in what respect they are not showing. The accounts are said to be true and fair if:

1. The books of account have recorded all the business transactions correctly.
2. The books of account have been prepared according to the accepted principles of accountancy and have followed accounting standards issued by different regulatory bodies.
3. There are no errors and frauds present in the books of account.
4. The financial statements that have been prepared by the company are in conformity with the books of accounts and all mandatory provisions of Companies Act.
5. The profit and loss shown in the profit and loss account shows the true and fair results of entity's operations and the value of assets and liabilities appearing in the balance sheet is shows the correct financial picture.
6. The books of accounts must disclose all material facts regarding revenue, expenses, assets and liabilities.

—— Space to write important points for revision ——

2016 - Dec [9] (a) "Some material mis-statements remain unreported by Auditors."—Comment. **(8 marks)**

Answer:

The concept of materiality is applied by the auditor both in planning and performing the audit, and in evaluating the effect of identified misstatements on the audit and of uncorrected misstatements, if any, on the financial statements. In general, misstatements, including omissions, are considered to be material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements. Judgments about materiality are made in the light of surrounding circumstances, and are affected by the auditor's perception of the financial information needs of users of the financial statements, and by the size or nature of a misstatement, or a combination of both. The auditor's opinion deals with the financial statements as a whole and therefore the auditor is not responsible for the detection of misstatements that are not material to the financial statements as a whole.

Risk of material misstatement: The risk that the financial statements are materially misstated prior to audit. This consists of two components, described as follows at the assertion level:

(i) **Inherent risk:** The susceptibility of an assertion about a class of transaction, account balance or disclosure to a misstatement that could be material, either individually or when aggregated with other misstatements, before consideration of any related controls.

(ii) **Control risk:** The risk that a misstatement that could occur in an assertion about a class of transaction, account balance or disclosure and that could be material, either individually or when aggregated with other misstatements, will not be prevented, or detected and corrected, on a timely basis by the entity's internal control.

Space to write important points for revision

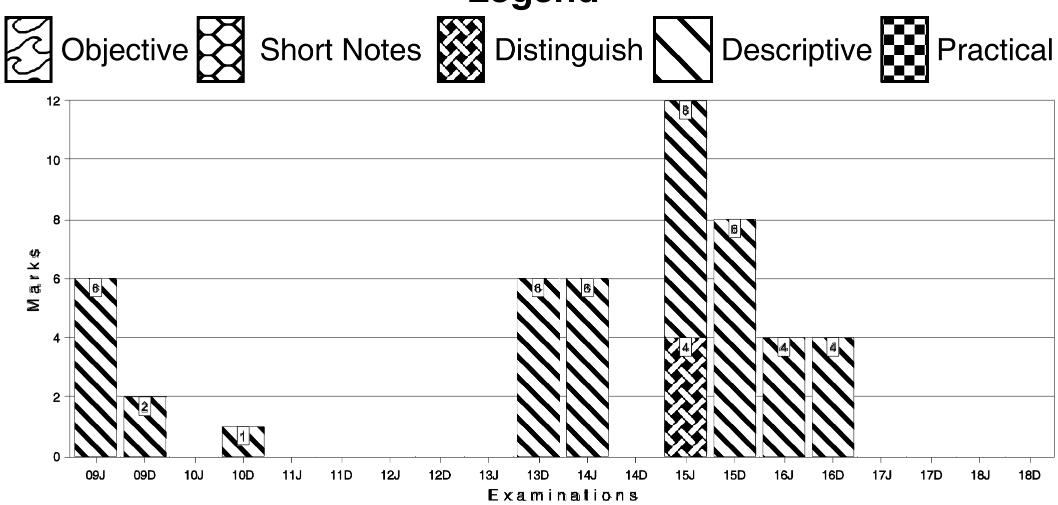
7 TYPES OF AUDIT

THIS CHAPTER INCLUDES

- Voluntary Audit or Private Audit
- Advantages of Auditing for Sole Proprietors
- Advantages of Auditing for Partnership Firms & Others
- Statutory Audit
- Government Audit
- Difference Between Private (Voluntary) Audit and Statutory (Mandatory) Audit
- Difference Between Statutory Audit and Government Audit
- Independent Financial Audit
- Forensic Audit
- Social Audit
- Environmental Audit
- Efficiency Cum Performance Audit
- Propriety Audit
- Operational Audit
- Continuous Audit
- Information Systems Audit
- Annual Audit (Final Audit)
- Interim Audit
- Balance Sheet Audit
- Statutory Report.

Marks of Objective, Short Notes, Distinguish Between, Descriptive & Practical Questions

Legend



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CHAPTER AT A GLANCE

S. No.	Topic	Important Highlights
1.	**Voluntary Audit or Private Audit**	"Though audit is not necessary for each form of ownership, yet they go for audit''. "Audit of accounts may not be compulsory, yet on e may get the books of accounts audited for various reasons''.
2.	**Statutory Audit**	Statutory audit is the checking of accounts required by law. A statute or law may require having an annual audit of financial records of a company or any other entity. The law may require the audit to be conducted in the specified manner.
3.	**Government Audit**	United Nations (UN)Handbook on Government Auditing in Developing Countries states that "Government auditing is the objective, systematic, professional and independent examination of financial, administrative and other operations of a public entity for the purpose of evaluating and verifying them, presenting a report containing comments, conclusions and recommendations and expressing the appropriate professional opinion in respect of financial statements."
4.	**Independent Financial Audit**	An independent financial audit may be conducted by a qualified auditor at the request of a client, which may be a sole-proprietorship, partnership, non-profit organization or any other entity.

		Its objective is to comment on the truthfulness and fairness of the Financial Statements, and it may be compulsory under some Acts which govern the entity.
5.	**Internal Audit**	Internal Auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.
6.	**Scope of Internal Audit**	1. Reliability and Integrity of Financial and Operating Information 2. Economical and Efficient Use of Resources 3. Compliance with Laws, Policies, Plans, Procedures, and Regulations 4. Accomplishment of Established Goals for Operations 5. Safeguarding of Assets
7.	**Forensic Audit**	• Major accounting scandals involving Enron, Worldtel, Parmalat and Satyam have been widely reported. • In all these cases, the methods and purpose of manipulations in the Financial Statements were peculiar to the motives of such manipulations.
8.	**Social Audit**	• Organizations, these days, focus on attaining economic growth through performing processes that ensure social and environmental development simultaneously.

		• A social audit is a way of measuring, understanding, reporting and improving an organization's performance towards meeting its social and ethical objectives.
9.	**Environmental Audit**	According to the United States Environmental Protection Agency (USEPA), environmental audit may be defined as a systematic, documented, periodic and objective review by a regulated entity of facility operations and practices related to meeting environmental requirements,"
10.	**Propriety Adit**	The Propriety Audit means the verification of following main aspects to find out whether: (i) Proper recording has been done in appropriate books of accounts. (ii) The assets have not been misused and have been properly safeguarded. (iii) The business funds have been utilized properly. (iv) The concern is yielding the expected results..
11.	**Continuous Audit**	• Continuous audit may be defined as the examination and verification of a firm's financial transactions and their supporting documents, continuously throughout the year, at regular or irregular intervals. • A continuous audit driven system generates alarm triggers that provide advance notice about anomalies and errors detected by the system. • It is performed usually by the firm's internal auditors to eliminate the year-end workload.

12.	**Information Systems Audit**	"Information systems auditing is an organizational function that evaluates asset safeguarding, data integrity, system effectiveness, and system efficiency in computer based information systems. It has arisen for seven major reasons: i. The consequences of losing the data resource; ii. The possibility of misallocating resources because of decision based on incorrect data or decision rules; iii. The possibility of computer abuse if computer systems are not controlled; iv. The high value of computer hardware, software, and personnel; v. The high costs of computer error; vi. The need to maintain the privacy of individual persons; and vii. The need to control the evolutionary use of computers."
13.	**Final Audit**	Annual Audit is conducted at the end of the accounting year, after the books of accounts have been closed.
14.	**Interim Audit**	Interim audit is an audit conducted between two annual audits. It may be conducted for a specific period, such as a quarter or half year, with an interim object of declaration of interim dividend or valuation of shares on a certain date, in case of mergers.

15.	**Balance Sheet Audit**	Balance sheet audit is generally synonymous with statutory audit. In a balance sheet audit, the auditor reviews and critically examines the Financial Statements, which include the Balance Sheet and Profit & Loss Account prepared by the management. He verifies each assertion in the Financial Statements, working backwards and checking through original entries made in the books of accounts and evidences to support the entries recorded.
16.	**Complete, Partial and Detailed (in depth) Audit**	A complete audit is an audit where the scope of audit is not confined to specific limits, which may be set by the management or any other authority. The auditor is required to check all the possible aspects of a business, including manufacturing operations, data flow processes, accounting records and procedures, etc. In general business practices, it is not feasible to get a complete audit conducted.
17.	**Partial Audit**	Is a non statutory audit, which restricts the scope of the auditor to checking of certain specific aspects only. The auditor's powers to enquiry are restricted by his terms of engagement. He may not be allowed to obtain information which falls outside the purview of the scope defined for him.
18.	**Detailed Audit**	Is also known as audit-in-depth. It involves checking of transactions from the time of their recording till their final effect on the Financial Statements. Every stage that a transaction goes through in the accounting process is closely examined by the auditor using various audit evidences.

19.	**Statutory Report**	Statutory Audit of a public company implies the audit of the transactions of the company which are the subject-matter of the report under Section 143. The auditor, however, has to certify as correct only as much of the Statutory Report as relates to the shares allotted by the company, cash received in respect of such shares and other receipts and payments of the company.

DISTINGUISH BETWEEN

2015 - June [4] (c) Answer the question:

(ii) Distinguish between Statutory audit and Government Audit.

(4 marks)

Answer:

Sl. No.	Statutory Audit	Government Audit
i.	Applicable to (a) All private companies (b) All co-operative societies (c) Proprietorship and partnership concerns in some cases. E.g. Tax audit under **Section 44AB** of the Income Tax Act.	Applicable to (a) Government departments (b) Statutory corporations (c) Government companies
ii.	(a) In case of private companies: shareholders. (b) In case of sole proprietor and partnership: proprietor or partners.	(a) In case of government departments: Comptroller and Auditor General. (b) In case of statutory corporation: as per the provisions of the special statute for that corporation.

	(c) In case of trust: trustee or Managing Committee. (d) In case of co-operative societies: Managing Committee with prior approval of the Registrar.	(c) In case of government company: Company Law Board, on the advice of the Comptroller and Auditor General.
iii.	Report is submitted to the owners/ shareholders in a format prescribed by the **Companies Act, 2013**, in the case of Companies.	Report is submitted to the shareholders and a copy is given to the Comptroller and Auditor General in a format prescribed by the CAG.

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DESCRIPTIVE QUESTIONS

2008 - Dec [5] {C} Comment on the following statements based on legal provision :

(f) Management Audit is conducted by Statutory Auditor of the Company. **(2 marks)**

Answer :

The statement is incorrect. The management audit is conducted by ;

(i) An administrative staff
(ii) An audit committee
(iii) An officer on special duty
(iv) Outside management consultants.

—— Space to write important points for revision ——

2008 - Dec [7] (e) What are the objectives of Operational Audit? **(4 marks)**

Answer :

The Objectives of operational audit are as given below:

1. To ensure that the operational activities are as per objectives of the company.

2. To assure management that MIS has been functioning properly to attain organizational objectives.
3. To assure management that the management control system is functioning efficiently and effectively.

—— Space to write important points for revision ——

2008 - Dec [8] (c) State the need for Management Audit. **(4 marks)**

Answer :

The objectives of management audit are:

(i) to detect and correct the human limitations of top management;
(ii) to improve upon management's productivity;
(iii) to avoid possible losses arising from inefficient management and
(iv) to study the current state of all affairs of the management and suggest suitable measures for improvement.

—— Space to write important points for revision ——

2009 - June [5] {C} Comment on the following statements based on legal provisions:

(g) Management emphasises on problem identification rather than problem solving. **(2 marks)**

Answer :

True. Identification of problems is the first step towards their solution. The management ensures and examines whether policies and procedures adopted in the organization, are consistent with objectives and understood properly at all functional levels.

—— Space to write important points for revision ——

2009 - June [6] (a) What are the limitation of Management audit? **(4 marks)**

Answer :

The limitations of Management audit are as given below :

- The management audit is audit of the management, by the management, and for the management. The management auditors are selected by the management itself.

- The management auditors are generally familiar with the organization, the staff and employees. The personal aspects cannot be overlooked in such audits. Some may use this audit to level the score with someone while other may utilize it to favour someone.
- They are more likely to take the facts for granted and may not probe into depth to investigate the matter any further.
- Time and cost constraints may limit the scope, operation and extent of such audits.
- The management audit team as selected by the management may not look, act and work as a team. Conflicting interests, attitude and inclination may jeopardize the entire objective of the audit.

—— Space to write important points for revision ——

2009 - Dec [8] (a) Management audit is beneficial to the Foreign Collaborators also. How ? **(2 marks)**

Answer :

Management audit is beneficial to every one connected with the organization in any manner because it is intended to make improvements in all processes and functions of management. Foreign collaborators invest their funds in the organization and would always wish for better utilization of it. They would like to ensure that the management is not inefficient; management audit provides them such assurance.

—— Space to write important points for revision ——

2010 - Dec [7] (d) (iii) Do you agree that Management Audit can be conducted by an Audit Committee? **(1mark)**

Answer :

Yes, the management audit can be conducted by any group of individuals appointed by the management. Audit committee is also a good choice for conducting the management audit.

—— Space to write important points for revision ——

2013 - Dec [5] {C} Answer the following:

(b) What is Tax audit? **(2 marks)**

Answer:

Tax Audit :

- "A systematic and independent examination of data, statements, records, operations and performances (financial or otherwise) of an enterprise for a stated purpose.
- In any auditing situation, the auditor perceives and recognises the propositions before him for examination, collects evidence, evaluates the same and on this basis formulates his judgment which is communicated through his audit report".
- Under the existing provisions of **Section 44AB**, every person carrying on business is required to get his accounts audited if the total sales, turnover or gross receipts in the previous year exceed one crore rupees.
- Similarly, a person carrying on a profession is required to get his accounts audited if the total sales, turnover or gross receipts in the previous year exceed Twenty five lakh rupees.

Space to write important points for revision

2013 - Dec [6] (a) (i) State the basic features and necessity of continuous Audit.

(ii) State the scope and advantages of Operational Audit. **(4 marks)**

Answer:

(a) (i) Continuous audit may be defined as the examination any verification of a firm's financial transactions and their supporting documents, continuously throughout the year, at regular or irregular intervals.

Features of Continuous Audit :

(i) It is a process conducted throughout the year.
(ii) It is conducted at regular or irregular intervals.
(iii) It focuses on testing 100% of transactions.
(iv) Technology is important to enabling it.
(v) It provides advance notice about errors and irregularities detected.
(vi) Surprise visits by the auditor are involved.

Necessary of Continuous Audit :

(i) Internal controls are inadequate.
(ii) The transactions run in large numbers.

(iii) The management is interested in getting statement of accounts audited periodically for enabling better management of resources.

(ii) Operational audit, in its initial stages, was developed as a branch of internal auditing. Internal audit focuses on accounting operations of the entity but operational audit has a wider scope of working and covers all other operations, such as production and marketing too.

Advantages :

- Operational audit is one of the management tools to get first hand information.
- It is more useful in an entity where the management is at a distance from actual operations.
- It is very useful in large organizations where management cannot control the actual operations due to layers of delegation of responsibility.
- The management information system has various tools like routine performance report from department heads, internal audit reports, surprise checks, periodic inspections and investigation to control the managers responsible for their departments.
- The operational audit is also one of the tools used in large or geographically vast entities to control the operation at first stage and to fill up the gaps of information provided by department heads through periodic reports.

—— Space to write important points for revision ——

2014 - June [5] {C} (d) Why do the financial institutions demand Management Audit by companies, while participating in their equities?

(2 marks)

Answer:

Management Audit:

Financial Institutions conduct the Management Audit while participating in equities of a company to avoid possible loss arising out of inefficient management. Financial Institutions also conduct Management Audit for following reasons:

(i) For investments in a company
(ii) For granting loans to company
(iii) For giving guarantee etc.

—— Space to write important points for revision ——

2014 - June [7] (b) (i) Tabulate the differences between statutory audit and forensic audit. **(4 marks)**

Answer:

Difference Between Statutory Audit and Forensic Audit

Sl. No.	Statutory Audit	Forensic Audit
(i)	Express an opinion on the truthfulness and fairness of the Financial Statements.	Determine if any fraud has been committed in the client's business.
(ii)	Substantive and compliance procedures are used.	Substantive procedures, audit-in depth, trend, past-data analysis are used.
(iii)	Accounts relating to the relevant accounting year are checked.	Accounts may be checked for as many number of years as required to detect the cause of the fraud, if any.
(iv)	Check the arithmetical accuracy and compliance with procedures.	Propriety aspect is focused on.
(v)	Qualifications may be given in case of adverse findings.	The amount of fraud, the persons behind it and the legal implication are mentioned in the audit report.

—— Space to write important points for revision ——

2015 - June [1] Answer the questions:
(g) What do you understand by Information Security Audit?
(h) What is continuous Audit? **(2 marks each)**

Answer:

(g) Information Security Audit:

- Information Security Audit is an audit of the level of information security in an organization.
- The controls in any business organization can be classified as technical, physical and administrative controls.
- Thus, information security audit involves checking of security controls from the physical security of data centres to the logical security of databases.
- When centered on the IT aspects of information security, it can be seen as a part of an information technology audit. However, information security encompasses much more than IT.

Answer:

(h) Continuous Audit:

- According to the IIA (The Institute of Internal Auditors, USA), continuous auditing is "a method used to perform control and risk assessments automatically on a more frequent basis.
- Continuous auditing changes the audit paradigm from periodic reviews of a sample of transactions to ongoing audit testing of 100 percent of transactions. It becomes an integral part of modern auditing at many levels... technology is a key to enabling such an approach."
- Continuous audit may be defined as the examination and verification of a firm's financial transactions and their supporting documents, continuously throughout the year, at regular or irregular intervals.
- A continuous audit driven system generates alarm triggers that provide advance notice about anomalies and errors detected by the system. It is performed usually by the firm's internal auditors to eliminate the year-end workload.

Space to write important points for revision

2015 - June [4] (a) Comment on the following:

(ii) Operational audit is merely an extension of Internal Audit.

(4 marks)

Answer:

(ii) The statement is **true.** In operational audit function, the internal auditor goes beyond financial controls and looks into operational areas also. Operational auditing having scope and objectives similar to that of Internal Audit is therefore an extension of Internal Audit.

—— Space to write important points for revision ——

2015 - Dec [4] Answer the question:

(c) (i) What are the matters to be specially considered while conducting the audit of a Partnership firm? **(8 marks)**

Answer:

(i) Special Points in Audit of a Partnership Firm: Matters which should be specially considered in the audit of accounts of a partnership firm are as under:

(i) Confirming that the letter of appointment, signed by a partner, duly authorised, clearly states the nature and scope of audit contemplated by the partners, specially the limitation, if any, under which the auditor shall have to function.

(ii) Examine the partnership deed signed by all partners and its registration with the registrar of firms. Also ascertain from the partnership deed about capital contribution, profit sharing ratios, interest on capital contribution, powers and responsibilities of the partners, etc.

(iii) Studying the minute book, if any, maintained to record the policy decision taken by partners specially the minutes relating to authorisation of extraordinary and capital expenditure, raising of loans, purchase of assets, extraordinary contracts entered into and other such matters which are not of a routine nature.

(iv) Verifying that the business in which the partnership is engaged authorised by the partnership agreement; or by any extension or modification thereof agreed to subsequently.

(v) Examining whether books of account appear to be reasonable and are considered adequate in relation to the nature of the business of the partnership.

(vi) Verifying generally that the interest of no partner has suffered prejudicially by an activity engaged in by the partnership which, it was not authorised to do under the partnership deed or by any violation of a provision in the partnership agreement.

(vii) Confirming that a provision for the firm's tax payable by the partnership has been made in the accounts before arriving at the amount of profit divisible among the partners. Also see various requirements of legislations applicable to the partnership firm like **Section 44AB** of the **Income- tax Act, 1961** have been complied with.

(viii) Verifying that the profits and losses have been divided among the partners in their agreed profit-sharing ratio.

—— Space to write important points for revision ——

2016 - June [3] Answer the questions:

(a) What is Statutory Audit?

(d) What are basic features of Continuous Audit? **(2 marks each)**

Answer:

(a) Statutory audit is the checking of accounts required by law. A statute or law may require having an annual audit of financial records of a company or any other entity. The law may require the audit to be conducted in the specified manner. The manner of reporting, contents of the report and the authority to which the report of auditors should be presented are all specified by the statute. Statutory audits are mandatory in nature. The statutory auditor is generally the principal auditor in an organization.

(i) In the case of companies, the **Companies Act, 2013** governs the audit of accounts, its reporting, and manner of preparing the audit report.

(ii) In the case of audit of a Government body, the scope and audit programmes are set by the Comptroller and Auditor General and the **Companies Act, 2013.**

(iii) In the case of audit of an insurance company or a nationalized bank, the audit is governed by specific statutes and IRDAIRBI guidelines. Co-operative banks are also governed by the **Co-operative Societies Act, 1912**.

(d) The Basic Features of Continuous Audit:

(i) It is a process conducted throughout the year.
(ii) It is conducted at regular or irregular intervals.
(iii) It focuses on testing 100% of transactions.
(iv) Technology is important to enabling it.
(v) It provides advance notice about errors and irregularities detected.
(vi) Surprise visits by the auditor are involved.

—— Space to write important points for revision ——

2016 - Dec [3] Answer the questions:
(a) What are the advantages of Social Audit?
(b) State objectives of Management Audit. **(2 marks each)**

Answer:

(a) The advantages of Social Audit may be enumerated as below:

(i) Encourages community participation among different business entities.
(ii) Ensures continuous efforts towards environmental protection and use of environment friendly production processes.
(iii) Builds customer satisfaction and trust through ethical business practices.
(iv) Promotes collective decision making and sharing responsibilities.
(v) Develops human resources by working towards improvement of workers' and the underprivileged persons' working/living conditions.

(b) The objectives of management audit are:

(i) To detect and correct the human limitations of top management;
(ii) To improve upon management's productivity;
(iii) To avoid possible losses arising from inefficient management and
(iv) To study the current state of all affairs of the management and suggest suitable measures for improvement.

—— Space to write important points for revision ——

Repeatedly Asked Questions		
No.	**Question**	**Frequency**
1	What are basic features of Continuous Audit? 13 - Dec [6] (a) (i), 16 - June [3] (d)	2 Times

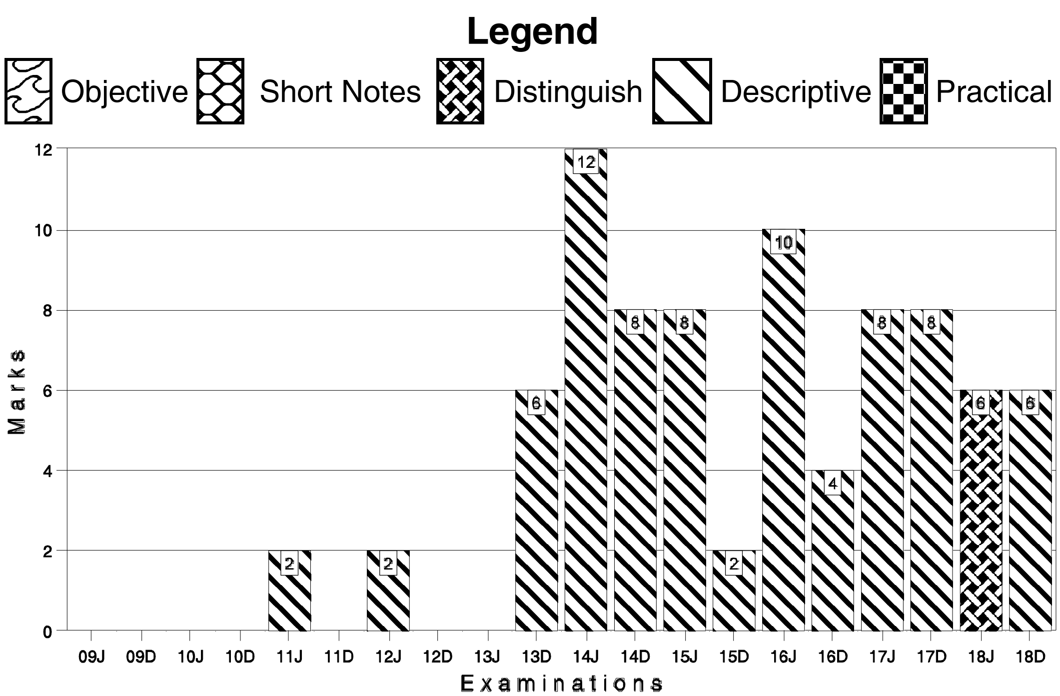
Table Showing Marks of Compulsory Questions										
Year	**14 J**	**14 D**	**15 J**	**15 D**	**16 J**	**16 D**	**17 J**	**17 D**	**18 J**	**18 D**
Descriptive	2									
Total	2									

8 AUDIT ENGAGEMENT, PROGRAMME, WORKING PAPERS

THIS CHAPTER INCLUDES

• Audit Engagement • Audit Programme • Audit Working Papers • Audit Note Book	• Audit Risk • Audit Evidence • Audit Report

Marks of Objective, Short Notes, Distinguish Between, Descriptive & Practical Questions



For detailed analysis Login at *www.scannerclasses.com*
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CHAPTER AT A GLANCE

S. No.	Topic	Important Highlights
1.	**Audit Engagement**	• An audit engagement refers to an audit that an auditor performs. • More specifically, it refers only to the initial stage of an audit during which the auditor notifies the client he has accepted the audit work and clarifies his understanding of the audit's purpose and scope.
2.	**Audit Programme**	• An audit programme is a detailed plan of the auditing work to be performed, specifying the procedures to be followed in verification of each item and the financial statements and the estimated time required. • To be more comprehensive, an audit programme is written plan containing exact details with regard to the conduct of a particular audit. It is a description or memorandum of the work to be done during an audit. • Audit programme serves as a guide in arranging and distributing the audit work as well as checking against the possibility of the omissions.

3.	**Audit Working Papers**	• Audit working papers are the record of the planning and execution of the audit engagement. • Auditors retain a set of working papers for each audit engagement for each year. • The audit working papers for the current year are referred to as the current working papers. • Working papers that are relevant to more than one audit engagement are often kept separately in a file referred to as permanent working papers.
4.	**Audit Note Book**	• An audit book is usually a bound book in which a large variety of maters observed during the course of audit are recorded. • The audit note book is a permanent record of the auditor. For each individual audit, the auditor usually maintains a separate audit note book. • The audit note book should be maintained clearly, completely and systematically. • An audit note book is a great evidential tool available as a defence with the auditors in the event of any charge is brought against them.
5.	**Audit Risk**	Major accounting scandals involving Enron, Worldtel, Parmalat and Satyam have been widely reported. In all these cases, the methods and purpose of manipulations in the Financial Statements were peculiar to the motives of such manipulations. i. **Inherent risk** – It is the susceptibility of a account balance or class of transaction to

		misstatements that could be material, either individually or when taken together with misstatements in other balance or classes, assuming that there were no internal controls. ii. **Control risk**- It is the risk that misstatement, that could occur in an account balance or class of transactions and that could be material, either individually or when taken together with misstatements in other balances or classes, will not be prevented/detected/corrected on timely basis by the accounting and internal control systems iii. **Detection risk** -It is the risk that an auditor's substantive procedures (the procedures designed to obtain evidence as to the completeness, accuracy and validity of the data produced by the accounting system) will not detect a misstatement that exists in account balance or class of transactions that could be material, either individually or when taken together with misstatements in other balances or classes.
6.	**Audit Evidence**	• While auditing, the auditor come across various assertions of the management. • The auditor has to evaluate these assertions so that he would be able to express his opinion on the financial statements. • This evaluation can be made in the light of some facts and reasons. • These facts and reasons are called Audit Evidence'.

		• The auditor should evaluate whether he has obtained sufficient appropriate audit evidence so that reasonable conclusions can be drawn there from.
7.	**Audit Report**	Concept & Definitions While conducting every audit auditor has to go through three phases (a) Preliminary work for audit. (b) Conduct of actual audit, and (c) Conclusion of audit, which means submission of Audit Report.

DISTINGUISH BETWEEN

2018 - June [7] (a) Distinguish between Permanent and Current Audit File.
(6 marks)

Answer:

Permanent and Current Audit File:

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

Sr. No.	Permanent Audit File	Current Audit File
1.	Legal and organizational structure of the entity, e.g. Memorandum of Association and Article of Association in case of a company.	Correspondence relating to acceptance of annual re - appointment.
2.	Extracts or copies of legal documents, agreements and minutes relevant to the audit.	Extracts of important matters in the minutes of Board Meetings and General Meetings relevant to the audit.

3	A record of study and evaluation of internal controls.	Copies of management letters.
4	Analysis of significant ratios and trends.	Analysis of transactions and balances.
5.	Copies of the audited financial statements of previous year(s).	Copies of communication with other auditors, experts and third parties.
6.	Notes regarding significant accounting policies.	Audit programme.
7.	Significant audit observations of the earlier years.	Conclusions reached on significant aspects of audit.

Space to write important points for revision

DESCRIPTIVE QUESTIONS

2008 - Dec [6] (e) Risk occurring due to insufficient or incompetent evidence collected by the auditors to express his opinion on the financial statement is called an Audit Risk. Is the statement correct? **(2 marks)**

Answer :

False: The audit risk implies and involves risks associated with process of auditing as well as performance of auditor. Audit risk occurs due to insufficiency or incompetent evidence collected by the auditor to express his opinion on the financial statements.

Space to write important points for revision

2011 - June [6] (a) State the components of Audit risk. **(2 marks)**

Answer :

Audit Risk:

- Audit risk is the risk of a material misstatement of a financial statement item that is or should be included in the audited financial statements of an entity. In theory, audit risk ranges anywhere from zero, where there is complete certainty of no material misstatement, to one, where there is complete certainty of a material misstatement.

- In practice, however, audit risk is always greater than zero.
- There is always some risk of material misstatement as it is not possible, (except for the audit of the simplest of financial statements), due to the limitations inherent in both accounting and auditing, to be absolutely certain that a material misstatement will not exist.

i. **Audit risk**	is the risk that the auditor gives an inappropriate audit opinion when the financial statements are materially misstated. Such misstatements can result from either fraud or error. SA 400 on "Risk Assessments and Internal Controls" identities the following three components of audit risk:
ii. **Inherent risk**	it is the susceptibility of an account balance or class of transaction to misstatements that could be material, either individually or when taken together with misstatements in other balance or classes, assuming that there were no internal controls.
iii. **Control risk**	it is the risk that misstatement, that could occur in an account balance or class of transactions and that could be material, either individually or when taken together with misstatements in other balances or classes will not be prevented/detected/corrected on timely basis by the accounting and internal control systems.

—— Space to write important points for revision ——

2012 - June [5] {C} Comment on the following statements based on legal provisions:

(a) Development of the audit evidence is the basic to the understanding of the audit process. **(2 marks)**

Answer :

True: The development of audit evidence is fundamental to understand the audit process. It is the evidence which gives information about the state of affairs of the company. Evidence helps the auditor to decide what is to be audited and how much is to be audited. Evidences are collected through various audit techniques from various sources.

—— Space to write important points for revision ——

2013 - Dec [5] {C} Answer the following:

(a) What do you understand by audit evidence? **(2 marks)**

Answer:

- Auditing is a logical process. An auditor is called upon to assess the actualities of the situation, review the statements of account and give an expert opinion about the truthness and fairness of such accounts.
- This he cannot do unless he has examined the financial statements objectively.
- Objective examination connotes critical examination and scrutiny of the accounting statements of the undertaking with a view to assessing how far the statements present the actual state of affairs in the correct context and whether they give a true and fair view about the financial results and state of affairs.
- An opinion founded on a rather reckless and negligent examination and evaluation may expose the auditor to legal action with consequential loss of professional standing and prestige.
- Audit evidence may be defined as the 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.

—— Space to write important points for revision ——

2013 - Dec [7] (b) (ii) Explain the significance of audit working papers. **(4 marks)**

Answer:

The audit working papers constitute the link between the auditor's report and the client's records. According to SA -230 , Audit Documentation refers to the record of audit procedures performed, relevant audit evidence obtained, and conclusions the auditor reached (terms such as "working papers" or "work papers" are also sometimes used). The objects of an auditor's working papers are to record and demonstrate the audit work from one year to another.

Audit documentation serves a number of purposes:

- Assisting the engagement team to plan and perform the audit.
- Assisting members of the engagement team responsible for supervision to direct and supervise the audit work, and to discharge their review responsibilities in accordance with SA 220.
- Enabling the engagement team to be accountable for its work.
- Retaining a record of matters of continuing significance to future audits.
- Enabling the conduct of quality control reviews and inspections in accordance with SQC 1.
- Enabling the conduct of external inspections in accordance with applicable legal, regulatory or other requirements.

—— Space to write important points for revision ——

2014 - June [6] (a) (ii) Discuss in brief, the principles, which are useful in assessing the reliability of audit evidence. **(4 marks)**

Answer:

Useful principles for assessing the reliability of audit evidence:

Audit evidence refers to any information, verbal or written, obtained by the auditor on which he bases his opinion on financial statements.

The reliability of audit evidence depends on its source-internal or external and on its nature-visual, documentary or oral. While the reliability of audit evidence is dependent on the circumstances under which it is obtained, the following generalisations may be useful in assessing the reliability of audit evidence.

(a) External evidence (e.g. confirmation received from third party) is usually more reliable than internal evidence.

(b) Internal evidence is more reliable when related internal control is satisfactory.
(c) Evidence in the form of documents and written representations is usually more reliable than oral representations.
(d) Evidence obtained by the auditor himself is more reliable than that obtained through the entity.

—— Space to write important points for revision ——

2014 - June [7] (b) (ii) What is meant by Audit Note Book? State its importance. What are the contents of a typical Audit Note Book?

(8 marks)

Answer:

Audit Note Book:

An audit book is usually a bound book in which a large variety of matters observed during the course of audit are recorded. The audit note book is a permanent record of the auditor. For each individual audit, the auditor usually maintains a separate audit note book. The audit note book should be maintained clearly, completely and systematically. An audit note book is a great evidential tool available as a defence with the auditors in the event any charge is brought against them. In case of City Equitable Fire Insurance Company, the auditors were relieved because they had maintained record of the audit work performed at each stage.

Contents of audit note book:

(i) Name of the business enterprise.
(ii) Organisation structure.
(iii) Important provisions of Memorandum and Articles of Association.
(iv) Communication with the previous auditor, if any.
(v) Management representations and instructions.
(vi) List of books of accounts maintained by the enterprise.
(vii) Accounting methods, internal control systems followed by the enterprise, applicable laws etc.
(viii) Key management personnel.
(ix) Errors and fraud discovered.

(x) Matters requiring explanations or clarifications.

(xi) Special points that need attention in the audit report and for subsequent audits.

—— Space to write important points for revision ——

2014 - Dec [1] Answer the questions:

(h) What do you understand by audit programme?

(i) State the three components of audit risk. **(2 marks each)**

Answer:

(h) An audit programme is a written plan containing exact details with regard to the conduct of a particular audit. It is a description or memorandum of the work to be done during an audit. Audit Programme serves as a guide in arranging and distributing the audit work as well as checking against the possibility of omissions.

Answer:

(i) Three components of audit risks:

- Inherent risk (risk that material errors will occur)
- Control risk (risk that the client's system of internal control will not prevent or correct such errors); and
- Detection risk (risk that any remaining material errors will not be detected by the auditor).

—— Space to write important points for revision ——

2014 - Dec [4] Answer the question:

(a) Comment on the following:

(iii) The Audit Note Book is a permanent record of the auditor. **(4 marks)**

Answer:

Audit Note Book:

An audit book is usually a bound book in which a large variety of matters observed during the course of audit are recorded. The audit note book is a permanent record of the auditor. For each individual audit, the auditor usually maintains a separate audit note book. The audit note book should be maintained clearly, completely and systematically. An audit note book is a great evidential tool available as a defence with the auditors in the event of any charge is brought against them. In case of City Equitable Fire Insurance Company, the auditors were relieved because they have maintained record of the audit work performed at each stage:

(i) Contents of Audit Note Book.
(ii) Name of the business enterprise.
(iii) Organisation structure.
(iv) Important provisions of Memorandum and Articles of Association.
(v) Communication with the previous auditor, if any.
(vi) Management representations and instructions.
(vii) List of books of accounts maintained by the enterprise.
(viii) Accounting methods, internal control systems followed by the enterprise, applicable laws etc.
(ix) Key management personnel.
(x) Errors and fraud discovered.
(xi) Matters requiring explanations or clarifications.
(xii) Special points that need attention in the audit report and for subsequent audits.

—— Space to write important points for revision ——

2015 - June [4] (a) Comment on the following:

(i) An audit process involves significant collection of evidences. **(4 marks)**

(b) (ii) Briefly explain the audit working paper files. **(4 marks)**

Answer:

(a) (i) "An audit process involves significant collection of evidences"

In any audit, the auditor examines the available evidences to him and gives the opinion based on such examination. Moreover, he has to carry out the audit within the framework of standard auditing practices and that too with ethical conduct. The auditor has to proceed in a systematic manner so that he would be in a position to collect and review the purposeful evidences and also satisfy himself of the correctness of the financial operations of the business. Usually, the whole audit process involves the following aspects, namely:

- Defining the scope of the audit work, i.e. preparation of the audit engagement letter
- Obtaining the knowledge of the client's business and formulating the audit programme
- Evaluation of the accounting and internal control system existing in the auditee enterprise
- Determining the nature, timing and the extent of audit procedures keeping in mind the audit risk and the materiality involved
- Adequate documentation is also necessary i.e. preparation of audit note book and working papers
- Formulation of opinion about the financial statements
- Issuing of audit report.

An auditor resorts to the following techniques for collection of relevant evidences, namely

- Vouching
- Confirmation
- Physical examination and observation
- Analytical procedures
- Test checking
- Inquiry
- Electronic data processing
- Preparation of reconciliation statements
- Flow Charts
- Scanning

Further, the various provisions of the law governing the enterprise are complied with. He has to further examine the accounting principles followed and disclose the deficiencies and limitation of the scope if any. At the same time, it also a fact that the selection of the appropriate audit procedures is a matter of experience and judgement.

Answer:

(b) (ii) Audit working paper files :

- Audit working papers are the record of the planning and execution of the audit engagement.
- Auditors retain a set of working papers for each audit engagement for each year.
- The audit working papers for the current year are referred to as the current working papers.
- Working papers that are relevant to more than one audit engagement are often kept separately in a file referred to as permanent working papers. .
- The audit working papers (current and permanent) for a client audit engagement are sufficiently detailed to enable any appropriately experienced and competent auditor who is not familiar with the client to obtain an overall understanding of the engagement.
- Further, as per SA 230, working papers are the momentous records of the auditor which help in establishing that the reasonably logical and verifiable conclusions were reached on the basis of relevant audit evidence.
- These working papers also facilitate audit planning and supervision of the audit work.
- The form and content of working papers vary from audits to audits, but they are affected by the following matters:
  (a) nature of engagement;
  (b) form of audit report;
  (c) nature and complexity of client's business;
  (d) nature and condition of client's records;
  (e) degree of reliance of internal controls;
  (f) supervision of work performed by assistants.

Types of working paper files:

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

Permanent Audit File	Current Audit File
(a) Legal and organizational structure of the entity, e.g. MOA and AOA in case of a company.	(a) Correspondence relating to acceptance of annual re-appointment.
(b) Extracts or copies of legal documents, agreements and minutes relevant to the audit.	(b) Extracts of important matters in the minutes of Board Meetings and General Meetings relevant to the audit.
(c) A record if study and evaluation of internal controls.	(c) Copies of management letters.
(d) Analysis of significant ratios & trends.	(d) Analysis of transactions and balances.
(e) Copies of the audited financial statements of previous year(s).	(e) Copies of communication with other auditors, experts and third parties.
(f) Notes regarding significant accounting policies.	(f) Audit programme.
(g) Significant audit observations of the earlier years.	(g) Conclusions reached on significant aspects of audit.

Space to write important points for revision

2015 - Dec [1] Answer the question:

(j) What is meant by Audit programme and Audit Note Book? **(2 marks)**

Answer:

Audit Programme:

1. An audit programme is a detailed plan of applying the audit procedure in the given circumstances with instructions for the appropriate techniques to be adopted for accomplishing the audit objectives.
2. It is framed keeping in view the nature, size and composition of the business, dependability of the internal control and the given scope of work.

3. It provides sufficient details to serve as a set of instructions to the audit team and also helps to control the proper execution of the work.

Audit Note Book:

1. An audit note book is usually a bound book in which a large variety of matters observed during the course of audit are recorded.
2. It forms part of audit working papers.
3. A fresh audit note book is maintained for each year.

—— Space to write important points for revision ——

2016 - June [3] Answer the question:

(c) What do you understand by Audit Evidence? **(2 marks)**

Answer:

Audit Evidence:

- While auditing, the auditor come across various assertions of the management. The auditor has to evaluate these assertions so that he would be able to express his opinion on the financial statements.
- This evaluation can be made in the light of some facts and reasons. These facts and reasons are called 'Audit Evidence'.
- The auditor should evaluate whether he has obtained sufficient appropriate audit evidence so that reasonable conclusions can be drawn there from.
- It is to be noted that sufficiency an appropriateness are interrelated and apply to evidence obtained from both substantive and compliance procedures.
- Sufficiency refers to the quantum of audit evidence obtained and appropriateness relates to its relevance and reliability.
- The following factors influence auditor's judgement while obtaining audit evidence:
  (a) The nature of the item;
  (b) The adequacy of internal controls;
  (c) The nature and size of the business carried on by the entity;
  (d) Situations which may exert an unusual influence on the management;
  (e) The financial position of the entity;

(f) The materiality of the item;
(g) The experience gained during the previous audits;
(h) The results of auditing procedures, including fraud or error which may have been found;
(i) The type of information available;
(j) The trend indicated by accounting ratios and analysis.

—— Space to write important points for revision ——

2016 - June [9] (a) What is Audit Programme? State its advantages. **(8 marks)**

Answer:

Audit Programme:

- An audit programme is a detailed plan of the auditing work to be performed, specifying the procedures to be followed in verification of each item and the financial statements and the estimated time required.
- To be more comprehensive, an audit programme is written plan containing exact details with regard to the conduct of a particular audit.
- It is a description or memorandum of the work to be done during an audit. Audit programme serves as a guide in arranging and distributing the audit work as well as checking against the possibility of the omissions.
- As per SA 300, the auditor should prepare a written audit programme setting forth the procedures that are needed to be implemented while carrying out the audit plan.
- He may take into account the reliance to be placed on internal controls.
- The auditor has some flexibility in deciding when to perform audit procedures.
- But, sometimes he may have no discretion as to timing, such as, observing the stock taking by the client's personnel.
- The audit programme should consider previous year's audit programmes and these may be modified, if necessary.

An audit programme may be classified into two categories:

(i) Programme common to all types of audit. For example, checking of books of accounts; and

(ii) Special programme containing the work relating to a particular audit. For example, the audit programme for a partnership firm would be different from that of a company.

Advantages of audit programme:

The main advantages of an audit programme are as follows:

(i) It serves as a ready check list of audit procedures to be performed.

(ii) The audit work can be properly allocated to the audit assistants or the article clerks.

(iii) The auditor may easily know the extent of work done at any point of time. Thus, the progress of work done can be under the supervision and control of the auditor.

(iv) Audit programme would not only be useful for the audit assistants in carrying the audit work but for the principal too as he would be in a position to account for the individual responsibilities.

(v) A uniformity of the work can be attained as the same programme would be followed from time to time.

(vi) It is a useful basis for planning the programme for the following year.

(vii) It may be used as evidence by the auditor in the event when any charge is brought against him.

He can prove that there has no negligence on his part and he exercised reasonable care and skill while performing the task.

—— Space to write important points for revision ——

2016 - Dec [3] Answer the questions:

(c) What are the contents of a typical Audit Note Book?

(e) Comment on the following in relation to SA– 230:
"Audit documentation serves a number of additional purposes."

(2 marks each)

Answer:

(c) The contents of a typical audit note book may be enumerated as below:

(i) Name of the business enterprise.

(ii) Organization structure.

(iii) Important provisions of Memorandum and Articles of Association.

(iv) Communication with the previous auditor, if any.
(v) Management representations and instructions.
(vi) List of books of accounts maintained by the enterprise.
(vii) Accounting methods, internal control systems followed by the enterprise, applicable laws etc.
(viii) Key management personnel.
(ix) Errors and fraud discovered.
(x) Matters requiring explanations or clarifications.
(xi) Special points that need attention in the audit report and for subsequent audits.

(e) Audit Documentation:

According to SA 230 on "Audit Documentation", audit documents once collected serve a number of additional purposes. These purposes are as follows:

- Enabling the conduct of quality control reviews and inspections.
- Enabling the conduct of external inspections in accordance with applicable legal, regulatory, or other requirements.
- Enabling the engagement team to be accountable for its work.
- Retaining a record of matters of continuing significance to future audits.
- Assisting the engagement team to plan and perform the audit.
- Assisting members of the engagement team responsible for 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 Statement."

—— Space to write important points for revision ——

2017 - June [7] (a) Define 'Audit Engagement Letter'. What are the general contents of an audit engagement letter? **(2 + 6 = 8 marks)**

Answer:

Auditor's Engagement

In case of a statutory audit the objective and scope of an audit is clearly described in the relevant law. However, in a non-statutory audit it has to be stated with absolute clarity so as to avoid any kind of ambiguity as to the objective and scope of audit. A misunderstanding may arise about the exact scope of the work. For example, the client may be under an impression that while the auditor is preparing the accounts, the audit is also being carried out. Therefore, in order to avoid any kind of misunderstanding or dispute it is in the interests of both the auditor as well as the client to exactly define the scope of the engagement and reduce the same in writing by way of audit engagement letter. An auditor's engagement letter signifies the confirmation by the auditor of his acceptance of appointment as auditor, the documentation of the objective and scope of audit or other work, and the extent of his responsibilities to the client and the form of any reports. **ICAI (CA) has issued SAS 4410, SRS 4400 and SRE 2400 in this regard**. Although the form and content of the engagement letter differs from client to client but in general the following references should be made in audit engagement letter:

(i) The objective and the scope of the engagement.
(ii) Management's responsibility for the financial statements.
(iii) The existence of inherent limitations of audit and resulting material misstatements that may remain undiscovered,
(iv) The need for use of services of internal auditors and/ or other experts that may arise during the course of the engagement.
(v) The requirement of management confirmation letter as regards representations made by them concerning audit.
(vi) Restriction of the auditor's liability, if any.
(vii) Basis for computation of audit fees and billing arrangements.
(viii) The form of reports or other communication of results of the engagement.

—— Space to write important points for revision ——

2017 - Dec [7] (a) Discuss the various methods of obtaining audit evidences. How will you assess the reliability of audit evidences obtained?

(5 + 3 = 8 marks)

Answer:

An auditor applies the following 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 a 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.

(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 agreement.

(iv) Recalculation: Recalculation consists of checking the mathematical accuracy of 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 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.

(vii) Inquiry: Inquiry consists of 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 client's staff.

As per SA 500, reliability of audit evidence depends on its source (whether internal or external) and nature (whether visual, documentary or oral). However, the following generalizations may be considered useful while assessing the reliability of audit evidence.

(i) Evidence obtained from independent and external sources are more reliable.

(ii) Internal evidence becomes more reliable when the related internal control over its preparation and maintenance is effective.

(viii) Evidence obtained directly by the auditor is more reliable than those obtained indirectly or by inference.

(ix) Evidence in documentary form is usually more reliable than oral representation.

(x) Audit evidence provided by original documents is more reliable than audit evidence provided by photocopies or facsimiles or documents that have been filmed or digitized. 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. In case there appears any inconsistency, the auditor must obtain additional evidence by conducting other audit procedures.

—— Space to write important points for revision ——

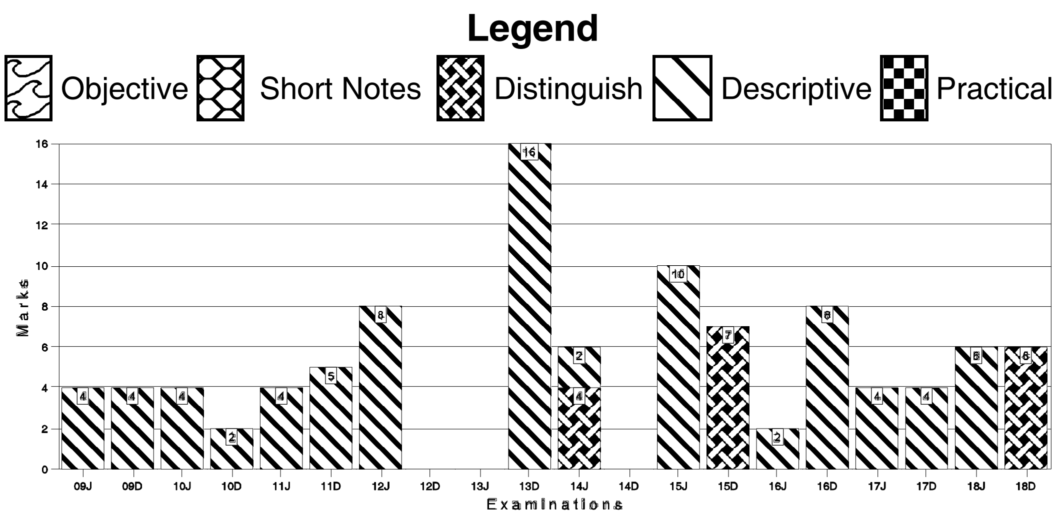
2018 - Dec [7] (a) Discuss the method of obtaining Audit Evidences.

(6 marks)

9 INTERNAL CHECK, INTERNAL CONTROL AND INTERNAL AUDIT

THIS CHAPTER INCLUDES	
• Internal Check • Difference between a Checklist and an Internal Control Questionnaire • Distinction between Internal Check, Internal Audit and Internal Control • Surprise Check	• Cut off Procedures • Examination in Depth/Auditing in Depth: “Walk Through Test” • Difference between Test Checking and Statistical Sampling • Internal Audit

Marks of Objective, Short Notes, Distinguish Between, Descriptive & Practical Questions



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CHAPTER AT A GLANCE

S. No.	Topic	Important Highlights
1.	**Internal Check**	• The accounting of transactions has a number of steps such as posting to the concerned books of accounts, recording receipts and payments of cash etc. • These processes involve a various number of staffs. Thus in an internal check system, practically a continuous internal audit is carried on by the staff itself. • The work of one individual is checked by the other in the staff. • Internal check is a valuable part of the internal control.
2.	**Internal Control Questionnaires**	• The evaluation of internal check system in an organization is of great concern both to the statutory auditor as well as to the internal auditor. • The guiding factor for audit operation by the statutory auditor depends to a great extent on the soundness or otherwise of the internal controls in business. • Due to the limitation of time a statutory auditor can spend on a company's audit, he has to decide the extent of in-depth audit of many areas, particularly the checking and verification of routine aspects of financial transactions.

3.	**Surprise Check**	All the audit procedures which are applied as not in the general routine of conducting an audit but are spontaneous in nature for surprise checks. They are performed without giving a prior notice to the client. **Features of Surprise Check:** • It is spontaneous in nature i.e. unplanned. • Random selection of items to be checked. • Helps in assuring maintenance of up-to-date accounts. • Performed in situations facing weak internal controls.
4.	**Cut off Procedures**	• Periods usually coincide with calendar months, which lead to the need for specific demarcation between transactions forming the part of one period from those included in the following period. • Thus, cut-off procedures are adopted to allocate revenues and costs to the proper accounting period.
5.	**Examination Indepth/Auditing in Depth**	i. Fixation of the maximum tolerable error limit/desired confidence level. ii. Selecting a few transactions in each area of audit to be checked. iii. Verification of those selected transactions-100% by verifying the accounting aspects, internal control aspects, documentation and audit trail.

6.	**Internal Control**	The internal control system comprises all the methods and procedures adopted to assist in achieving the objective of efficient conduct of business, ensure adherence to management policies, safeguarding of assets, prevention and detection of frauds and errors, and checking the accuracy and completeness of the accounting records. Internal checks and internal audit are integral parts of the overall internal control system.
7.	**Internal Audit**	"Internal audit is an independent appraisal activity within the organization for the review of financial, accounting and other operations done as a basis of service to the management. It is a managerial control which functions by measuring and evaluating the effectiveness of other controls".

DISTINGUISH BETWEEN

2014 - June [7] (c) (i) Tabulate the differences between a Checklist and Internal control questionnaire. **(4 marks)**

Answer:

Difference Between A Checklist and An Internal Control Questionnaire

Sl. No.	Basis	Check List	Internal Control Questionnaire
(i)	**Point of Time**	It is issued at the commencement of audit and reported back after completion of audit.	It can be issued at any point of time and reported back immediately.

(ii)	**Issued to**	It is issued to the audit staff to be followed by them during audit and reported back at completion.	It is issued to various people at different levels in the organization.
(iii)	**Contents**	It contains instructions to be followed by audit assistants.	It contains questions to be answered by the employees of the organization.
(iv)	**Objective**	It works as a guideline for audit staff so that no area remains unchecked.	This is used to collect the information to know about the internal control system and evaluate the weaknesses therein.

—— Space to write important points for revision ——

2015 - Dec [4] Answer the question:

(a) (i) Distinguish between internal audit and internal check. **(7 marks)**

Answer :

S. No.	Basis	Internal Check	Internal Auditing
1	**Way of Checking**	It operates in routine to doubly check every part of a transaction at the time of occurrence and recording of the same.	In an internal audit system, each component of work is checked.
2	**Objective**	Its objective is to ensure that no one employee has exclusive control over any transaction or group of transactions and their recording in the books.	Its objective is to evaluate the internal control system and to detect frauds and errors.

3	**Point of time**	Methods of recording transactions are devised where work of an employee is checked continuously by correlating it with the work of others.	In an internal audit system, work is checked after it is done.
4.	**Thrust of system**	The thrust of internal control lies in fixing of responsibility and division of work to avoid duplication.	The thrust of internal system is to detect errors and frauds.
5	**Cost Involvement**	It is a part of internal control and a method of division of work, therefore does not add to the cost.	In an internal audit system, work is checked specially; therefore cost is involved in addition to accounting
6	**Repot**	The summary of day to day transactions work as report for the senior.	The internal auditor submits his report to the management

Space to write important points for revision

2018 - Dec [7] (b) Distinguish between Internal Control and Internal Check. **(6 marks)**

DESCRIPTIVE QUESTIONS

2008 - Dec [5] {C} Comment on the following statements based on legal provision :

(c) Auditor can avoid checking of records where good internal check system exist. **(2 marks)**

Answer :

If the statutory auditor is satisfied with internal control system and performance of internal auditor, he often decides to curtail his audit programme by dispensing with checking already done effectively and efficiently by internal control staff. It must however, be mentioned that the statutory auditor is not protected against the liabilities for negligence which may arise due to his reliance on work performed by the internal auditor.

—— Space to write important points for revision ——

2008 - Dec [8] (e) Auditor while undertaking Audit of environment of personal computer should know that inadequate control measures may create serious problems. What are those ? **(2 marks)**

Answer :

Inadequate control measures can create serious problems like

(i) theft, alteration or loss of data

(ii) physical damage to data and the system itself

(iii) reduction in efficacy and efficiency of system.

—— Space to write important points for revision ——

2009 - June [8] (c) How has Internal Audit become an important Management tool- Answer with reasons. **(4 marks)**

Answer :

Internal Audit has become an important management tool for the following reasons :

1. Internal Auditing is a specialized service to look into the standards of efficiency of business operation.
2. Internal Auditing can evaluate various problems independently in terms of overall management control and suggest improvement.
3. Internal Audit's independent appraisal and review can ensure the reliability and promptness of MIS and the management reporting on the basis of which the top management can take firm decisions.
4. Internal Audit system makes sure the internal control system including accounting control system in an organization is effective.

5. Internal Audit ensures the adequacy, reliability and accuracy of financial and operational data by conducting appraisal and review from an independent angle.
6. Internal Audit is an integral part of "Management by System".
7. Internal Audit can break through the power ego and personality factors and possible conflicts of interest within the organization.
8. It ensures compliance of accounting procedures and accounting policies.
9. Internal Auditor can be of valuable assistance to management in acquiring new business, in promoting new products and in launching new projects for expansion or diversification of business.

—— Space to write important points for revision ——

2009 - Dec [5] {C} Comment on the following statements based on legal provisions:

(a) Internal Auditor has a big role to play in preventing fraud. **(2 marks)**

Answer :

The statement is correct: Internal auditing is tantamount to day to day auditing which has a significant role to play in detecting and preventing fraud and other misappropriation of money and other assets. It is independent appraisal activity within the organization for the review of operations as services to the management.

—— Space to write important points for revision ——

2009 - Dec [8] (f) Internal Audit and Internal Control are one and same. Explain. **(2 marks)**

Answer :

No, Internal audit and internal control are different. Internal audit is part of Internal control. Internal control goes beyond financial and accounting aspects.

—— Space to write important points for revision ——

2010 - June [6] (d) Internal Check is said to have some fundamental aims. If so give details. **(4 marks)**

Answer :

- Internal check is a part of the overall internal control system and operates as a built-in device as far as the staff organisation and job allocation aspects of the control system are concerned.
- A system of internal check in accounting implies organisation of system of book keeping and arrangement of staff duties in such a manner that no one person can completely carry through a transaction and record every aspect thereof.
- The essential elements of a goods system of internal check are:
  (i) Existence of checks on the day-to-day transaction.
  (ii) Which operate continuously as a part of the routine system.
  (iii) Whereby the work of each person is either proved independently or is made complementary to the work of another.

Its objective is to prevent and to bring about a speedy detection of frauds, wastes and errors. The system is based on the principle that when the performance of each individual in an organisation, normally and automatically, is checked by another, the chances of occurrence of errors, or their remaining undetected, are greatly reduced; also that, when two or more persons essentially must combine either to receive or to make a payment, there will be lesser possibility of a fraud being perpetrated by them.

—— Space to write important points for revision ——

2010 - Dec [8] (f) Name at least 4 aspects which are being examined by the Auditor while making appraisal and review of Internal Audit/Check.

(2 marks)

Answer :

The internal control, internal audit and internal check are evaluated by the statutory auditor to decide the scope of audit being conducted by him. He can evaluate the system depending upon his judgment, experience and expertise.

Following aspects should be looked into by auditor to appraise the internal control, audit and check system:

1. Documentation and work flow.

2. Organisation structure.

3. Systems of communication.
4. Assessment of performance.
5. Internal Check System.
6. Variance analysis.

—— Space to write important points for revision ——

2011 - June [5] {C} Comment on the following statements based on legal provisions:

(f) Internal Auditing is a function distinct from Authorisation and recording. **(2 marks)**

Answer :

True: It is imperative that the control to be exercised by the organization on the Internal Audit department shall not include the functional area of auditing. If internal audit function is desired to serve as a real management tool it must be allowed to function independently to achieve better efficiency and productivity.

—— Space to write important points for revision ——

2011 - June [6] (g) What is Auditing in depth ? **(2 marks)**

Answer :

Auditing in depth: Auditing in depth means the tracing of a transactions through its various stages from origin to completion, examining the supporting records at each stage and ascertaining whether all the requirements laid down in the system of internal check have been complied with.

—— Space to write important points for revision ——

2011 - Dec [5] {C} Comment on the following statements based on legal provisions:

(f) For an internal audit function to be effective, the same must be independent of the activities to be audited. **(2 marks)**

Answer :

True: In every audit, the auditor and his associates must be completely independent of the auditee. It is important that the control of organization on internal audit department should not include the auditing function and area. Audit is meaningless if it is not independent.

—— Space to write important points for revision ——

2011 - Dec [8] (c) (i) The patterns and degree of internal control may vary between organisation to organisation due to certain variable factors. Name at least six such factors. **(3 marks)**

Answer :

The control environment in an enterprise depends largely on the following factors:

(i) The entity's organizational structure and methods of assigning authority and responsibility (including segregation of duties and supervisory functions).

(ii) The function of the board of directors or the corresponding governing body and its committees, e.g. how strong is the audit committee of the board of directors.

(iii) Management's philosophy and operating style. Does the management believe in having a strong control environment (which implies that the management itself would also be subjected to the discipline of controls)?

(iv) Management's control system including the internal audit function, personnel policies and procedures.

—— Space to write important points for revision ——

2012 - June [5] {C} Comment on the following statements based on legal provisions:

(e) Cost Accountant cannot be Internal Auditor as Internal Audit is related to financial accounting.

(f) Test checks may be applied to all transactions. **(2 marks each)**

Answer :

(e) False: Cost Accountant can also be the internal auditor provided, he is not the Cost Auditor of the same company.

(f) False: Only some transactions are subject to Test Check. Cash/Bank Book and Pass Book should be thoroughly checked.

In section 148 of the Companies Act, 2013,—

(i) in sub-section (3),—

(a) for the words "Cost Accountant in practice", the words "cost accountant" shall be substituted;

(b) in the Explanation, for the words "Institute of Cost and Works Accountants of India", the words "Institute of Cost Accountants of India" shall be substituted;

(ii) in sub-section (5), in the proviso, for the words "cost accountant in practice", the words "cost accountant" shall be substituted.

—— Space to write important points for revision ——

2012 - June [6] (c) Internal Control and Internal Check are same.— Comment. **(4 marks)**

Answer :

- Internal control is the system of control established by the management in order to carry on business in an orderly and efficient manner, ensure adherence to management policies, safeguard assets and completeness of records whereas Internal check is a system of allocation of responsibility, division of work and methods of recording transactions, whereby the work of one employee is checked continuously by another.
- Internal check system is one part of internal control system. Internal control is broader concept as compared to internal check system; it contains many more types of controls other than the internal check system.
- In internal control system, controls other than the internal check system are internal audit system and other non- financial control systems like quality control, purchasing controls, marketing controls etc.

- The essence of internal check system is that the check should be automatic, continuous and objective while the essence of internal control system is in implementation of Internal check and Internal audit.

Way of checking: In internal check system work is automatically checked whereas in internal audit system work is checked specially.

Cost involvement: In internal check system checking is done when the work is being done. Mistake can be checked at an early stage in internal check system.

Thrust of system: Thrust of internal check system is to prevent the errors and whereas the thrust of internal audit system is to detect the errors and frauds.

Time of checking: In internal check system checking is done when the work is being done whereas in internal audit system work is checked after it is done. Mistakes can be detected at an early stage in internal check system.

—— Space to write important points for revision ——

2013 - Dec [6] (b) (ii) What are the limitations of Internal Control?

(4 marks)

Answer:

Limitations of Internal Control :

(i) Organization Structure	Deficiencies in organizational structure make internal control ineffective.
(ii) Size of the Organization	Small organizations have very low levels of internal control, which are almost negligible due to more interferences by owners and management.
(iii) Unusual Transactions	The internal control procedures, normally fail to keep a check on unusual , transactions.
(iv) Costly	The implementation of internal control procedures and processes involves incurring cost in terms of time, effort and resources.

(v) Abuse of Power	Members at the top-level management may override / interfere with control.
(vi) Collusion of two or more people	It may lead to internal controls being over-ridden.
(vii) Obsolescence	Control system may become redundant with passage of time if not updated with change in the size and nature of business.
(viii) Frequent follow-up measures	Follow-up procedures need to be frequent to ensure its effectiveness, which is extremely time consuming.

—— Space to write important points for revision ——

2013 - Dec [7] (c) (i) State the areas of operations of Internal Audit and its features. **(8 marks)**

(ii) What is cut off procedure? Explain its significance in the context of Auditing. **(4 marks)**

Answer:

(i) According to the Institute of Internal Auditors, internal audit involves five areas of operations :

(i) **Reliability and integrity of financial and operating information**	Internal auditors should review the reliability and integrity of financial and operating information and the means used to identify, measure, classify and report such information.

(ii) **Compliance with laws, policies, plans, procedures and regulations**	Internal auditor should review the systems established to ensure compliance with those policies, plans and procedures, laws and regulations which could have a significant impact on operations and reports and should determine whether the organization is in compliance thereof.
(iii) **Safeguarding of Assets**	Internal auditors should verify the existence of assets and should review the means of safeguarding assets.
(iv) **Economic and efficient use of resources**	Internal auditor should ensure the economic and efficient use of resources available.
(v) **Accomplishing the established objectives and goals for operations**	Internal auditor should review operation or programmes to ascertain whether results are consistent with established objectives and goals and whether the operations or programmes are being carried out as planned.

Features of Internal Audit :

(a) It is an independent appraisal activity within the organization.

(b) It can be conducted by the staff of the entity or by an independent professional appointed for that purpose.

(c) It is conducted for review of accounting, financial and other operations and controls established within an organization.

(d) It is conducted as a service to the organization and is not a part of the organization.

(e) It intends to furnish the analysis, appraisal, suggestions and information concerning the activities reviewed to the management.

(f) Internal auditing functions as a continuous effort for promoting effective control at cost reasonable cost.

(ii) Cut off procedure would mean a procedure adopted to give a delink between two time periods prompted by accounting procedure or a legal requirement.

Example: Date of accounting closing to ascertain the profit or loss - for accounting procedure.

Ascertain the profits between pre and post incorporation periods - legal requirement. Possible areas where cut off procedure has significant impact are given below:

(a) Accounts receivable and accounts payable these are the most susceptible to recording of transactions in the inappropriate accounting period.

(b) Purchase bills or raising of sales invoice which requires to be linked to the accounting period for determining the profit or loss of the period.

It is the auditor's duty to examine cut off points and ensure that the transactions are recorded in the relevant period in which the commercial transactions relate or take place.

Space to write important points for revision

2014 - June [5] {C} Answer the following:

(a) What is test checking in Audit Work? **(2 marks)**

Answer:

Test Checking

Test checking is concerned with selecting and examining a representative sample from a large number of similar items. There is no hard and fast rule of selecting item for the test checking. The justification for the test checking lies in the theory of probability which states that a sample selected from a series of items will tend to exhibit the same characteristics as present in the population, i.e. full series of items. While test checking the following aspects need to be considered:

(i) Presentation and disclosure.
(ii) Adherence to the generally accepted accounting practices.
(iii) Compliance with the statutory requirements.

(iv) Existence of errors and frauds.
(v) Arithmetical accuracy.
(vi) Materiality of the items involved.

—— Space to write important points for revision ——

2015 - June [1] Answer the question:
(i) What do you understand by test checking in Audit Work? **(2 marks)**

Answer:

Please refer 2014 - June [5] {C} (a) on page no. 371

—— Space to write important points for revision ——

2015 - June [4] (a) Comment on the following:
(iii) There is no need to design better internal controls in an EDP or computerised system. **(4 marks)**
(iv) Internal check is a part and parcel of internal control. **(4 marks)**

Answer:

(iii) This is **not true** Computerization, automatically implies a constant review of the system to increase the efficiency in producing reliable data. As a result the internal controls are normally better designed under computerized systems. Automatic checks are instituted and the responsibilities of various people are clearly stated.

Answer:

(iv) **Yes** Internal control is a plan of organization and covers all methods and procedures adopted by management to assist its objectives of ensuring the orderly and efficient conduct of business, it includes physical and financial control and covers internal check and internal audit also. Hence, internal check is part of internal control.

—— Space to write important points for revision ——

2016 - June [3] Answer the question:
(b) What is Test Checking? **(2 marks)**

Answer:

Please refer 2014 - June [5] {C} (a) on page no. 371

—— Space to write important points for revision ——

2016 - Dec [10] (a) Why and how is Internal Audit necessary to the Management? **(8 marks)**

Answer:

The need for internal audit has increased in demand due to the following reasons:

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

Internal Audit has become an important management tool for the following reasons:

(i) Internal audit ensures compliance of Companies (Auditors Report) Order, 2015.
(ii) It ensures compliance of accounting standards and policies.
(iii) It ensures reliability of MIS through internal audit's independent appraisal and review.
(iv) It looks into the standard of efficiency of business operation.
(v) It can evaluate various problems independently and suggest improvement.
(vi) This system makes the internal control system effective.
(vii) It ensures the adequacy, reliability, accuracy and understandability of financial and operational data.
(viii) It performs as an integral part of 'Management by System'.
(ix) It can add valuable assistance to management in acquiring new business, promoting new products and expansion or diversification of business etc.

—— Space to write important points for revision ——

2017 - June [7] (b) 'Checklist and Internal Control Questionnaire are not the same.' – Discuss. **(4 marks)**

Answer:

Difference Between a Checklist and Internal Control Questionnaire

S. No.	Basis	Check List	Internal Control Questionnaire
i.	**Point of Time**	It is issued at the commencement of audit and reported back after completion of audit.	It can be issued at any point of time and reported back immediately.
ii.	**Issued to**	It is issued to the audit staff to be followed by them during audit and reported back at completion.	It is issued to various people at different levels in the organization.
iii.	**Contents**	It contains instructions to be followed by audit assistants.	It contains questions to be answered by the employees of the organization.
iv.	**Objective**	It works as a guideline for audit staff so that no area remains unchecked.	This is used to collect the information to know about the internal control system and evaluate the weaknesses therein.

—— Space to write important points for revision ——

2017 - Dec [7] (b) 'An auditor applies various techniques to evaluate the internal control system of an organization'—Discuss. **(4 marks)**

Answer:

Techniques for Evaluation of Internal Control System

(i) Narrative Record: It is a complete and exhaustive description of the system. It is appropriate in circumstances where a formal control system is lacking, like in the case of small businesses. Gaps in the control system are difficult to identify using a narrative record.

(ii) **Check List:** It is a series of instructions that a member of the audit staff is required to follow. They have to be signed/ initialed by the audit assistant as proof for having followed the instructions given. A specific statement is required for every weakness area.

(iii) **Flow Chart:** It is a pictorial representation of the internal control system depicting its various elements such as operations, processes and controls, which help in giving a concise and comprehensive view of the organization's working to the auditor. The internal control evaluation process becomes easier through a flow chart as a broad picture of all the controls involved can be gauged in a glimpse.

(iv) **Internal Control Questionnaire:** This is the most widely used method for collecting information regarding the internal control system and involves asking questions to various people at different levels in the organization. The questionnaire is in a pre- designed format to ensure collection of complete and all relevant information. The questions are formed in a manner that would facilitate obtaining full information through answers in "Yes" or "No".

—— Space to write important points for revision ——

2018 - June [7] (b) "Internal Audit is an important tool for the management." - Discuss. **(6 marks)**

Answer:

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

(a) Internal Audit ensures compliance of Companies (Auditors Report) Order, 2016.

(b) It ensures compliance of accounting standards and policies.

(c) It ensures reliability of MIS through internal audit's independent appraisal and review.

(d) It looks into the standard of efficiency of business operation.

(e) It can evaluate various problems independently and suggest improvement.

(f) This system makes the internal control system effective.

(g) It ensures the adequacy, reliability, accuracy and understandability of financial and operational data.
(h) It performs as an integral part of 'Management by system'.
(i) It can add valuable assistance to management in acquiring new business, promoting new products and expansion or diversification of business etc.

—— Space to write important points for revision ——

Repeatedly Asked Questions		
No.	**Question**	**Frequency**
1	What is test checking? 14 - June [5] (a), 15 - June [1] (i), 16 - June [3] (b)	3 Times
2	'Checklist and Internal Control Questionnaire are not the same.' – Discuss. 14 - June [7] (c) (i), 17 - June [7] (b)	2 Times

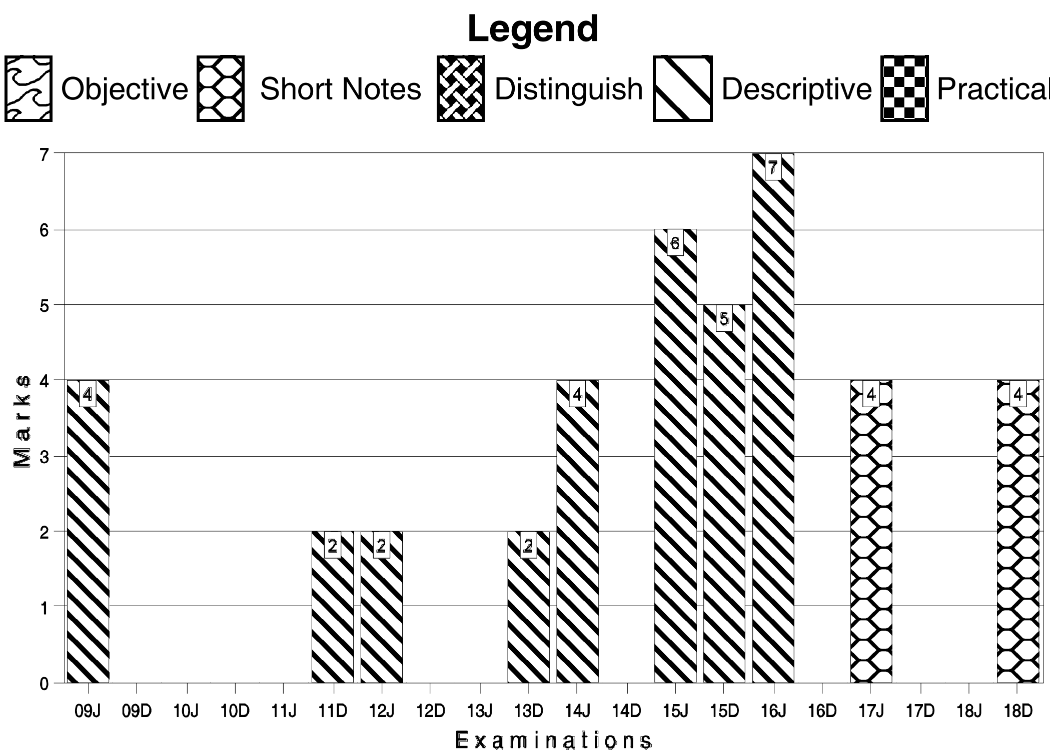
Table Showing Marks of Compulsory Questions										
Year	**14 J**	**14 D**	**15 J**	**15 D**	**16 J**	**16 D**	**17 J**	**17 D**	**18 J**	**18 D**
Descriptive	2									
Total	2									

10 VOUCHING AND VERIFICATION

THIS CHAPTER INCLUDES

• Meaning of Voucher • Types of Vouchers • Meaning of Vouching • Teaming and Leading/Lapping	• Audit Receipt • Audit Expenditure • Verification of Assets and Liabilities.

Marks of Objective, Short Notes, Distinguish Between, Descriptive & Practical Questions



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CHAPTER AT A GLANCE

S. No.	Topic	Important Highlights
1.	**Voucher**	A voucher is a piece of substantiating evidence, in the form of a written record of expenditure, disbursement, or completed transaction. **Examples of types of vouchers:** Cash Memo, Sale Invoice, Purchase Requisition Slip, Purchase Invoice, Gate Keeper's Note, Bank Paying Slip, Bank Statements, Minutes Book, etc.
2.	**Types of Vouchers**	i. **Original and Collateral Vouchers:** Original vouchers are called primary vouchers, and their copies or supporting documents are called collateral vouchers. ii. **Internal and External Vouchers:** Vouchers may generate inside the company (internal vouchers) or outside the company (external vouchers). iii. **Missing Vouchers:** A missing voucher can be any of the following: missing Cash Memo, missing page in a Cash Collection Statement, missing inward challan for goods received, missing Inspection Report for material, missing TDS Certificate for tax deductions at source, missing Resolution to authorize increase in borrowing power by the company, missing Bank Statement for a day or a month, etc.

3.	**Vouching**	"Vouching is the examination by the auditor of all documentary evidences, which are available to support the authenticity of the transaction entered in the client's record." - Spicer and Pegler.
4.	**Teeming & Lading/ Lapping**	Teeming and Lading is a commonly followed method of misappropriation of cash by concealing cash shortages and covering them through recoveries from another customer. It is not uncommon in case of cash collections if the internal check and internal control on cash transactions are not proper.
5.	**Audit of Receipts**	(1) Cash Sales (2) Sale of Assets
6.	**Audit of Expenditure**	**(1) Transactions with Directors** i. **Compliance with Sec 188 of Co. Act, 2013:** Check that any contract entered into by the director or his relatives etc. with the company is in accordance with the provisions of Section 188 of the Companies Act, 2013. ii. **Disclosure of interest by Director:** Every director of a company who is directly or indirectly, concerned or interested in a contract or agreement entered or proposed to be entered into with the company, must disclose his interest to the company at the Board meeting (Section 184). iii. **Compliance with Sec 197 of Co. Act, 2013:** The remuneration paid to the directors of public companies or the private companies which are the

		subsidiaries of public companies should be in accordance with the provisions of Section 197 of the Companies Act, 2013. **(2) Payment for Acquisition of Assets** i. **Authorization:** The payment for acquisition of assets should be made under proper authorization and be duly supported by receipt for amount paid. ii. **Ownership:** Check the title deeds in case of purchase of immovable properties. Also ensure that the ownership in case of the moveable asset has been registered in the name the purchaser. iii. **Existence:** The auditor should also verify the existence, value and the title of the assets acquired. iv. **Compliance with Sec 179 of Co. Act, 2013:** In case of a company, ensure that the provisions of Section 179 of the Companies Act, 2013 have been complied with. v. **Capitalization of Assets:** Check that the cost of the asset purchased has been properly capitalized in the books of account. Thus, the amounts paid to bring the asset to their present condition or location and incurred upto the asset being put into use should be capitalized. Further such taxes (e.g. CENVAT) which are recoverable from the authorities shall not form the part of cost of the asset.

7.	**Verification of Assets and Liabilities**	• Only the vouching to ascertain the arithmetical accuracy is not enough, the auditor is supposed to go beyond that while doing audit. • In all types of transactions vouching is must, but in case of capital items the auditor is required to go beyond that and verify the physical existence and evaluate the assets and liabilities to arrive at true and fair view of the state of affairs of business.

SHORT NOTES

2017 - June [10] Write a short note:
(c) Audit of Inventories **(4 marks)**
Answer:
The following features of inventories have an impact on the related audit procedures:
(i) By their very nature, inventories normally turn over rapidly.
(ii) Inventories are susceptible to obsolescence and spoilage. Further, some of the items of inventory may be slow-moving while others may follow a seasonal pattern of movement.
(iii) Inventories are normally movable in nature, although there may be some instances of immovable inventories also, e.g., in the case of an entity dealing in real-estate.
(iv) All the items of inventory may not be located at one place but may be held at different locations such as factories and warehouses, or with third parties such as selling agents.

(v) The individual items of inventory may not be significant in value, but taken together, they normally constitute a significant proportion of total assets and current assets of manufacturing, trading and certain service entities.

(vi) Physical condition (e.g., stage of completion of work-in-process in certain industries) and existence of certain items of inventories may be difficult to determine.

(vii) Valuation of inventories may involve varying degrees of estimation, including expert opinions, e.g., in the case of Jewellery.

—— Space to write important points for revision ——

2018 - Dec [10] Write short note:

(b) Physical verification of Inventory and Auditor's responsibility thereof **(4 marks)**

DESCRIPTIVE QUESTIONS

2009 - June [6] (b) State in brief the important points that should be considered by an Auditor while conducting vouching. **(4 marks)**

Answer:

(A) It is important to note that in vouching of payments, the auditor does not merely seek proof that money has been paid away, but keeps into consideration the following relevant points:

i. Checking the relevant documentary evidence: It helps in assuring the genuineness of the transaction and accuracy in its recording.

ii. Checking the authority on the basis of which the entry has been made: It helps in assuring that the transaction has actually occurred.

iii. Confirming that the amount mentioned in the voucher has been posted to the appropriate account: It helps in assuring the proper classification according to accounting policies and practices.

iv. Checking that complete disclosure regarding the nature of the transaction is made.

(B) **Thus, the general principles of vouching as well as auditing can be listed as under:**
  (i) Genuineness
  (ii) Accuracy
  (iii) Authenticity
  (iv) Authorization
  (v) Classification
  (vi) Disclosure

—— Space to write important points for revision ——

2011 - Dec [5] {C} Comment on the following statements based on legal provisions (no mark for wrong reasons or justification):

(c) Vouching can be avoided. **(2 marks)**

Answer :

False. The vouching is fundamental stone on which accounting and auditing stand. Vouching is very helpful in detecting errors and frauds. It also checks various compliances as required by law. Thus vouching can not be avoided in auditing.

—— Space to write important points for revision ——

2012 - June [5] {C} Comment on the following statements based on legal provisions:

(b) Verification of assets and liabilities is very important function. **(2 marks)**

Answer :

(b) Correct. The value, ownership, title and existence of various assets and liabilities are to be checked and verified by the auditor before the submission of his report. The verification is very important function of auditing.

—— Space to write important points for revision ——

2013 - Dec [5] {C} Answer the following:

(c) Describe 'Voucher' and 'Vouching' **(2 marks)**

Answer:

Voucher : A Voucher is a piece of substantiating evidence, in the form of a written record of expenditure, disbursement, or completed transaction.

Vouching : Vouching is the examination by the auditor of all documentary evidences, which are available to support the authenticity of the transaction entered in the client's record.

—— Space to write important points for revision ——

2014 - June [6] (or) (b) **(ii)** What are the objects of verification of Assets and liabilities. **(4 marks)**

Answer :

Verification of assets and liabilities is done with the following objects:

(i) To know whether the Balance Sheet exhibits a true and fair view of the State of affairs of the business.
(ii) To find out whether the assets were in existence.
(iii) To find out the ownership and title of the assets.
(iv) To show correct valuation of assets and liabilities.
(v) To verify the arithmetical accuracy of the books of accounts.
(vi) To ensure that the assets have been recorded properly.
(vii) To detect frauds & errors, if any
(viii) To find out whether there is an adequate internal control regarding acquisition, utilization and disposal of assets.

—— Space to write important points for revision ——

2015 - June [1] Answer the question:

(j) What is vouching? **(2 marks)**

Answer:

"Vouching is the examination by the auditor of all documentary evidences, which are available to support the authenticity of the transaction entered in the client's record." - Spicer and Pegler.

The act of examining all documentary evidences (vouchers) is referred to as vouching. Its basic objective is to establish the authenticity of the transactions recorded in the primary books of account. Vouching is said to be "the essence of auditing" or may be termed as the "backbone of auditing" .

—— Space to write important points for revision ——

2015 - June [4] Answer the questions:

(c) (iv) What do you understand by Teeming and Lading with respect to misappropriation of cash? Explain the procedure that auditor has to follow for its timely detection. **(4 marks)**

Answer:

Teeming & Lading is a commonly followed method of misappropriation of cash by concealing cash shortages and covering them through recoveries from another customer. It is not uncommon in case of cash collections if the internal check and internal control on cash transactions are not proper. E.g., a salesman recovers ₹ 10,000 from customer C and misappropriates the same, but to conceal the misappropriation, he declares ₹ 10,000 received later from another customer D as received from C so that the balance of C confirms to the client's debtor list, and so on for recovery from E of same amount declared as from D.

Teeming and lading may not amount to fraud, but negligence on the part of the management and weaknesses in internal checks or controls may lead to substantial amounts being misappropriated by the cashier. This may result in a huge loss if he is not in a position to clear the debts when caught.

The auditor has to follow the following procedure for timely detection of teeming and lading:

(i) Ascertain if the Cash Memos are consecutively numbered, and the dates, name and amount as per the Daily Summary reconcile with relevant cash receipt records.

(ii) Reconcile individual cash amounts as per receipts with records in the Rough Cash Book.

(iii) Reconcile the receipts as recorded in the Rough Cash Book, main Cash Book, pre-numbered Cash Memos, with counterfoils of the pay-in-slips.

(iv) Ensure whether cash receipts are deposited in the bank on a timely basis.

(v) Examine the Debtors Ledger, especially entries showing part payments, to satisfy that the debtors concerned have indeed made part payments.

(vi) Confirmations may be obtained from the debtors from time to time.

2015 - Dec [4] Answer the question:
(a) (ii) State the main objects of verification of assets and liabilities.
(5 marks)

Answer:

Please refer 2014 - June [6] (Or) (b) (ii) on page no. 384

Space to write important points for revision

2016 - June [10] (b) What are the special considerations to be kept in the mind during vouching? **(7 marks)**

Answer:

Please refer 2009 - June [6] (b) on page no. 382

Space to write important points for revision

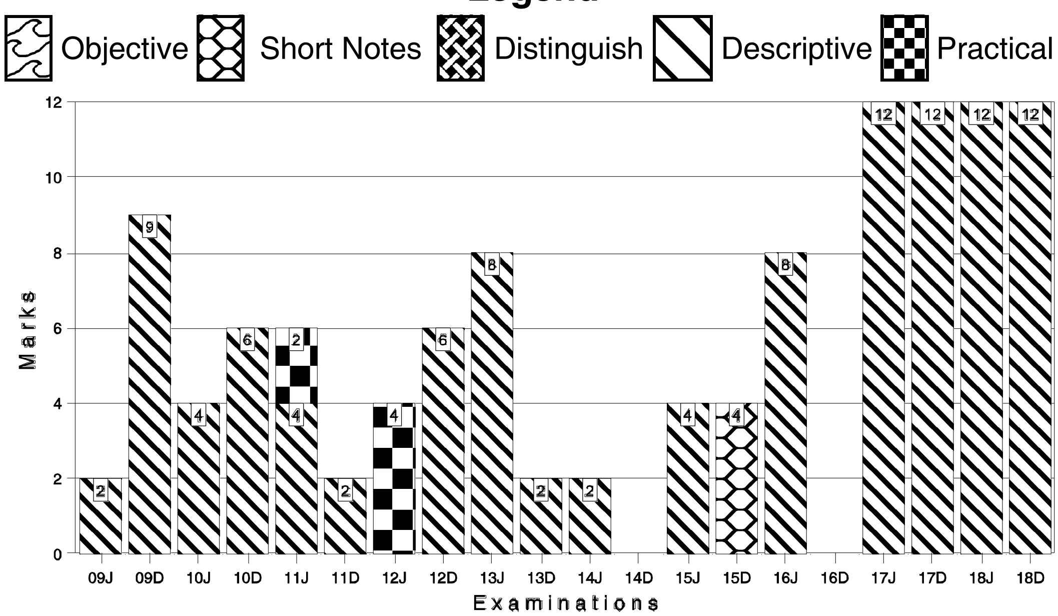
11 COMPANY AUDITOR

THIS CHAPTER INCLUDES

- Appointment of Auditors
- Qualification of Company Auditor
- Disqualification of Company Auditor
- Manner of Rotation of Auditors by the Companies on expiry of their term
- Removal of Auditor
- Registration of Auditor
- Remuneration of Statutory Auditors
- Power and Duties of Auditors
- Auditor not to render certain services
- Audit Committee

Marks of Objective, Short Notes, Distinguish Between, Descriptive & Practical Questions

Legend



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CHAPTER AT A GLANCE

S. No.	Topic	Important Highlights
1.	**Object of audit**	• The main object of audit is to ensure that the statement of accounts of the relevant financial year truly and fairly reflect the state of affairs of the company. • Audit also provides a moral check on those who are entrusted with the task of running business and of keeping and maintaining the books of account of the company. • An audit of accounts is conducted with two-fold purpose: (i) detection and prevention of errors; (ii) detection and prevention of fraud.
2.	**Appointment of auditors**	• The Act provides that every company shall, at each annual general meeting appoint an auditor or auditors to hold office from the conclusion of that meeting until the conclusion of next annual general meeting. • The Act also provides for methods of appointment of auditors along with their qualifications and disqualifications.
3.	**Auditor's report**	The Act provides that the auditor's report shall be signed only by the person appointed as an auditor of the company.
4.	**Appointment of first auditor**	***Appointment of first auditor in case of every company except government company or company owned/ controlled by Central Government/State Government/Central Government and State Government [Section 139(6)] :***

		• The first auditor of a company, other than a Government company, shall be appointed by the Board within thirty days from the date of registration of the company and if the Board fails to appoint such auditor, it shall inform the members of the company and the members shall make the appointment of first auditor within ninety days of information at an extra ordinary general meeting and such auditor shall hold office till the conclusion of the first annual general meeting. • Appointment of first auditor shall be made by Comptroller and Auditor-General of India (CAG) within sixty days of registration of the company. If CAG fails to appoint the first auditor within given time then Board of such company shall appoint first auditor within next 30 days. • If Board fails to appoint the first auditor within given time then it shall inform to members and members shall make the appointment of first auditor within 60 days of information at an extra ordinary general meeting. • The First Auditor shall hold office till the conclusion of first AGM.
5.	**Appointment of auditors at AGM (first AGM and subsequent AGM)**	Appointment of auditor shall be made by members at First AGM and every subsequent 6th AGM. At the first AGM, every company shall appoint an individual or a firm as an auditor. The auditor so appointed shall hold office from the conclusion of first AGM till the conclusion of 6th AGM.

6.	**Rotation of auditor**	*In case of an individual as auditor:* (a) No individual shall be appointed or re-appointed as auditor for more than 1 term of 5 consecutive years. (b) An individual auditor, who has completed his term of 5 consecutive years, shall not be eligible for re- appointment as auditor in the same company for 5 years from the date of completion. *In case of a firm as an auditor:* (a) No audit firm shall be appointed or re-appointed as auditor for more than 2 terms of 5 consecutive years. (b) An audit firm which has completed its 2 terms of 5 consecutive years, shall not be eligible for re-appointment as auditor in the same company for 5 years from the completion of such terms (c) If any firm/LLP which has one or more partners who are also partners in the outgoing audit firm/LLP cannot be appointed as auditors during the 5 year period.
7.	**Appointment of an auditor in casual vacancy**	• **Casual vacancy arising by other than resignation:** Whereas casual vacancy is arising by other than resignation then vacancy shall be filled the Board within 30 days. • **Casual vacancy arising due to resignation:** If casual vacancy is arising due to the resignation of auditor, it shall be filled within 30 days by the Board of Directors, and the appointment made by the Board shall be approved in a general meeting convened within 3 months from the date of recommendation of the Board.

8.	**Appointment of auditor in Casual Vacancy in case of Govt. Company**	Casual vacancy shall be filled by the CAG within 30 days. If CAG fails to fill the vacancy within given time then BOD shall fill the vacancy within next 30 days.
9.	**Auditors not to render certain cases**	(a) accounting and book keeping services; (b) internal audit; (c) design and implementation of any financial information system; (d) actuarial services; (e) investment advisory services; (f) investment banking services; (g) rendering of outsourced financial services;
10	**Audit Committee Section 177**	Constitution of an Audit committee is mandatory for the; (i) Every listed Public Company; and (ii) Such other classes of the companies, as may be prescribed. As per the Rule 6 of the Companies (Meetings of the Board and its Power) Rules, 2014 following class of the companies have been prescribed for this purpose; (i) All public companies with a paid up share capital ₹ 10 Crore or more; (ii) All Public Companies having turnover of ₹ 100 Crore or more; (iii) All Public Companies having in aggregate, outstanding Loans, or borrowings and debentures or deposits exceeding ₹ 50 Crore or more. **In Section 177 of the Companies Act, 2013,—** (i) in sub-section (1), for the words "every listed company", the words "every listed public company" shall be substituted;

		(ii) in sub-section (4), in clause (iv), after the proviso, the following provisos shall be inserted, namely:— **Provided further that** in case of transaction, other than transactions referred to in Section 188, and where Audit Committee does not approve the transaction, it shall make its recommendations to the Board: **Provided also that** in case any transaction involving any amount not exceeding one crore rupees is entered into by a director or officer of the company without obtaining the approval of the Audit Committee and it is not ratified by the Audit Committee within three months from the date of the transaction, such transaction shall be voidable at the option of the Audit Committee and if the transaction is with the related party to any director or is authorised by any other director, the director concerned shall indemnify the company against any loss incurred by it: **Provided also that** the provisions of this clause shall not apply to a transaction, other than a transaction referred to in Section 188, between a holding company and its wholly owned subsidiary company.

SHORT NOTES

2015 - Dec [4] Answer the question:
(a) (iii) Write a note on duties of a Company auditor.

(4 marks)

Answer:

Duties of the company auditor are as follows:

(i) Whether the loans & advances made by the company on the basis of security have been properly secured & the terms are not against the interest of the company or its members;

(ii) Whether the transactions merely representing book-entries as recorded in the books are not against the interest of the company;

(iii) The securities have been sold by Company other than Banking Investment Company, at a price-less than purchase price;

(iv) Whether loans & advances made by the Company have been shown as deposits.

(v) Personal expenses have been charged to revenue account;

(vi) Whether cash has actually been received in respect of any shares shown in the books to have been allotted for cash.

(vii) Whether the position as stated in the books is correct, regular and is not misleading.

—— Space to write important points for revision ——

DESCRIPTIVE QUESTIONS

2008 - Dec [7] (d) Statutory Auditor can be appointed as Internal Auditor of the same company for the same period. – Do you agree ? **(2 marks)**

Answer :

No. The statutory auditor cannot be appointed as an internal auditor for the same company for the same period. The independence of auditor will not be there.

—— Space to write important points for revision ——

2008 - Dec [8] (f) Audit Committee is only luxury to the company. Do you agree ? **(2 marks)**

Answer :

False: Audit committee is not a luxury and it serves as communication channel among various departments and has to interact with management, internal auditor, statutory auditor and the public.

—— Space to write important points for revision ——

2009 - June [8] (d) (i) Ray & Bose, Chartered Accountants, who were appointed as Auditor for Financial Year 2008-09 were removed during the month of December 2008. Whether the said Auditor can claim any compensation?

(ii) Statutory Auditor of the company is legally, bound to attend the AGM of the company. State correct position. **(1 + 1 = 2 marks)**

Answer :

(i) The Auditor is entitled to full year remuneration. It is immaterial whether he is removed before the expiry of his term or not.

Answer :

(ii) **Section 146** of **Companies Act, 2013**, provides that the auditor shall be entitled to attend any general meeting and to be heard at any general meeting which he attends on any part which concerns him as auditor. He is empowered to speak about company's accounts. Whether he exercises this right is up to him.

—— Space to write important points for revision ——

2009 - Dec [5] {C} Comment on the following statements based on legal provisions:

(d) M/s. S.S. & Associates, Chartered Accountants who were appointed as Auditor by the members in A.G.M. refuses to accept the appointment. In such cases Central Govt. only can appoint another Auditor. **(2 marks)**

(h) Auditor has no liability to the third party as there is no contract between Auditor and third party. Do you agree? **(4 marks)**

Answer :

(d) When the appointed auditors refuse to take up the assignment, the company should take recourse to **Section 139** and hold an extra ordinary general meeting for appointment of auditor, as Board of Director has no powers to appoint auditor in place of auditor resigned. The refusal of auditor would be tantamount to assuming that he has resigned.

Answer:

(h) The statement is incorrect. Liabilities to third party:

(i) No doubt there is no privity of contract, the third party can hold the auditor liable for any **fraud.**

(ii) Generally, it appears that as there is no **privity** of contract between auditor & third party he cannot be held liable and as he is never appointed by third party he has nothing to do with such a party & this was confirmed by the case of ***Le Lievre & Dennes VS Gould 1893.***

(iii) Auditor has moral responsibility to third party.

(iv) If any body relying on the audited statement of a company, takes any decision & suffers any loss because such statements were false, the auditors will be responsible to them.

(v) If auditor had authorized the issue of a prospectus containing Misleading statements, he would be held liable for damages to third party, which has purchased the shares of the company on the strength of such a misleading statement even though there might not have been any privity of contract between the auditor & the shareholder.

—— Space to write important points for revision ——

2009 - Dec [7] (b) Bright Ltd. was incorporated on 1.6.09. Mr. E who was related to the Chairman of the Company was appointed as Auditor of the company by the Director in its meeting held on 14.7.09. Whether the appointment was valid? **(3 marks)**

Answer :

- **Section 141** of **Companies Act, 2013** deals with qualifications and disqualifications of statutory auditor of the company.
- This section does not say that a relative to the chairman of the company can not be appointed as statutory auditor of the company.

- Regarding the second part, it is clear that Mr. E is first auditor of the company.
- Appointment of auditor is governed by **Section 139**, which states that first auditor should be appointed by the Board of Director, within one month of the registration of the company.
- The company was incorporated on 1.6.09 and first auditor should have been appointed on or before 1.7.09 which is not so in the cited case. Hence his appointment is invalid.

—— Space to write important points for revision ——

2010 - June [5] {C} Comment on the following statements based on legal provisions:

(b) Auditor is not liable in case of honorary Audit. **(2 marks)**

Answer :

(b) False : The auditor has to conduct and conclude his audit as per the directives and guidelines given in the **Companies Act, 2013.** The quantum of fees does not decide the scope, standard or strength of audit. The auditor's liability exists for the audit conducted by him. It does not matter whether he has conducted the audit with fees or on honorary basis.

—— Space to write important points for revision ——

2010 - June [6] (e) Articles of Association of ABC Ltd. provides that Fixed Deposit Receipts should not be shown to the statutory Auditor. Accordingly Manager (Accounts) refused to show. State the legality. **(2 marks)**

Answer :

Restriction of the rights of statutory auditor : To enable the statutory auditor to perform the duties, certain rights are vested in him vide **Section 143** of the **Companies Act, 2013**, viz.

(i) Right to access the books and records at all times,

(ii) Right to acquire information and explanation from officers.

(iii) Right to attend AGM.

—— Space to write important points for revision ——

2010 - Dec [5] {C} Comment on the following statements based on legal provisions:

(b) Auditor, on receipt of appointment letter, is to inform to Central Government within 45 days. **(2 marks)**

(c) The Auditor has nothing to do with inherent or control risk. **(2 marks)**

(d) Auditor demanded notice for Annual General Meeting but the Director of the Company refused. **(2 marks)**

Answer :

(b) False. Auditor should inform the ROC within 30 days of receipt of appointment.

Answer:

(c) True that the auditor has nothing to do with the inherent or control risk however, he should decide the scope of his audit work depending upon the merits of every case. He has to take all measures to bring the audit risk to the minimum possible.

Answer:

(d) **Section 146** of **Companies Act, 2013**, provides that the auditor shall be entitled to attend any general meeting and to be heard at any general meeting which he attends on any part which concerns him as auditor. He is empowered to speak about company's accounts. Whether he exercises this right is up to him. He has right to receive all notices to general meeting.

—— Space to write important points for revision ——

2011 - June [5] {C} Comment on the following statements based on legal provisions:

(c) Only officer on Special duty is called company Talent—do you agree? **(2 marks)**

Answer :

False. Officer on special duty is one of the company-talents. Company talent includes (i) an administrative staff (ii) an audit committee (iii) outside management consultant (iv) other consultants.

—— Space to write important points for revision ——

2011 - June [6] (c) The statutory Auditor submitted his report on purchases relying on the verification Report carried on by the Internal Auditor. Whether this was proper. **(2 marks)**

Answer :

Audit reports of the statutory auditor is his sole responsibility and the responsibility is not by any means reduced, because of such reliance. Hence there is professional negligence in the present case.

—— Space to write important points for revision ——

2011 - Dec [7] (d) Statutory auditor cannot avoid the generally accepted fundamental assumption underlying the preparation of financial statements. State such assumptions and actions to be taken if not followed. **(2 marks)**

Answer :

Generally accepted fundamental accounting assumptions are :

(i) **Going concern :** the enterprise is normally viewed as continuing its operation for the foreseeable future. It is assumed that the enterprise has neither the intention nor the necessity of liquidation or curtailing materially the scale of its operations.

(ii) **Consistency :** It is assumed that accounting policies will be consistent from one period to another.

(iii) **Accrual :** Revenues & cash are recognized as they are earned or incurred.

Disclosure is necessary with details if these are not followed.

—— Space to write important points for revision ——

2012 - Dec [5] {C} Comment on the following statements based on legal provisions:

(c) Auditor certified a statement in the Prospectus which was subsequently found misleading. Auditor certified such statement as per advice of management. Hence Auditor has no liability. **(2 marks)**

Answer :

As per **Section 35** of **Companies Act, 2013**, an auditor is liable for certifying misleading statement in the prospectus and he has to compensate for damages suffered by the person.

—— Space to write important points for revision ——

2012 - Dec [6] (b) State the Auditors' duties towards shareholders in respect of loan given by the Company.

(g) At the AGM, a resolution was passed by all the Shareholders restricting some of the powers of a Cost Auditor. State the validity of the Resolution. **(2 marks each)**

Answer :

(b) Auditors' duties towards shareholders in respect of loan given by the company is to inquire :-

(i) Whether the loans are properly secured and the terms are not against the interest of the company.

(ii) Whether short term or long term loans are properly classified under current or Non Current Assets.

(iii) Whether loans made by the company have been shown as fixed assets.

(iv) Whether payment of Principal and interest are regular.

(v) Whether proper statutory registers are maintained.

(vi) To see that proper approval has been taken before giving any loan to director.

Answer:

(g) The **Company's Act, 2013** states the duties, responsibilities, qualifications and liabilities of the auditors in its **Sections 148** and **143.** Shareholders can not do any thing in any meeting regarding the **Companies Act, 2013**. Resolution passed by shareholders can not be imposed on provisions given in the Act. As such it is ultra vires and therefore invalid for the shareholders to restrict, curtail, extend or amend the duties and responsibilities of auditors as given in the **Companies Act, 2013.**

—— Space to write important points for revision ——

2013 - June [6] (b) Cost Accountant are appointed by Share-holders in General Meeting. Is the appointment valid? Comment. **(2 marks)**

(d) Sec. 177 of Companies Act, 2013 lays down the Auditor's duty as a member of Audit Committee. **(2 marks)**

Answer :

(b) A Cost Accountant is not qualified for appointment as auditor of company even of a private limited company.

In ection 148 of the Companies Act, 2013,—

(i) in sub-section (3),—

(a) for the words "Cost Accountant in practice", the words "cost accountant" shall be substituted;

(b) in the Explanation, for the words "Institute of Cost and Works Accountants of India", the words "Institute of Cost Accountants of India" shall be substituted;

(ii) in sub-section (5), in the proviso, for the words "cost accountant in practice", the words "cost accountant" shall be substituted.

Answer:

(d) This statement is false. Auditor is not a member of Audit Committee. He has no right to vote. However he shall attend and participate at the meetings of the Audit Committee **(Sec. 177)**.

—— Space to write important points for revision ——

2013 - June [7] (b) Statutory Auditor can not be Internal Auditor of the company — Offer your views. **(2 marks)**

(e) In addition to normal audit, the Statutory Auditor receives INR 50,000 for rendering services as Taxation Advisor during 2012-13. What type of disclosure is required under Schedule III of Companies Act, 2013? **(2 marks)**

Answer :

(b) This statement is true.

The statutory auditor is required to comment on the report of Internal Audit and performance of the Internal Auditor. If the statutory auditor also works as Internal Auditor, it will not be possible for him to give an independent and objective report **u/s 143**. He will not be able to discharge his duties in proper and dispassionate manner. As such a statutory Auditor of the company cannot be its Internal Auditor.

Answer:

(e) When any remuneration is paid for additional work besides remuneration for normal Audit such additional remuneration, fees expense or otherwise must be disclosed in Profit & Loss A/c. separately as required of schedule III of the **Companies Act, 2013**:
  (a) As auditor.
  (b) As advisor or in any other capacity in respect of:
    (i) Taxation matters;
    (ii) Company Law matters;
    (iii) Management services;
    (iv) Other services;
    (v) Reimbursement of expenses.

—— Space to write important points for revision ——

2013 - Dec [5] {C} Answer the following:

(d) What are the disqualifications for appointment of Statutory Auditor of a Company? **(2 marks)**

Answer:

Section 141 of **Companies Act, 2013** provides that none of the following persons shall be qualified for appointment as auditor of a company.

(a) A body corporate.
(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 is indebted to the company or has given any guarantee or provided any security in connection with the indebtedness of any third person to the company for amount exceeding ₹ one lakh.
(e) A person holding any security of that company after a period of any year W.E.F. 13/12/2000.

—— Space to write important points for revision ——

2014 - June [5] {C} Answer the following:

(c) Can a Cost Accountant be appointed as statutory auditor of a private limited company by its shareholders in an Annual General Meeting? **(2 marks)**

Answer:

No, a Cost Accountant be appointed as statutory of a private limited company by its shareholders in an Annual General Meeting.

In Section 148 of the Companies Act, 2013,—

(i) in sub-section (3),—

  (a) for the words "Cost Accountant in practice", the words "cost accountant" shall be substituted;

  (b) in the Explanation, for the words "Institute of Cost and Works Accountants of India", the words "Institute of Cost Accountants of India" shall be substituted;

(ii) in sub-section (5), in the proviso, for the words "cost accountant in practice", the words "cost accountant" shall be substituted.

—— Space to write important points for revision ——

2015 - June [4] Answer the questions:

(c) (iii) State the disqualifications of a company auditor. **(4 marks)**

Answer:

Please refer 2013 - Dec [5] {C} (d) on page no. 401

—— Space to write important points for revision ——

2016 - June [8] (b) Discuss briefly the scope of Audit Committee in public limited company. **(8 marks)**

Answer:

(b) Scope of Audit Committee:

An Audit Committee consists of three to five members formed to serve as communication link among various departments. Audit Committee has a fourfold relationship and therefore has to interact with management, internal auditor, statutory auditor and the public.

The Scope of Audit Committee can be discussed as follows:

(i) Review of annual financial statements before submission to the Board of Directors.

(ii) Selection of the Statutory Auditor.

(iii) Act as lies on between the Statutory Auditor and Board of Directors.

(iv) Administrative control of the internal control functions through the feedback between the Internal Auditor and the Audit Committee.

(v) Over seeing internal central operation.

(vi) Over seeing internal audit operations and feedback between internal audit committee and developing the internal auditing authority through broad based internal audit programming.

(vii) Review and approval of financial information for publication.

(viii) Review proposed changes in accounting system and procedures.

(viii) Help resolve differences between management, internal and statutory auditor.

(ix) Report on the audit committee acting in the Annual Reports of Board of Directors.

(x) Ensure reliability of organisation's financial statements and operational activities. To be effective and purposeful, the audit committee should maintain the following-

(xi) Audit Committee should have the independence of management, Statutory Auditor and Internal Auditor. The Board of Directors allows full freedom to the audit committee to investigate into any areas of operation.

(xii) The relation between the audit committee and management should be cordial and congenial towards optimum efficiency and healthy growth of the organization.

(xiii) There should be a regular line of communication through occasional meetings with the management.

(xiv) There should be good communication relationship interwoven among management, internal auditor and statutory auditor.

—— Space to write important points for revision ——

2017 - June [8] (a) Who are the persons not qualified for appointment as an Auditor of a company under Section 141 of the Companies Act, 2013?

(7 marks)

(b) Mention the services that an Auditor cannot render u/s 144 of the Companies Act, 2013. **(5 marks)**

Answer:

(a) Section 141 of **Companies Act, 2013** provides that none of the following persons shall be qualified for appointment as auditor of a company.

(a) A body corporate.
(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 is indebted to the company or has given any guarantee or provided any security in connection with the indebtedness of any third person to the company for amount exceeding ₹ one lakh.
(e) A person holding any security of that company after a period of any year w.e.f. 13/12/2000.

(b) Auditor not to Render Certain Services [Section 144]

An auditor appointed under this Act shall provide to the company only such other services as are approved by the Board of Directors or the audit committee, as the case maybe, but which shall not include any of the following services (whether such services are rendered directly or indirectly to the company or its holding company or subsidiary company, namely:

(a) accounting and book keeping services;
(b) internal audit;
(c) design and implementation of any financial information system;
(d) actuarial services;
(e) investment advisory services;
(f) investment banking services;
(g) rendering of outsourced financial services;
(h) management services; and
(i) any other kind of services as may be prescribed.

Provided that an auditor or audit firm who or which has been performing any non-audit services on or before the commencement of this Act shall comply with the provisions of this section before the closure of the first financial year after the date of such commencement.

2017 - Dec [8] (a) Discuss the provisions under Section 139 (7) relating to the appointment of the first auditor in a Government Company. How can an auditor, duly appointed by a company, be removed before expiry of his term?

(4 + 3 = 7 marks)

(b) Discuss the duty of an auditor to report certain matters in the audit report u/s 143(3). **(5 marks)**

Answer:

(a) Appointment of First Auditor in Case of a Government Company [Section 139(7)]:

(i) 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.

(ii) 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.

(iii) 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.

(iv) The auditor, so appointed, shall hold office till the conclusion of the first annual general meeting.

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**.

(i) An application to the Central Government for removal of the auditor shall be made in Form ADT-2. The application shall be accompanied with fees as provided for this purpose under the Companies (Registration Offices and Fees) Rules, 2014.

(ii) The application shall be made to the Central Government within thirty days of the resolution passed by the Board.

(iii) 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.

(iv) The auditor concerned shall be given a reasonable opportunity of being heard.

(b) Duty Regarding Inclusion of Certain Matters in the Audit Report: 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.

2018 - June [8] (a) Discuss the provisions of Companies Act, 2013 as regards reporting of frauds by Company Auditor. **(6 marks)**

Answer:

The Provisions of Companies Act, 2013 regarding reporting of frauds by a company auditor are as follows:

1. 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) 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.
2. 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.
3. 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.

4. The report shall be in the form of a statement as specified in Form ADT-4.
5. 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 20,4 respectively.

—— Space to write important points for revision ——

2018 - June [8] (b) Discuss about the manner in which rotation of Auditors may be done by the company on expiry of their term. **(6 marks)**

Answer:

The Audit Committee shall recommend to the Board, the name of an individual auditor or of an audit firm who may replace the incumbent auditor on expiry of the term of such incumbent.

1. Where a company is required to constitute an Audit Committee, the Board shall consider the recommendation of such committee, and in other cases, the Board shall itself consider the matter of rotation of auditors and make its recommendation for appointment of the next auditor by the members in annual general meeting.
2. For the purpose of the rotation of the auditors-
   (i) In case of an auditor (whether an individual or audit firm), the period for which the individual or the firm has held office as auditor prior to the commencement of the Act shall be taken into account for calculating the period of five consecutive years or ten consecutive years, as the case may be;
   (ii) The incoming auditor or audit firm shall not be eligible, if such auditor or audit firm is associated with the outgoing auditor or audit firm under the same network of audit firms.

   Explanation I : For the purposes of these rules, the term "same network" includes the firms operating or functioning, hitherto or in future under the same brand name, trade name or common control.

   Explanation II: For the purpose of rotation of auditors,-

   (a) A break in the term for a continuous period of five years shall be considered as fulfilling the requirement of rotation;

(b) If a partner who is in charge of an audit firm and also certifies the financial statements of the company, retires from the said firm and joins another firm of Chartered Accountants, such other firm shall also be ineligible to be appointed for a period of five years.

—— Space to write important points for revision ——

2018 - Dec [8] (a) Discuss the functions and power of the Audit Committee. **(6 marks)**

2018 - Dec [8] (b) Discuss the procedure for appointment for first Auditor of the Company and his tenure. **(6 marks)**

PRACTICAL QUESTIONS

2008 - Dec [5] {C} Comment on the following statements based on legal provision :

(g) ABC Ltd. in its meeting held on 30.09.08 appointed Mr. X as Auditor of the company. Mr. X is holding Securities Valuing ₹ 500/- in that company from 01.01.07. Can he accept the appointment ? **(2 marks)**

Answer :

False. A person holding any security of a company is disqualified for appointment as statutory auditor of that company. In the light of above provision, Mr. X cannot accept the appointment.

—— Space to write important points for revision ——

2011 - June [5] {C} Comment on the following statements based on legal provisions:

(e) M/s. A.B. Associates, Chartered Accountants were appointed as Auditor of the Company in the month of Sept. 2010 at a fee of ₹ 3,00,000/- plus other expense at actual. In the month of Dec. 10, the Auditor was removed by the Company. Auditor claimed ₹ 3,00,000/- but the Company paid ₹ 1,00,000/- being remuneration for 4 months from September to December, 2010. **(2 marks)**

Answer :

The Auditors claim was correct. The auditors has right to receive remuneration of the Audit work completed by him. He is also entitled to a full years remuneration if he is removed during the year. ***(Homer Vs. Quiter 1908)***.

—— Space to write important points for revision ——

2012 - June [6] (a) Newly formed ABC & Associates, Chartered Accountants have received offer from 25 Public Ltd. Companies having a Paid-up Capital of INR 10 lakh and 5 Private Companies with Paid-up Capital of INR 15 lakh each. All the offers have been accepted. Comment on validity. **(4 marks)**

Answer :

Sec. 139 of **Companies Act, 2013** provides that a person or a firm can accept the appointment.

(i) As Auditor of 20 Companies in case of Companies having a paid up share capital of less than ₹ 25 lakhs.

OR

(ii) 20 Companies out of which not more than 10 (ten) shall be companies each of which has a paid up share capital of ₹ 25 lakhs or more

The ceiling of 20 companies does not apply to the Private Companies.

In the above case, since the paid up capital of all the public companies is less than ₹ 25 lakhs, Auditor can accept appointment of maximum 20 Public companies. They are to surrender the appointment of any 5 public companies.

Besides they can accept appointment of all the 5 (five) private companies.

—— Space to write important points for revision ——

Repeatedly Asked Questions		
No.	**Question**	**Frequency**
1	State the disqualifications of a company auditor. 13 - Dec [5] (d), 15 - June [4] (c) (iii), 17 - June [8] (a)	3 Times

Table Showing Marks of Compulsory Questions										
Year	14 J	14 D	15 J	15 D	16 J	16 D	17 J	17 D	18 J	18 D
Descriptive	2									
Total	2									

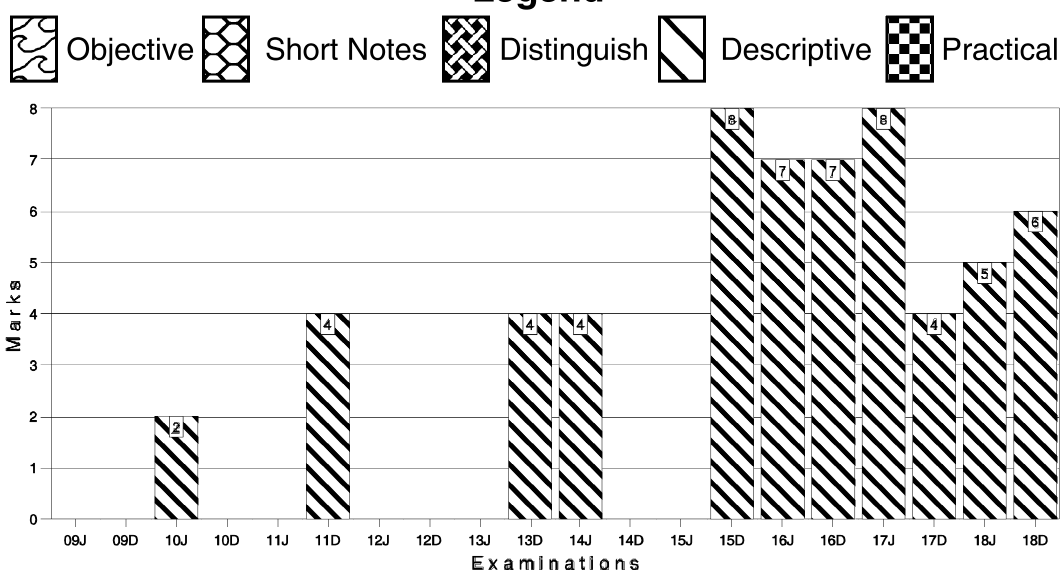
12 COST AUDIT AND SECRETARIAL AUDIT

THIS CHAPTER INCLUDES

- Cost Audit Provision of Section 148 of the Companies Act
- Applicability of Cost Audit
- Appointment of Cost Auditor
- Remuneration of the Cost Auditor
- Cost Audit Report
- Section 204 of the Companies Act, 2013
- Procedures of Appointment of Secretarial Audit

Marks of Objective, Short Notes, Distinguish Between, Descriptive & Practical Questions

Legend



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CHAPTER AT A GLANCE

S. No.	Topic	Important Highlights
1.	**Cost Auditor**	1. Every company referred to in sub-rule (1) 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, 2. After the expiry of thirty days, the company shall issue formal letter of appointment to the cost auditor. 3. Every cost auditor, who conducts an audit of the cost records of a company, shall submit the cost audit report along with his or its reservations or qualifications or observations or suggestions, if any, inform CRA-3. 4. Every cost auditor shall forward his report to the Board of Directors of the company within a period of one hundred and eighty days from the closure of the financial year. 5. Every company covered under these rules 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 alongwith 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.
2.	**Secretarial Audit**	Companies required conducting secretarial audit: 1. Every listed company and 2. Company belonging to other class of companies: The other class of companies are • every public company having a paid-up share capital of fifty crore rupees or more; or • every public company having a turnover of two hundred fifty crore rupees or more.

DESCRIPTIVE QUESTIONS

2010 - June [5] {C} Comment on the following statements based on legal provisions:

(d) Cost Audit Report is submitted to the Company within 90 days from the end of Company's financial year. **(2 marks)**

Answer:

False : Cost audit report is submitted to the Central Govt. with a copy to company within 180 days from the end of financial year to which the cost audit report relates.

2011 - Dec [8] (b) Central Government issued order for audit of Cost Accounts of ABC Ltd. In view of this, state the following:

(i) Who appoints the Cost Auditor ?
(ii) Whether Company's Statutory Auditor can conduct Cost Audit ?
(iii) To whom the Cost Audit report is submitted ?
(iv) Time limit within which such report is submitted by the Cost Auditor.

(4 marks)

Answer :

(i) Cost auditor is appointed by Board of Directors of the company with the previous approval of the Central Government **(Sec. 148)**

Answer :

(ii) The statutory auditor of the company cannot be appointed as cost auditor. Cost Auditor shall be a cost accountant within the meaning of the **Cost & Works Accountants Act, 1959.**

Answer :

(iii) Cost audit report is submitted to the Central Government with copy to the company in such form as may be prescribed.

Answer :

(iv) Report shall be submitted to the Central Govt. within such time as may be prescribed.

—— Space to write important points for revision ——

2013 - Dec [6] (b) (i) State the advantages of Cost Audit to Management and Shareholders. **(4 marks)**

Answer:

Cost Audit is the verification of the correctness of cost accounts and of the adherence to the cost accounting plan.

Advantage of Cost Audit:

To the Management :

(i) Management gets reliable data for its day to day operation like price fixing, control, decision making, etc.
(ii) A close and continuous check on all wastage’s will be kept through a proper system of reporting to management.

(iii) Inefficiencies in the working of the company will be brought to light to facilitate corrective action.

(iv) Management by exception becomes possible through allocation of responsibilities to individual managers.

(v) System of budgetary control and standard costing will be greatly facilitated.

(vi) Reliable check on valuation of closing stock and work in-progress can be established.

(vii) Helps in detection of frauds and errors.

To the shareholders : Cost Audit ensures that proper records are kept as to purchases and utilization of material and expenses incurred on wages etc. It also makes sure that the valuation of closing stock and work-in-progress is on a fair basis. Thus, the shareholders are assured of a fair return on their investment.

—— Space to write important points for revision ——

2014 - June [7] (a) (iii) What is meant by cost audit? State the duties of a cost auditor. **(4 marks)**

Answer:

Cost Audit

It is an audit process for verifying the cost of manufacture or production of any article, on the basis of accounts as regards utilisation of material or labour or other items of costs, maintained by the company. In simple words the term cost audit means a systematic and accurate verification of the cost accounts and records and checking of adherence to the objectives of the cost accounting.

As per ICAI London "cost audit is the verification of the correctness of cost accounts and of the adherence to the cost accounting plan".

In cost audit, auditor has to perform the following duties:

- Examine the correctness of the cost records maintained by the concern; and
- To report as to whether the cost accounting plans have been adhered to or not.

—— Space to write important points for revision ——

2015 - Dec [4] Answer the question:
(c) (ii) Briefly mention the provisions relating to Cost Audit. **(8 marks)**
Answer:
Cost Audit is an audit process for verifying the cost of manufacture or production of any article, on the basis of accounts as regards utilisation of material or labour or other items of costs, maintained by the company.
It is covered by **Section 148 of the Companies Act, 2013.** The audit conducted under this section shall be in addition to the audit conducted under Section 143.
As per Section 148 the Central Government may by order specify audit of items of cost in respect of certain companies.
Further, the Central Government may, by order, in respect of such class of companies engaged in the production of such goods or providing such services as may be prescribed, direct that particulars relating to the utilisation of material or labour or to other items of cost as may be prescribed shall also be included in the books of account kept by that class of companies.
Applicability for Maintenance of Cost Records: Rule 3 of the Companies (Cost Records and Audit) Rules, 2014 provides the classes of companies, engaged in the production of goods or providing services, having an overall turnover from all its products and services of ₹ 35 crore or more during the immediately preceding financial year, required to include cost records in their books of account. These companies include Foreign Companies defined in sub-section (42) of Section 2 of the Act, but exclude a company classified as a Micro enterprise or a Small enterprise including as per the turnover criteria provided under Micro, Small and Medium Enterprises Development Act, 2006. The said rule has divided the list of companies into (A) Regulated sectors and (B) Non- regulated sectors.
Maintenance of Cost Records: As per Rule 5 of the Companies (Cost Records and Audit) Rules, 2014, every company under these rules including all units and branches thereof, shall, in respect of each of its financial year, is required to maintain cost records in Form CRA -1. The cost records shall be maintained on regular basis in such manner as to facilitate calculation of per unit cost of production or cost of operations, cost of sales and margin for each of its products and activities for every financial year on monthly or quarterly or half-yearly or annual basis.

Applicability of Cost Audit: Rule 4 of the Companies (Cost Records and Audit) Rules, 2014 states the provisions related to the applicability of cost audit depending on the turnover of the company as follows-

(i) Classes of companies specified under item (A) "Regulated Sectors" are required to get its cost records audited if the overall annual turnover of the company from all its products and services during the immediately preceding financial year is ₹ 50 crore or more and the aggregate turnover of the individual product(s) or service(s) for which cost records are required to be maintained under Rule 3 is ₹ 25 crore or more.

(ii) Classes of companies specified under item (B) "Non-Regulated Sectors" are required to get its cost records audited if the overall annual turnover of the company from all its products and services during the immediately preceding financial year is ₹ 100 crore or more and the aggregate turnover of the individual product(s) or service(s) for which cost records are required to be maintained under Rule 3 is ₹ 35 crore or more.

Who can be Cost Auditor: The audit shall be conducted by a Cost Accountant who shall be appointed by the Board of such remuneration as may be determined by the members in such manner as may be prescribed. It may be noted that no person appointed under Section 139 as an auditor of the company shall be appointed for conducting the audit of cost records.

In Section 148 of the Companies Act, 2013,—

(i) in sub-section (3),—

   (a) for the words "Cost Accountant in practice", the words "cost accountant" shall be substituted;

   (b) in the Explanation, for the words "Institute of Cost and Works Accountants of India", the words "Institute of Cost Accountants of India" shall be substituted;

(ii) in sub-section (5), in the proviso, for the words "cost accountant in practice", the words "cost accountant" shall be substituted.

Appointment of Cost Auditor: Rule 6 of the Companies (Cost Records and Audit) Rules, 2014 requires the companies prescribed under the said Rules to appoint an Auditor within 180 days of the commencement of every financial year. However, before such appointment is made, the written consent of the cost auditor to such appointment and a certificate from him or it shall be obtained.

The certificate to be obtained from the cost auditor shall certify that the-

(a) the individual or the firm, as the case may be, is eligible for appointment and is not disqualified for appointment under the Companies Act, 2013, the Cost and Works Accountants Act, 1959 and the rules or regulations made thereunder;

(b) the individual or the firm, as the case may be, satisfies the criteria provided in section 141 of the Companies Act, 2013 so far as may be applicable;

(c) the proposed appointment is within the limits laid down by or under the authority of the Companies Act, 2013; and

(d) the list of proceedings against the cost auditor or audit firm or any partner of the audit firm pending with respect to professional matters of conduct, as disclosed in the certificate, is true and correct.

Every referred 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 30 days of the Board meeting in which such appointment is made or within a period of 180 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.

The cost auditor appointed as such shall continue in such capacity till the expiry of 180 days from the closure of the financial year or till he submits the cost audit report, for the financial year for which he has been appointed.

(ii) in sub-section (5), in the proviso, for the words "cost accountant in practice", the words "cost accountant" shall be substituted.

Space to write important points for revision

2016 - June [8] (a) State the objectives of cost audit from the point of view of Government. **(7 marks)**

Answer:

The objective of cost audit from the point of view of government :

(i) To ensure whether the national resources are prudently and optimally used.

(ii) To reduce cost of production of commodities and regularize their distribution.

(iii) To determine whether particular industry should be given subsidy/grants.

(iv) To determine whether particular industry should be protected from external competition.

(v) To make comparisons of cost parameters of different firms manufacturing same product.

(vi) To assess the costs of the same product on different regions so as to decide to grant incentives etc.

(vii) To fix the maximum price of a commodity.

(viii) To devise, apply and evaluate cost control measures.

Space to write important points for revision

2016 - Dec [9] (b) Explain the requirement of cost audit in brief.

(7 marks)

Answer:

Cost Audit:

Cost Audit represents the verification of cost accounts and check on the adherence to cost accounting plan. Cost Audit ascertains the accuracy of cost accounting records to ensure that they are in conformity with Cost Accounting principles, plans, procedures and objective. Cost Audit comprise of verification of the cost accounting records such as the accuracy of the cost accounts, cost reports, cost statements, cost data and costing technique and examination of these records to ensure that they adhere to the cost accounting principles, plans, procedures and objective. Cost Audit is also a form of statutory audit. As per Section 148, of Companies Act, 2013 the Central Government, may direct specified companies to have its records cost audited.

Cost Audit will prove to be useful to the management, society, shareholders and the Government.

Usefulness to the Management:	(i) The management will get reliable data for its day-to-day operations like price fixing, control, decision making, etc. (ii) A close and continuous check an all wastages will be kept through a proper system of reporting to management. (iii) Inefficiencies in the working of the company will be brought to light to facilitate corrective action. (iv) Management by exception becomes possible through allocation of responsibilities to individual managers. (v) System of budgetary control and standard costing will be greatly facilitated. (vi) Reliable check on valuation of closing stock and work-in-progress can be established., (vii) Helps in detection of frauds and errors.
Usefulness to the Society:	(i) Cost audit is often introduced for the purpose of fixation of price. The prices so fixed are based on the correct costing data and so the consumers are saved from exploitation. (ii) Price increase by the industry is not allowed without proper justification as to increase in cost of production; consumers are saved from unreasonable price. (iii) Cost Audit is also useful for the purpose of Cost Control; Cost reduction and proper utilisation of scarce resources.
Usefulness to Shareholders:	Cost Audit ensures that proper records are kept as to purchases and utilisation of material and expenses incurred on wages, etc. It also makes sure that the valuation of closing stock and

	work-in-progress is on a fair basis. Thus, the shareholders are assured of a fair return on their investment.
Usefulness to the Government:	(i) Where the government enters into a cost plus contract, cost audit helps the government to fix the price of the contract. (ii) Cost audit helps the fixation of selling prices of essential commodities and thus, undue profiteering is checked. (iii) Cost audit enables the government to focus its attention on inefficient units. (iv) Cost audit enables the government to decide in favour of giving protection to certain industries. (v) Cost audit facilitates settlement of Trade Dispute. (vi) Cost Audit promotes healthy competition among units in the industry.

—— Space to write important points for revision ——

2017 - June [9] (b) Discuss the provisions of Cost Audit under Companies Act 2013. **(8 marks)**

Answer :

Please refer 2015 - Dec. [4] (c) (ii) on page no. *417*

—— Space to write important points for revision ——

2017 - Dec [9] (a) What is the procedure of appointing a cost auditor in a company? **(4 marks)**

Answer:

Procedure for Appointment of a Cost Auditor:

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.

—— Space to write important points for revision ——

2018 - June [9] (a) What is the procedure to be followed for fixing the remuneration of a Cost Auditor? **(5 marks)**

Answer:

Authority for fixing the Remuneration of a Cost Auditor:

Rule 14 of the Companies [Audit and Auditors] Rules, 2014 has laid down the procedure of appointment and fixing the remuneration of a cost auditor. It states as follows:

Remuneration of the Cost Auditor: For the purpose of sub-section (3) of Section 148 –

(a) In the case of companies which are required to constitute an audit committee -
   (i) The Board shall appoint an individual, who is a Cost Accountant, or a firm of Cost Accountants in practice, as cost auditor on the recommendations of the Audit Committee, which shall also recommend remuneration for such cost auditor;
   (ii) The remuneration recommended by the Audit Committee under (i) shall be considered and approved by the Board of Directors and ratified subsequently by the shareholders;

(b) In the case of other companies which are not required to constitute an audit committee, the Board shall appoint an individual who is a cost accountant or a firm of cost accountants in practice as cost auditor and the remuneration of such cost auditor shall be ratified by shareholders subsequently.

In Section 148 of the Companies Act, 2013,—

(i) in sub-section (3),—
   (a) for the words "Cost Accountant in practice", the words "cost accountant" shall be substituted;
   (b) in the Explanation, for the words "Institute of Cost and Works Accountants of India", the words "Institute of Cost Accountants of India" shall be substituted;

(ii) in sub-section (5), in the proviso, for the words "cost accountant in practice", the words "cost accountant" shall be substituted.

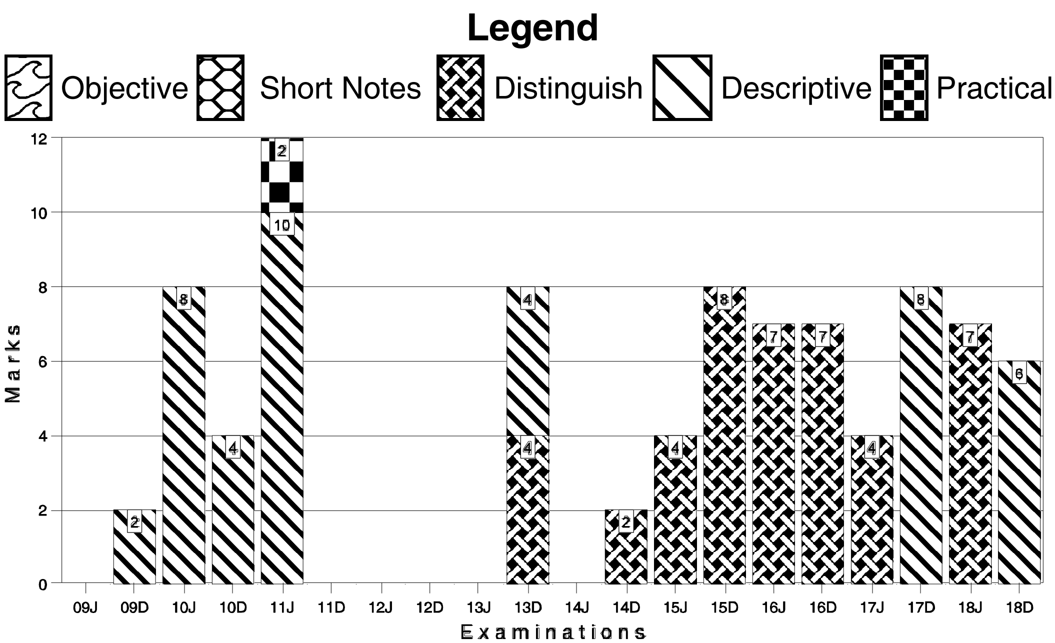
—— Space to write important points for revision ——

2018 - Dec [9] (a) Discuss the relevant provisions of Companies (Cost Records and Audit) Rules, 2014 on applicability of Cost Audit to different sectors. **(6 marks)**

Repeatedly Asked Questions		
No.	**Question**	**Frequency**
1	Discuss the provisions of Cost Audit under Companies Act 2013. 15 - Dec [4] (c) (ii), 17 - June [9] (b)	2 Times

13	AUDIT REPORT
THIS CHAPTER INCLUDES	
• Scope, Basic Elements and Significance of Audit Report • Unqualified Opinion • Qualified Opinion/Report • Disclaimer of Opinion • Piecemeal Opinion • Adverse or Negative Report • CARO - Companies (Auditor's Report) Order, 2016	• Revision of The Audit Report • Audit of Abridged Financial Statements • Provision for Proposed Dividend • Accounts of Liquidators/Report • Audit of Consolidated Financial Statements (CFS) • Audit Certificate.

Marks of Objective, Short Notes, Distinguish Between, Descriptive & Practical Questions



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CHAPTER AT A GLANCE

S. No.	Topic	Important Highlights
1.	**Audit Report**	"A Report is a statement of collected & 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."
2.	**Unqualified opinion**	An opinion is said to be unqualified, when the Auditor concludes that the Financial Statements give a true and fair view in accordance with the financial reporting framework used for the preparation and presentation of the Financial Statements.
3.	**Disclaimer of Opinion**	A Disclaimer of Opinion Report is given when the Auditor is unable to form an overall opinion about the matters contained in the Financial Statements.
4.	**Adverse or Negative Report**	An Adverse or Negative Report is given when the Auditor concludes that based on his examination, he does not agree with the affirmations made in the Financial Statements/ Financial Report.
5.	**Caro – companies (Auditor's Report) Order, 2016**	CARO – COMPANIES (AUDITOR'S REPORT) ORDER, 2016 issued by the Central Government as per the power granted under section 143(11) of the Companies Act, 2013. According to Sec 143, the auditor is required to report on certain matters only if he is not satisfied after his examination of the accounts

		but after this new order, the auditor has to make a statement on each of the specified matters likewise in case of Govt. companies, this order is in addition to the directions of the Comptroller and Auditor General in India.
6.	**Audit Certificate**	Sometimes apart from an audit report for general use, an auditor is often called upon to give a certificate for special purpose. The certificate should include the following: — i. Auditor should see that there is a suitable declaration by the management about the subject matter. ii. Auditor should give the certificate on his letter head or on stationary carrying his name and address to avoid misunderstanding. iii. Auditor should clearly state his limitations and indicate the extent to which he has relied upon a technical expert if any.

DISTINGUISH BETWEEN

2013 - Dec [7] (a) (iii) Distinguish between 'Qualified Report' and 'Adverse Report' of an Auditor. **(4 marks)**

Answer:

Distinguish between Qualified Report and Adverse Report :

Qualified Report	Adverse Report
(i) A Qualified Audit Report is one in which an Auditor gives an opinion subject to certain reservations.	An Adverse Report is given when the Auditor concludes that based on his examination, he does not agree with the affirmations made in the Financial Report.

(ii)	Auditor's reservation is generally stated as; "Subject to the above, we report that the Balance Sheet shows a true and fair view".	The Auditor states that the financial statements do not present a true and fair view of the state of affairs and working results of the organization.
(iii)	The accounts present a true and fair view subject to certain reservations.	The accounts do not present a true and fair view on the whole.
(iv)	A Qualification is made in the Audit Report when the Auditor has reservation on specific item of material nature.	An Adverse Report is given when the Auditor has his reservations on the true and fair view presented by the Financial Statements.

Space to write important points for revision

2014 - Dec [1] Answer the question:

(g) What is the basic difference between audit report and audit certificate? **(2 marks)**

Answer :

Basis	**Audit Report**	**Audit Certificate**
(i) Meaning	Audit Report is a statement of collected and considered information so as to give a clear picture of the state of affairs of the business to the persons who are not in possession of the full facts.	Audit Certificate is a written confirmation of the accuracy of the information stated there in.
(ii) Opinion	Audit Report contains the opinion of the auditor on the accounts,	Audit Certificate does not contain any opinion but only confirms the accuracy of the figures with the books of accounts.

(iii) Guarantee	Audit Report may not guarantee correctness of financial statement in absolute terms,	Audit Certificate guarantees absolute correctness of the figures & information mentioned in the certificate.

—— Space to write important points for revision ——

2015 - June [4] Answer the question:

(b) (iii) Tabulate the differences between Clean Audit Report and Qualified Audit Report. **(4 marks)**

Answer:

Distinguish between Clean Audit Report and Qualified Audit Report

Clean Audit Report	Qualified Audit Report
The Auditor issues a Clean Report, (also called as unconditional opinion) when he does not have any reservation with regard to the matters contained in the Financial Statements.	A Qualified Audit Report is one where an Auditor gives an opinion subject to certain reservations.
In a Clean Report, the Auditor states that the Financial Statements give a true and fair view of the state of affairs and results for the period.	The Auditor's reservation is generally stated as - "Subject to the above, we report that the Balance Sheet shows a true and fair view."
The Auditor is justified in issuing a clean report if: (i) The accounts are prepared using generally accepted accounting principles. (ii) The Auditor has examined sufficient reliable evidence in respect of transactions recorded in the books.	A Qualified Opinion should be expressed when the Auditor concludes that: (i) An Unqualified Opinion cannot be expressed. (ii) The effect of any disagreement with Management is not so material and pervasive as to require an Adverse Opinion, or

(iii) The transactions recorded represent a true recording of the events. (iv) The transactions are within the legal competence of the entity. (v) There are no material mis-statements in the Financial Statements. (vi) The Financial Statements comply with the format and disclosure requirements as per the Statute.	(iii) The Limitation on scope is not so material and pervasive as to require a Disclaimer of Opinion.

Space to write important points for revision

2015 - Dec [4] Answer the question:
(b) (iii) Distinguish between audit report and audit certificate. **(8 marks)**

Answer:

Difference between Audit Report and Audit Certificate:

(i) Meaning	Audit Report is a statement of collected and considered information so as to give a clear picture of the state of affairs of the business to the persons who are not in possession of the full facts. While Audit Certificate is a written confirmation of the accuracy of the information stated there in.
(ii) Opinion	Audit Report contains the opinion of the auditor on the accounts, while Audit Certificate does not contain any opinion but only confirms the accuracy of the figures with the books of accounts.
(iii) Basis	Audit Report is made out on the basis of information obtained & books of account verified by the auditor, while Audit Certificate is made out on the basis of the particular data capable of verification as regards accuracy.

(iv)	**Guarantee**	Audit Report may not guarantee correctness of financial statement in absolute terms, while Audit Certificate guarantees absolute correctness of the figures & information mentioned in the Certificate.
(v)	**Coverage**	Audit Report always covers entire accounts of the concern, while Audit Certificate covers only certain part of the accounts of the concern.
(vi)	**Responsibility**	Audit Report does not hold auditor responsible for anything wrong in the accounts, while Audit Certificate makes an auditor responsible if anything mentioned in the certificate found as wrong later on.
(vii)	**Suggestion**	Audit Report may provide certain suggestions for improvement while Audit Certificate does not provide any such suggestion.
(viii)	**Nature**	Audit Report is based on the vouching & verification of books of accounts, voucher, assets & liabilities, while Audit Certificate is based on checking arithmetical accuracy of the facts.
(ix)	**Scope**	Audit Report covers all transactions done during the year, while the Audit Certificate is very specific.
(x)	**Characteristics**	Audit Report is subjective as it is opinion oriented, while Audit Certificate is objective as it is fact oriented.
(xi)	**Form**	Audit Report is required to be presented in the prescribed format, while Audit Certificate, except in few cases, is not required to be presented in any Standard format.

(xii) Address	Audit Report is addressed to the members of the company at large or appointing authority, while Audit Certificate is addressed to particular person or sometimes may include the words like "To Whomsoever it may concern".

Space to write important points for revision

2016 - June [9] (b) Distinguish between clean audit report and qualified audit report. **(7 marks)**

Answer:

Clean Audit Report:

An opinion is said to be unqualified, when the Auditor concludes that the Financial Statements give a true and fair view in accordance with the financial reporting framework used for the preparation and presentation of the Financial Statements. Or,

The Auditor gives a Clean or Unqualified Report, when he does not have any significant reservation in respect of matters contained in the Financial Statements.

An Unqualified Opinion indicates the following:

(a) The Financial Statements have been prepared using the Generally Accepted Accounting Principles, which have been consistently applied,

(b) The Financial Statements comply with relevant statutory requirements and regulations, and

(c) There is adequate disclosure of all material matters relevant to the proper presentation of the financial information, subject to statutory requirements, where applicable.

(d) Any changes in the accounting principles or in the method of their application, and the effects thereof, have been properly determined and disclosed in the Financial Statements.

Qualified Audit Report:

(i) A Qualified Audit Report is one where an Auditor gives an opinion on the truth and fairness of Financial Statements, subject to certain reservations.

(ii) The Auditor's Reservation is generally stated as: "Subject to the above, we report that the Balance Sheet shows a true and fair view."

(iii) The overall impact of all reservations or qualification taken together is not material enough to vitiate the overall true and fair view of Financial Statements, but it is important that such a matter(s) should be brought to the attention of the shareholders.

(iv) The Report should also give detailed reasons alongwith quantitative impact on the qualifications on Financial Statements.

(v) A Qualified Opinion should be expressed when the Auditor concludes that:
   (a) An Unqualified Opinion cannot he expressed, or
   (b) The effect of any disagreement with Management is not so material and pervasive as to require an Adverse Opinion, or
   (c) The Limitation on scope is not so material and pervasive as to require a Disclaimer of Opinion.

—— Space to write important points for revision ——

2016 - Dec [10] (b) Distinguish between Audit Report and Audit Certificate. **(7 marks)**

Answer:

Difference between Audit Report and Audit Certificate:

(i) Meaning: Audit Report is a statement of collected and considered information so as to give a clear picture of the state of affairs of the business to the persons who are not in possession of the full facts. While Audit Certificate is a written confirmation of the accuracy of the information stated there in.

(ii) Opinion: Audit Report contains the opinion of the auditor on the accounts, while Audit Certificate does not contain any opinion but only confirms the accuracy of the figures with the books of accounts.

(iii) Basis: Audit Report is made out on the basis of information obtained & books of account verified by the auditor, while Audit Certificate is made out on the basis of the particular data capable of verification as regards accuracy.

(iv) Guarantee: Audit Report may not guarantee correctness of financial statement in absolute terms, while Audit Certificate guarantees absolute correctness of the figures & information mentioned in the certificate.

(v) Coverage: Audit Report always covers entire accounts of the concern, while Audit Certificate covers only certain part of the accounts of the concern.

(vi) Responsibility: Audit Report does not hold auditor responsible for anything wrong in the accounts, while Audit Certificate makes an auditor responsible if anything mentioned in the certificate found as wrong later on.

(vii) Suggestion: Audit Report may provide certain suggestions for improvement while Audit certificate does not provide any such suggestion.

(viii) Nature: Audit Report is based on the vouching & verification of books of accounts, voucher, assets & liabilities, while Audit Certificate is based on checking arithmetical accuracy of the facts.

(ix) Scope: Audit Report covers all transactions done during the year, while the Audit Certificate is very specific.

(x) Characteristics: Audit Report is subjective as it is opinion oriented, while Audit certificate is objective as it is fact oriented.

(xi) Form: Audit Report is required to be presented in the prescribed format, while Audit Certificate, except in few cases, is not required to be presented in any standard format.

(xii) Address: Audit report is addressed to the members of the company at large or appointing authority, while Audit Certificate is addressed to particular person or sometimes may include the words like "To Whomsoever it may concern".

Audit report versus Audit certificate

(i) Audit report is an expression of opinion on the truth and fairness of the accounts.

(ii) Audit certificate is authentication of true and correctness of the data or fact certified.

(iii) The existence of opinion distinguishes a report from the certificate.

(iv) The example of audit report is report issued by statutory auditor of a company under Section 143 of the Companies Act, 2013.

(v) The example for audit certificate is certification of consumption of imported items to be submitted to the government department for obtaining some license etc.

—— Space to write important points for revision ——

2017 - June [9] (a) Distinguish between Qualified Audit Report and Adverse Report. **(4 marks)**

Answer:

Distinguish between Qualified Report and Adverse Report:

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

—— Space to write important points for revision ——

2018 - June [9] (b) Distinguish between 'Audit Report' and 'Audit Certificate'. **(7 marks)**

Answer:

	Basis	Audit Report	Audit Certificate
1.	Meaning	Audit Report is a statement of collected and considered information so as to give a clear picture of the state of affairs of the business to the persons who are not in possession of the full facts.	While Audit Certificate is a written confirmation of the accuracy of the information stated there in.
2.	Opinion	Audit Report contains the opinion of the auditor on the accounts.	While Audit Certificate does not contain any opinion, but only confirms the accuracy of the figures with the books of accounts.
3.	Basis	Audit Report is made out on the basis of information obtained and books of account verified by the auditor.	While Audit Certificate is made out on the basis of the particular data capable of verification as regards accuracy.
4.	Guarantee	Audit Report may not guarantee correctness of financial statement in absolute terms.	While Audit Certificate guarantees absolute correctness of the figures and information mentioned in the Certificate.
5.	Coverage	Audit Report always covers entire accounts of the concern.	While Audit Certificate covers only, certain part of the accounts of the concern.

6.	Responsibility	Audit Report does not hold auditor responsible for anything wrong in the accounts.	While Audit Certificate makes an auditor responsible, if anything mentioned in the certificate found as wrong, later on.
7.	Suggestion	Audit Report may provide certain suggestions for improvement.	While Audit Certificate does not provide any such suggestion.
8.	Nature	Audit Report is based on the vouching and verification of books of accounts, voucher, assets and liabilities.	While Audit Certificate is based on checking arithmetical accuracy of the facts.
9.	Scope	Audit Report covers all transactions done during the year.	While the Audit Certificate is very specific.
10.	Characteristics	Audit Report is subjective, as it is opinion oriented.	While Audit Certificate is objective, as it is fact oriented.
11.	Form	Audit Report is required to be presented in the prescribed format.	While Audit Certificate, expect in few cases, is not required to be presented in any standard format.
12.	Address	Audit report is addressed to the members of the company at large or appointing authority.	While Audit Certificate is addressed to particular person or sometimes may include the words like "To whomsoever it may concern."

DESCRIPTIVE QUESTIONS

2008 - Dec [6] (a) What are the contents of good Audit Report?

(4 marks)

Answer :

The auditor's report is clear writing expression of opinion of auditor on the financial statements of the auditee. Auditing guidelines given in SA, have laid down certain guidelines relating to contents of Audit Report viz.

(i) Title
(ii) Addressee
(iii) Opening or Introductory Paragraph
(iv) Scope Paragraph
(v) Opinion Paragraph
(vi) Date of the Report
(vii) Place of Signature
(viii) Auditor's Signature

—— Space to write important points for revision ——

2009 - Dec [8] (i) In course of audit, auditor advised to amend the Profit & Loss A/c which was faulty but the directors did not follow his advice. As an auditor, what you will do? **(2 marks)**

Answer :

As an auditor, I would qualify my report and state that financial statement do not represent the true and fair view of the states of the affairs of the company. I would also mention what is wrong in the profit and loss a/c and what it should be. I will also quantify the incorrectness and justify my stand on the issue.

—— Space to write important points for revision ——

2010 - June [7] (c) Statutory Auditor is to give a certificate regarding compliance of corporate Governance which is annexed with the Director's Report. What are the documents and records to be checked by you before signing of such certificate. **(4 marks)**

Answer :

The Corporate Governance Report requires following points to be checked by auditor during the audit :

(i) Minutes of BOD's meetings
(ii) Minute book of general body meeting
(iii) Minute book of Audit committee
(iv) Corporate Governance Report
(v) Mandatory annual intimations filed by each director about directorship in other companies
(vi) Consistency of segment wise information with the segment information disclosed in financial statements in according with AS - 17.

—— Space to write important points for revision ——

2010 - June [8] (d) Under what circumstances, Auditor has to Qualify his report. **(4 marks)**

Answer :

Some situations calling for qualifications in Audit Reports are:

(i) Where the Auditors are unable to obtain all the information and explanations which they consider necessary for the purposes of their audit, e.g. -
   (a) Absence of satisfactory documentary evidence of the existence of ownership of the material assets, such as, title deeds in respect of land,
   (b) Absence of vouchers in respect of material payments made by the Company,
   (c) Destruction of books and records by fire or accident,
   (d) Non-availability of books and records owing to unavoidable circumstances, such as books and records of a foreign branch with which no communication is possible.
(ii) Where proper books of accounts have not been kept in accordance with the law.

(iii) Where the Balance Sheet and P&L Account are not in agreement with the books of account and returns.

(iv) When the information required by law is not furnished.

(v) When the accounts do not disclose a true and fair view like -

   (a) Where the accounting practices followed by the Company are not considered appropriate to the circumstances and nature of the business e.g. treatment of HP Sales as outright sales,

   (b) Where there has been a change in accounting principles or procedures in relation to material items, such, valuation of stock, depreciation, treatment of by-product cost, etc. without adequate explanation and disclosure of effect of the change,

   (c) Where difference of opinion with management has arisen regarding valuation or realisability of assets, such as Stock-in-Trade, Debtors, Loans & Advances or the extent of liabilities, contingent or otherwise,

   (d) Where income or expenditure is not properly reflected so as to show a fair figure of profit for the year,

   (e) Where information is not required by law to be disclosed but the disclosure of which is considered essential by the Auditors in order to show a true and fair view,

   (f) Where there is a contravention of the provisions of the Companies Act having a bearing upon the accounts and transactions of the Company

   (g) Where the Company has contravened the provisions of its Memorandum and Articles of Association.

—— Space to write important points for revision ——

2010 - Dec [6] (e) How you will deal with in the Audit Report in respect of Fixed Assets being maintained at Mumbai Branch Office of a foreign company incorporated outside India. **(2 marks)**

Answer :

The auditor should report the following matters in his Audit Report :

Fixed assets :

(i) Company is maintaining proper records of fixed assets ;

(ii) Fixed assets are frequently verified by the management;

(iii) Material discrepancies found during verification are accounted properly

(iv) Any disposal of fixed assets has affected the going concern concept or not.

—— Space to write important points for revision ——

2010 - Dec [8] (d) How an Auditor shall conduct and Report when he finds any embezzlement of cash which considerably affects the financial position of the Company? **(2 marks)**

Answer :

Auditor should qualify his report. He should attach the details of embezzlement of cash with his report.

—— Space to write important points for revision ——

2011 - June [5] {C} Comment on the following statements based on legal provisions:

(g) Importance of follow-up of Audit Report cannot be avoided. **(2 marks)**

Answer :

The importance and necessity of follow up arises due to fact that human tendency is resistance to change and to delay the adoption of audit recommendation. Even due to passing of time the concerned employee may forget to implement the recommendations.

To achieve the full benefits of audit, defect and/or recommendations are to be taken care of immediately.

The objectives of appraisal is dissipated unless the defects are corrected or recommendations are implemented in time.

To avoid unhealthy tendencies the auditor will have to ensure close and constant follow - up.

—— Space to write important points for revision ——

2011 - June [6] (e) "Qualified" opinion and "Adverse" or "negative opinion" in the Audit Report are same. —Comment. **(2 marks)**

(i) Unless the observations and recommendation set out in Audit Report are considered, the objectives of appraisal is dissipated-offer your views. **(2 marks)**

Answer :

(e) ***Please refer 2013 - Dec [7] (a) (iii) on page no. 427***

Answer:

(i) This statement is correct: The importance of follow-up arises specially due to the fact that human tendency (1) is to resistance to change and (2) to delay the adoption of recommendation made by the auditors.

There is delay also to set right the deficiencies and irregularities pointed out in the audit report.

It is not possible to set right the adverse opinion of the Auditor in one sitting. Hence, periodical and regular follow-up is necessary by some responsible staff of the company.

The Auditor/Internal Auditor does not have line authority to enforce recommendations. He is to act in an advisory capacity.

Auditor is to pursue that recommendations are adhered to.

Progress of follow-up action on the report of auditors shall be informed to the top management periodically as an item in the Board meeting. Directors may fix up responsibility for time bound settlement for better follow up and final disposal of the items of observations.

—— Space to write important points for revision ——

2011 - June [8] (c) What are the main points to be reported to the shareholders by the Auditor—(limited to Eight such points). **(4 marks)**

Answer :

The auditor shall make a report to the members of the company on the accounts examined by him and on every financial statements which are required by or under this Act to be laid before the company in general meeting and the report shall after taking into account the provisions of this Act, the accounting and auditing standards and matters which are required to be included in the audit report under the provisions of this Act or any rules made thereunder or under any order made under **sub-section (11)** and to the best of his information and knowledge, the said accounts, financial statements give a true and fair view of the state of the company's affairs as at the end of its financial year and profit or loss and cash flow for the year and such other matters as may be prescribed.

The auditor's report shall also state:

(a) 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;

(b) whether, in his opinion, proper books of account as required by law have been kept by the company so far as appears from his examination of those books and proper returns adequate for the purposes of his audit have been received from branches not visited by him;

(c) whether the report on the accounts of any branch office of the company audited under **sub-section (8)** by a person other than the company's auditor has been sent to him under the proviso to that sub-section and the manner in which he has dealt with it in preparing his report;

(d) 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;

(e) whether, in his opinion, the financial statements comply with the accounting standards;

(f) the observations or comments of the auditors on financial transactions or matters which have any adverse effect on the functioning of the company;

(g) whether any director is disqualified from being appointed as a director under **sub-section (2)** of **Section 164**;

(h) any qualification, reservation or adverse remark relating to the maintenance of accounts and other matters connected therewith;

(i) whether the company has adequate internal financial controls system in place and the operating effectiveness of such controls;

(j) such other matters as may be prescribed.

—— Space to write important points for revision ——

2013 - Dec [7] (b) (i) State the parameters to be satisfied for issuing an unqualified audit report? **(4 marks)**

Answer:

For issuing an unqualified Audit Report, the Auditor has to satisfy himself that:

(i) Evidence	Reasonable evidence is obtained in support of transactions recorded in the books of account.
(ii) Standards	Accounting entries passed in the books of account are in conformity with the generally applicable accounting principles and AS followed consistently.
(iii) True and fair	The financial statements prepared represent a true and fair summary of the transactions that took place during the year.
(iv) Classification	The process of classification and aggregation followed in the preparation of the financial statement is fair and it does not hide a material fact nor does it highlight something, which may distort the real state of affairs.
(v) Format	The form of Financial Statement is in accordance with the form prescribed by law, if any.
(vi) Free of Misstatements	There are no material misstatement in the financial statement.

—— Space to write important points for revision ——

2017 - Dec [9] (b) Discuss the basic elements of an audit report.

(8 marks)

Answer:

The Basic Elements of the Auditors' Report are –

(i) Title: The Auditor's Report should have an appropriate title i.e. "Auditor's Report". It should be distinguished from other Reports, e.g. reports of officers of the entity, Board of Directors.

(ii) Addressee: The Auditor's Report should be appropriately addressed as required by the circumstances of the engagement and applicable laws and regulations. Ordinarily, the Auditor's Report is addressed to the authority appointing the Auditor.

(iii) Opening or Introductory Paragraph:

(a) The Auditor's Report should identify the Financial Statements of the entity that have been audited, including the date of and period covered by the Financial Statements.

(b) The Report should include a Statement that the Financial Statements are the responsibility of the entity's management and a Statement that the responsibility of the Auditor is to express an opinion on the Financial Statements based on the audit.

(iv) Scope Paragraph:

(a) The Auditor's Report should describe the scope of the audit by stating that the audit was conducted in accordance with standards on auditing generally accepted in India.

(b) The Report should include a statement that the audit was planned and performed to obtain reasonable assurance whether the Financial Statements are free of material misstatement.

(c) The Auditor's Report should describe the Audit as including examining, on a test basis, evidence to support the amounts and disclosures in Financial Statements, assessing the accounting principles used in the preparation of the Financial Statements, assessing significant estimates made by management, in the preparation of Financial Statements, and evaluating the overall position of Financial Statements.

(d) The Report should include a statement by the Auditor that the audit provides a reasonable basis for his opinion.

(v) Opinion Paragraph: The Opinion paragraph of the Report should indicate the Financial Reporting framework used to prepare the Financial Statements. It should state the Auditor's opinion as to whether the Financial Statements give a true and fair view in accordance with the financial reporting framework and, where appropriate, whether the Financial Statements comply with the statutory requirements.

(vi) Date of the Report: The date of an Auditor's Report is the date on which the Auditor signs the Report expressing an opinion on the Financial Statements. The Auditor should not date the Report earlier than the date on which the Financial Statements are signed or approved by Management.

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

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

—— Space to write important points for revision ——

2018 - Dec [9] (b) What is a qualified Audit Report? Discuss the circumstances when an Auditor shall qualify his report. **(2+4=6 marks)**

PRACTICAL QUESTIONS

2011 - June [7] (c) M/s. B.K. Associates, Chartered Accountants in addition to normal yearly Audit, rendered services for Taxation, Company Law matters etc. for which separate fees were received by them. While preparing Audit Report what points should be covered in his Audit Report ?

(2 marks)

Answer :

Where in addition to the normal audit the same auditor is also required to render services like taxation, management services, company law matters and for which separate fees are received by the auditor, amount of such additional fees/remuneration expenses or otherwise must be disclosed in the financial statement and audit report separately under following heads in order to give precise and correct information to the shareholders and others:

Tax representation

Company Law matters

Management Services

Other Service.

Space to write important points for revision

Important Highlights

Audit Report under CARO 2016

S.O. 1228(E): In exercise of the powers conferred by **sub-sec. (11)** of **Sec. 143** of the **Companies Act, 2013**. (18 of 2013) and in supersession of the Companies (Auditor's Report) Order, 2015 published in the Gazette of India, Extraordinary, Part II, **Sec. 3**, Sub-sec. (ii), vide number S.O. 990 (E), dated the 10th April, 2015, except as respects things done or omitted to be done before such supersession, the Central Government, after consultation with the, committee constituted under proviso to **sub-sec. (11)** of **Sec. 143** of the **Companies Act, 2013** hereby makes the following Order, namely:

1. **Short title, application and commencement**:
   (1) This Order may be called the Companies (Auditor's Report) Order, 2016.
   (2) It shall apply to every company including a foreign company as defined in clause (42) of **Sec. 2** of the **Companies Act, 2013** (18 of 2013) [hereinafter referred to as the Companies Act], except:

(i) a banking company as defined in clause (c) of **Sec. 5** of the **Banking Regulation Act, 1949** (10 of 1949);

(ii) an insurance company as defined under the **Insurance Act, 1938** (4 of 1938);

(iii) a company licensed to operate **under Sec. 8** of the Companies Act;

(iv) a One Person Company as defined under clause (62) of **Sec. 2** of the Companies Act and a small company as defined under clause (85) of **Sec. 2** of the Companies Act; and

(v) a private limited company, not being a subsidiary or holding company of a public company, having a paid up capital and reserves and surplus not more than rupees one crore as on the balance sheet date and which does not have total borrowings exceeding rupees one crore from any bank or financial institution at any point of time during the financial year and which does not have a total revenue as disclosed in Scheduled III to the **Companies Act, 2013** (including revenue from discontinuing operations) exceeding rupees ten crore during the financial year as per the financial statements.

2. **Auditor's report to contain matters specified in paragraphs 3 and 4:** Every report made by the auditor under **Sec. 143** of the **Companies Act, 2013** on the accounts of every company audited by him, to which this Order applies, for the financial years commencing on or after 1st April, 2015, shall in addition, contain the matters specified in paragraphs 3 and 4, as may be applicable:
Provided the Order shall not apply to the auditor's report on consolidated financial statements.

3. **Matters to be included in the auditor's report:** The auditor's report on the accounts of a company to which this Order applies shall include a statement on the following matters, namely:

(i) (a) whether the company is maintaining proper records showing full particulars, including quantitative details and situation of fixed assets;

(b) whether these fixed assets have been physically verified by the management at reasonable intervals; whether any material discrepancies were noticed on such verification and if so, whether the same have been properly dealt with in the books of account;

(c) whether the title deeds of immovable properties are held in the name of the company. If not, provide the details thereof;

(ii) whether physical verification of inventory has been conducted at reasonable intervals by the management and whether any material discrepancies were noticed and if so, whether they have been properly dealt with in the books of account;

(iii) whether the company has granted any loans, secured or unsecured to companies, firms, Limited Liability Partnerships or other parties covered in the register maintained **under Sec. 189** of the **Companies Act, 2013.** If so,

(a) whether the terms and conditions of the grant of such loans are not prejudicial to the company's interest;

(b) whether the schedule of repayment of principal and payment of interest has been stipulated and whether the repayments or receipts are regular;

(c) if the amount is overdue, state the total amount overdue for more than ninety days, and whether reasonable steps have been taken by the company for recovery of the principal and interest;

(iv) in respect of loans, investments, guarantees, and security whether provisions of **Secs. 185** and **186** of the **Companies Act, 2013** have been complied with. If not, provide the details thereof.

(v) in case, the company has accepted deposits, whether the directives issued by the Reserve Bank of India and the provisions of **Secs. 73** to **76** or any other relevant provisions of the **Companies Act, 2013** and the rules framed thereunder, where applicable, have been complied with? If not, the nature of such contraventions be stated; If an order has been passed by

Company Law Board or National Company Law Tribunal or Reserve Bank of India or any court or any other tribunal, whether the same has been complied with or not?

(vi) whether maintenance of cost records has been specified by the Central Government under sub-sec. (1) of **Sec. 148** of the **Companies Act, 2013** and whether such accounts and records have been so made and maintained.

(vii) (a) whether the company is regular in depositing undisputed statutory dues including provident fund, employees' state insurance, income-tax, sales-tax, service tax, duty of customs, duty of excise, value added tax, cess and any other statutory dues to the appropriate authorities and if not, the extent of the arrears of outstanding statutory dues as on the last day of the financial year concerned for a period of more than six months from the date they became payable, shall be indicated;

(b) where dues of income tax or sale tax or service tax or duty of customs or duty of excise or value added tax have not been deposited on account of any dispute, then the amounts involved and the forum where dispute is pending shall be mentioned. (A mere representation to the concerned Department shall not be treated as a dispute).

(viii) whether the company has defaulted in repayment of loans or borrowing to a financial institution, bank, Government or dues to debenture holders? If yes, the period and the amount of default to be reported (in case of defaults to banks, financial institutions, and Government, lender wise details to be provided).

(ix) whether moneys raised by way of initial public offer or further public offer (including debt instruments) and term loans were applied for the purposes for which those are raised. If not, the details together with delays or default and subsequent rectification, if any, as may be applicable, be reported;

(x) whether any fraud by the company or any fraud on the Company by its officers or employees has been noticed or reported during the year; If yes, the nature and the amount involved is to be indicated;

(xi) whether managerial remuneration has been paid or provided in accordance with the requisite approvals mandated by the provisions of **Sec. 197** read with Schedule V to the Companies Act? If not, state the amount involved and steps taken by the company for securing refund of the same;

(xii) whether the Nidhi Company has complied with the Net Owned Funds to Deposits in the ratio of 1:20 to meet out the liability and whether the Nidhi Company is maintaining ten per cent unencumbered term deposits as specified in the Nidhi Rules, 2014 to meet out the liability;

(xiii) whether all transactions with the related parties are in compliance with **Secs. 177** and **188** of **Companies Act, 2013** where applicable and the details have been disclosed in the Financial Statements etc., as required by the applicable accounting standards;

(xiv) whether the company has made any preferential allotment or private placement of shares or fully or partly convertible debentures during the year under review and if so, as to whether the requirement of **Sec. 42** of the **Companies Act, 2013** have been complied with and the amount raised have been used for the purposes for which the funds were raised. If not, provide the details in respect of the amount involved and nature of non-compliance;

(xv) whether the company has entered into any non-cash transactions with directors or persons connected with him and if so, whether the provisions of **Sec. 192** of **Companies Act, 2013** have been complied with;

(xvi) whether the company is required to be registered under **Sec. 45-IA** of the **Reserve Bank of India Act, 1934** and if so, whether the registration has been obtained.

4. **Reasons to be stated for unfavourable or qualified answers:**
   (1) Where, in the auditor's report, the answer to any of the questions referred to in paragraph 3 is unfavourable or qualified, the auditor's report shall also state the basis for such unfavourable or qualified answer, as the case may be.
   (2) Where the auditor is unable to express any opinion on any specified matter, his report shall indicate such fact together with the reasons as to why it is not possible for him to give his opinion on the same.

—— Space to write important points for revision ——

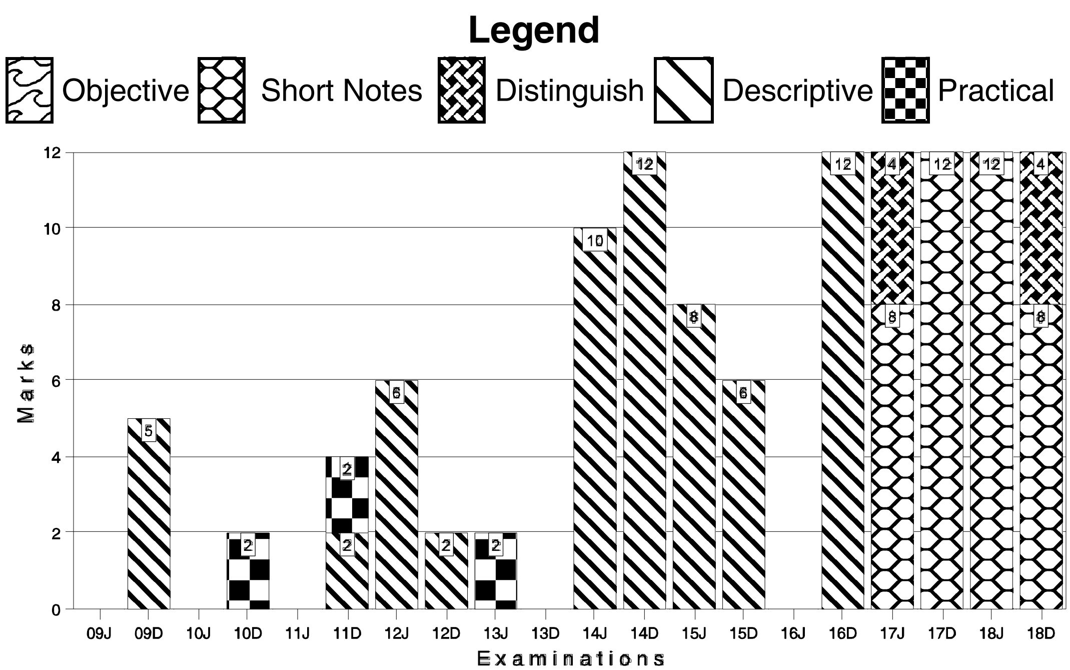
Repeatedly Asked Questions		
No.	**Question**	**Frequency**
1	Distinguish between audit report and audit certificate. 14 - Dec [1] (g), 15 - Dec [4] (b) (iii), 18 - June [9] (b)	3 Times
2	Distinguish between Qualified Audit Report and Adverse Report. 13 - Dec [7] (a) (iii), 17 - June [9] (a)	2 Times

14 MISCELLANEOUS AUDIT

THIS CHAPTER INCLUDES

• Branch Audit • Joint Audit • Audit of Shares • Audit of Debentures • Audit of Divisible Profit/Dividend • Audit of an Educational Institution	• Audit of Hospital • Audit of Co-operative Societies • Bank Audit • Audit of Trust • Audit of Municipalities and Panchayats .

Marks of Objective, Short Notes, Distinguish Between, Descriptive & Practical Questions



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SHORT NOTES

2017 - June [10] Write a short note:
(a) Audit of a Hospital **(4 marks)**
(d) Benefits offered by Joint Audit **(4 marks)**

Answer:

(a) Audit of 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.

(d) Advantages of Joint Audit

Joint Audit basically implies pooling together resources and expertise of more than one firm of auditors to render an expert job in a given time period which may be difficult to accomplish acting individually. It essentially involves sharing of the total work. This is by itself a great advantage. In specific terms the advantages that flow may be the following:

(i) Sharing of expertise
(ii) Advantage of mutual consultation
(iii) Lower work load
(iv) Better quality of performance
(v) Improved service to the client
(vi) Displacement of the auditor of the company often obviated.

(vii) In respect of multinational companies the work can be spread using the expertise of the local firms which are in a better position to deal with detailed work and the local laws and regulations.

(viii) Lower staff deployment cost

(ix) Lower cost to carry out the work

(x) A sense of healthy competition towards a better performance.

—— Space to write important points for revision ——

2017 - Dec [10] Write short notes *(any three):*

(a) Audit of Municipalities and Panchayats

(b) Audit of Bonus share issued by a company

(c) Branch Auditor

(d) Declaration of dividend by a company u/s 123 **(4 × 3 = 12 marks)**

Answer:

(a) 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.

(b) Audit of bonus share issued by a company (Section 63)

The auditor should take note of the following points:

(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 capitalizing reserves created by the revaluation of assets.

(v) Check whether the company has made any default in payment of interest or principal in respect of fixed deposits or debt securities issued by it.

(vi) Check whether the company has made any default in payment of statutory dues of the employees, such as, contribution to provident fund, gratuity and bonus.

(vii) Whether the partly paid-up shares are made fully paid-up.

(viii) Check whether the bonus shares shall not be issued in lieu of dividend.

(c) Branch Auditor

Branch Auditor may be appointed under Section 139 of 2013 Act to audit the Accounts of Branch Office of a Company. Such person, who is appointed as Branch Auditor, should be qualified for appointment as an auditor of the Company under 2013 Act. The Branch Auditor shall prepare a report on the Accounts of the Branch examined by him and send it to Company's Auditor. The report of Branch Auditor will be dealt by Company's auditor in the manner deemed fit. Branch auditor is responsible to report fraud, as applicable to Company's auditor.

(d) Declaration of dividend by a company u/s 123

No dividend shall be declared or paid by a company for any financial year except:

(a) out of the profits of the company for that year arrived at after providing for depreciation in accordance with the provisions of subsection (2), or out of the profits of the company for any previous financial year or years arrived at after providing for depreciation in accordance with the provisions of that sub-section and remaining undistributed, or out of both; or

(b) 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.

Provided that a company may, before the declaration of any dividend in any financial year, transfer such percentage of its profit for that financial year as it may consider appropriate to the reserves of the company.

Provided further that where, owing to inadequacy or absence of profits in any financial-year, any company proposes to declare dividend out of the accumulated profits earned by it in previous years and transferred by the company to the free reserves, such declaration of dividend shall not be made except in accordance with such rules as may be prescribed in this behalf.

Provided also that no dividend shall be declared or paid by a company from its reserves other than free reserves.

Provided also that no company shall declare dividend unless carried over previous losses and depreciation net provided in previous year or years are set off against profit of the company for the current year.

For the purposes of clause (a) of sub-section (1), depreciation shall be provided in accordance with the provisions of Schedule II.

—— Space to write important points for revision ——

2018 - June [10] Write short notes (*any three*):

(a) Responsibility of a Joint Auditor

(b) Elements of 'cost of inventory' as per AS 2

(c) Audit of Education Institutions

(d) Auditor's duty regarding Issue of Debentures. **(4 × 3 = 12 marks)**

Answer:

(a) **Responsibility of a Joint Auditor:**

1. For the audit work divided among themselves, each joint auditor is responsible only for the work allocated to him. Accordingly, among other duties,
   (i) Each joint auditor is required to scrutinize the audit report of the branch/ divisions specifically allocated to him.
   (ii) 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.
2. In respect of undivided work.
   (i) 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.)
   (ii) 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.
   (iii) In respect of compliance with disclosure requirement (i.e. Notes on accounts) of the relevant statute while examining the financial statements.
   (iv) For ensuring that the audit report complies with the requirements of the relevant statute.

(b) **Elements of 'Cost of Inventory' as per AS 2**

Cost of inventory includes the following

1. Cost of purchase
2. Cost of conversion
3. Other costs incurred in bringing the inventories to their present location and condition.

1. **Cost of purchase includes :**
   Purchase price, Duties and Taxes, Freight inward, other expenditures directly attributable to the acquisition less duties and taxes recoverable by enterprises from taxing authorities. Trade discount, Rebate, Duty drawback, Other similar items.
2. **Cost of conversion :**
   It consists of the cost directly related to the units + Systematic Allocation of fixed and variable production overheads that are incurred in converting material into finished goods.
   Fixed Production overhead means Indirect cost of production that remains relatively constant regardless of volume of production. Allocation of fixed production overhead is done on normal capacity.
   Variable Production overhead means indirect cost of production that varies directly or nearly directly with the volume of production. Allocation of variable production overhead is done on actual production.
   In case of Joint-products, when the cost of conversion of each product is not identifiable separately, total cost of conversion is allocated between the products on the rational and consistent basis, if by-products, scrap or waste materials are not of material value, they are measured at net realisable value, then the net realisable value is deducted from cost of conversion. Net cost of conversion is distributed among the main products.
3. **Other Costs:** Cost incurred in bringing the inventories to their present location and condition.

(c) **Audit of Education Institutions**

The Special steps involved in the audit of an educational institution are the following:

(i) Examine the Trust Deed, or Regulations in the case of school or college and note all the provisions affecting accounts. In the case of a university, refer to the Act of Legislature and the Regulations framed there under.

(ii) Read through the minutes of the meetings of the Managing Committee or Governing Body, noting resolutions affecting accounts to see that these have been duly complied with, specially the decisions as regards the operation of bank accounts and sanctioning of expenditure.

(iii) Check names entered in the Students' Fee Register for each month or term, with the respective class registers, showing names of students on rolls and test amount of fees charged; and verify that there operates a system of internal check which ensures that demands against the students are properly raised.

(iv) Check fees received by comparing counterfoils of receipts granted with entries in the cash book and tracing the collections in the Fee Register to confirm that the revenue from this source has been duly accounted for.

(v) Total up the various columns of the Fees Register for each month pre term to ascertain that fees paid in advance have been carried forward and the arrears that are irrecoverable have been written off under the sanction of an appropriate authority.

(vi) Check admission fees with admission slips signed by the head of the institution and confirm that the amount had been credited to a Capital Fund, unless the Managing Committee has taken a decision to the contrary.

(vii) See that free studentship and concessions have been granted by a person authorised to do so, having regard to the prescribed Rules.

(viii) Confirm that fines for late payment or absence, etc., have either been collected or remitted under proper authority.

(ix) Confirm that hostel dues were recovered before students' accounts were closed and their deposits of caution money refunded.

(x) Verity rental income from landed property with the rent rolls, etc.

(xi) Verify the inventories of furniture, stationery, clothing, provision and all equipment, etc.

These should be checked by reference to Stock Register and values applied to various items should be test checked.

(xii) Confirm that the refund of taxes deducted from the income from investment (interest on securities, etc.) has been claimed and recovered since the institutions are generally exempted from the payment of income-tax.

(xiii) Verify the annual statements of accounts and while doing so see that separate statements of account have been prepared as regards Poor Boys Fund, Games Fund, Hostel and Provident Fund of Staff, etc.

(d) Auditor's duty regarding Issue of Debentures:

(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.

—— Space to write important points for revision ——

2018 - Dec [10] Write short notes:

(a) Auditor's duty regarding unclaimed dividend

(c) Audit of Co-operative Society **(4 × 2 = 8 marks)**

DISTINGUISH BETWEEN

2017 - June [10] (b) Difference between Statutory Audit and Internal Audit. **(4 marks)**

Answer:

Statutory Auditor and Internal Auditor

SL No.	Basis	Statutory Audit	Internal Audit
i.	**Appointing Authority**	Statutory Auditor is appointed by the shareholder in the general meeting.	Internal Auditor is appointed by the Board.
ii.	**Scope of the work**	The scope of work is defined in the Companies Act.	The scope of work includes the adherence of management policies and procedures and identifies the weakness in the internal control.
iii.	**Removal of Auditor**	Statutory Auditor can be removed by the shareholders.	Internal Auditor can be removed by the Board.
iv.	**Remuneration**	It is fixed by the shareholders.	It is fixed by the board.
v.	**Audit Report**	It is submitted to the appointing Authority.	It is submitted to the Board as a suggestion to improve weakness in the internal control.

Space to write important points for revision

2018 - Dec [10] (d) Difference between Statutory Audit and Internal Audit **(4 marks)**

DESCRIPTIVE QUESTIONS

2009 - Dec [5] {C} Comment on the following statements based on legal provisions:

(g) ABC Ltd. has made provision for payment of dividend out of capital redemption reserve fund. **(2 marks)**

Answer :

Capital redemption reserve cannot be used for distribution of dividend. Dividends can be declared only out of current year of profits. The fundamental principle underlying the payment of dividend is that the dividend is return on capital and not return of capital. Therefore the following items are not available for declaration or payment of dividend.

(i) Capital Redemption Reserve
(ii) Fixed assets revaluation reserve (subject to satisfaction of certain conditions)
(iii) Excess amount of forfeiture/ reissue of shares.
(iv) Any specific reserve created out of specific provisions.

—— Space to write important points for revision ——

2009 - Dec [6] (f) As a Branch Auditor how you will conduct Branch Audit? **(3 marks)**

Answer :

- The branch audit should be conducted in the same manner as other statutory audits.
- The branch auditor has same powers, responsibility and liability as statutory auditor.
- His basic objective is to record and report his opinion on the state of affairs of the company as to whether the financial statements present the true and fair view of the state of affairs of the company.
- He will check the books of accounts, call for explanation of the concerned officials as required, collect internal and external evidence and frame his opinion and report.

—— Space to write important points for revision ——

2011 - Dec [5] {C} Comment on the following statements based legal provisions:

(d) When a company appoints Joint Auditor, auditors' liability and responsibility are increased because an auditor is made responsible for the audit work of another auditor. **(2 marks)**

Answer :

According to the statement issued by the ICAI, it would not be correct to hold an Auditor responsible for the work of another and each joint auditor will be responsible only for the work allotted to him. The statement is false.

—— Space to write important points for revision ——

2012 - June [5] {C} Comment on the following statements based on legal provisions:

(g) Dividend has been declared out of profit on re-issue of forfeited shares. **(2 marks)**

Answer :

Profit on re-issue of forfeited shares is transferred to capital reserve. Capital reserve is not available for distribution as dividend. The auditor should advise the management not to distribute the profit on forfeited shares as dividend.

—— Space to write important points for revision ——

2012 - June [6] (b) Accounts of Mumbai Branch was audited by a firm of Chartered Accountants of Mumbai. Even then the Company Auditor demanded to visit Mumbai Branch, Director (Finance) could not agree. Offer views. **(2 marks)**

Answer :

The Company auditor is entitled to visit the Branch office and has right to access all books and accounts records etc of the branch. The Director (Finance) cannot disallow the company auditor the right to visit Branches.

—— Space to write important points for revision ——

2012 - June [7] (b) Proposed dividend was not adjusted in the financial statements. Offer your views. **(2 marks)**

Answer :

Proposed dividend by Directors should be disclosed in the financial statements as per the requirement of Schedule III to **Companies Act, 2013.** Though the dividend proposed is subject to approval of the shareholders in the AGM, dividend proposal is one of the appropriation of Profits and as such it should be taken in the preparation of the financial statement as per schedule III.

—— Space to write important points for revision ——

2012 - Dec [7] (b) Company Auditor received the Branch Audit Report which contains qualifications on matters specially required to be disclosed pursuant to schedule III requirement. How this type of situation shall be dealt with by the Auditor? **(2 marks)**

Answer :

Any audit should never be treated as an extension of any previous audit. Every audit should be conducted and concluded in an independent manner. It is for the current auditor to determine whether he wants to accept or reject the report of branch auditor. If he rejects such report, he should give reasons for such rejection and he should conduct his own audit on that matter and frame his own report. As a matter of fact, he (current auditor) can deal with the audit report of the branch auditor in any manner he deems fit.

—— Space to write important points for revision ——

2014 - June [5] {C} Answer the following:

(b) State the duties of Auditor in respect of issue of Debentures as co-lateral security. **(2 marks)**

Answer:

Issue of Debentures as Collateral Security:

Debentures may be issued to creditors, bankers or any other person, without receiving any cash thereon. Here it acts as a collateral security and becomes real debentures in the event of the default of the loan. Usually the nominal value of such debentures is more than that of the amount of loan.

Auditor's Duty:

(i) The auditor should see that such debentures do not appear in the liabilities side of the balance sheet, but are shown by way of note under the heading loan.

(ii) He should ensure that necessary entries have been made in the register of mortgages and that the necessary papers are filed with the registrar of companies.

(iii) He should also examine the loan agreement and confirm that it has been approved by the Board.

—— Space to write important points for revision ——

2014 - June [7] (c) (ii) What are the matters to be considered while conducting the audit of a charitable institution? **(8 marks)**

Answer:

Audit of a Charitable Institution:

When conducting the audit of a charitable institution, the auditor should consider the following matters:

(i) The auditor should study the constitution of the charitable institution, for example, whether it is set up under the Societies Registration Act or as per **Section 8** of the **Companies Act, 2013** or as a trust.

(ii) Obtain a list of members of the governing body. This will help the auditor in identifying whether any of the members of the governing body has any interest in the charitable institution.

(iii) The auditor should obtain a copy of the budget sanctioned or the financial statement. This would enable him to acquaint himself with the different heads of income and expenditures of the institution.

(iv) Examination of the system of internal check, especially as regards the accounting of the amounts collected.

(v) Check that the amounts received towards income have been duly collected, received and deposited into the bank regularly and promptly.

(vi) These institutions receive subscriptions and donations which form the major part of their collections. Therefore, the auditor should check the following:

- The amount or the rate of the annual subscription.
- Any instructions given by the donors as to the specific utilization of donation.
- Adequacy of internal controls existing as regards unused receipt books, counter foils, etc.
- Where subscriptions are received in advance these should be properly dealt with in the accounts.

(vii) Verify the amounts of legacies received by reference to correspondence with any figures other available information.

(viii) Where the institution has made any investments or given loans, the amount of dividend and interest should be properly vouched with reference to the counterfoils or dividend warrants received. It should be ensured that such loans or grants are given under proper authorizations.

(ix) If some property is given or taken on rent, then the auditor should check the tenancy agreement, the rent slips and the authorized person for the collection or payment, as the case may be, of the rent.

(x) Most of the organisations organize special functions such as concert etc. The auditor should be careful in such cases. All the gross receipts and outgoings are to be properly vouched by him. It should be ensured that proper internal check was maintained as regards the receipts and outgoings. For example, the person responsible for collection and disbursements should be separate persons.

(xi) The expenditure of charitable institution is also one of the major areas of concern. Thus, the auditor should verify that the expenditure is made only for the charitable purpose. If the expenditure is not for the charitable purpose, then the auditor should examine the implications of applicable law and document for the same.

(xii) The auditor should physically verify the cash in hand, inventories and fixed assets.

—— Space to write important points for revision ——

2014 - Dec [4] (a) Comment on the following:

(iv) The responsibilities of joint auditors are joint and several. **(4 marks)**

Answer:

In respect of audit work divided among the joint auditors, each joint auditor is responsible only for the work allocated to him, whether or not he has prepared a separate report on the work performed by him. On the other hand, all the joint auditors are jointly and severally responsible:

(1) in respect of the audit work which is not divided among the joint auditors and is carried out by all of them;

(2) in respect of decisions taken by all the joint auditors concerning the nature, timing or extent of the audit procedures to be performed by any of the joint auditors. It may, however, be clarified that all the joint auditors are responsible only in respect of the appropriateness of the decisions concerning the nature, timing or extent of the audit procedures agreed upon among them; proper execution of these audit procedures is the separate and specific responsibility of the joint auditor concerned;

(3) 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 the joint auditors;

(4) for examining that the financial statements of the entity comply with the disclosure requirements of the relevant statute; and

(5) for ensuring that the audit report complies with the requirements of the relevant statute.

—— Space to write important points for revision ——

2014 - Dec [4] Answer the question:

(b) (i) What are the matters to be considered while conducting the audit of a hospital? **(8 marks)**

Answer:

Audit of 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 verified with 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.

Space to write important points for revision

2015 - June [4] Answer the question:
(b) (i) What are the advantages of joint audit? **(8 marks)**

Answer:

Advantages of Joint Audit

Joint Audit basically implies pooling together resources and expertise of more than one firm of auditors to render an expert job in a given time period which may be difficult to accomplish acting individually. It essentially involves sharing of the total work. This is by itself a great advantage. In specific terms the advantages that flow may be the following:

(i) Sharing of expertise
(ii) Advantage of mutual consultation
(iii) Lower work load
(iv) Better quality of performance
(v) Improved service to the client
(vi) Displacement of the auditor of the company often obviated.
(vii) In respect of multinational companies the work can be spread using the expertise of the local firms which are in a better position to deal with detailed work and the local laws and regulations.
(viii) Lower staff deployment cost
(ix) Lower cost to carry out the work
(x) A sense of healthy competition towards a better performance.

—— Space to write important points for revision ——

2015 - Dec [1] Answer the question:
(h) State the auditor's duties in respect of issue of redeemable debentures. **(2 marks)**

Answer:

The auditor shall check the following:

- Whether the issue is permitted by the Articles of the Company?
- Whether the company has passed any resolution in the general meeting or not?
- Whether the issue is as per the provision of the **Companies Act, 2013**?
- Whether proper entries have been made by the company if it is issued is at par or at a premium or at a discount?

- Whether the particulars regarding these debentures are properly maintained and reported or not?
- Whether the amount obtained is properly utilized for the purpose for which it was obtained?

—— Space to write important points for revision ——

2015 - Dec [4] Answer the question:
(b) (i) As an auditor of a company, how will you audit of re-issue of forfeited shares? **(4 marks)**

Answer:

Re-issue of forfeited shares:

- The auditor should ascertain that the Board of Directors has the authority under the Articles of Association of the company to reissue forfeited shares. Check the relevant resolution of the Board of Directors.
- Vouch the amounts collected from persons to whom the shares have been allotted and verify the entries recorded from re-allotment. Auditor should check the total amount received on the shares including received prior to forfeiture, is not less than the par value of shares.
- Verify that computation of surplus amount arising on the reissue of shares credited to Capital Reserve Account and
- Where partly paid shares are forfeited for non-payment of call, and re-issued as fully paid, the reissue is considered as an allotment at a discount and compliance of the provisions of **Section 53** is essential.

—— Space to write important points for revision ——

2016 - Dec [6] (b) Explain what are the sources for payment of Dividend. **(5 marks)**

Answer:

No dividend shall be declared or paid by a company for any financial year except — out of the profits of the company for that year arrived at after providing for depreciation, or out of the profits of the company for any previous financial year or years arrived at after providing for depreciation.

Source for payment of Dividend:

Section 123 permits payment of Dividend out of following sources only:

- Profit for the year for which dividend is to be paid.
- Undistributed or accumulated profits of previous financial years.
- Money provided by Central Government or State Government for the payment of dividends in pursuance of a guarantee given by that Government.

—— Space to write important points for revision ——

2016 - Dec [8] (a) What aspects are required to be examined by the auditor in conducting audit of Buy-back of shares by the company? **(7 marks)**

Answer:

Following areas are required to be examined by the auditor in conducting audit of Buyback of shares by the company:

- Confirm that Buy-Back was authorized by articles.
- Verify the minutes of the Board meeting and special resolution passed in the general meeting in which the approval of members is obtained.
- Where the buy-back has been authorised by the Board by means of a resolution passed at its meeting then check that the buy-back is not more than ten per cent, or less of the total paid-up equity capital and free reserves of the company.
- Check that the no buy-back of any kind of shares or other specified securities shall be made out of the proceeds of an earlier issue of the same kind of shares or same kind of other specified securities.
- To check that the buy-back shall not be more than twenty-five per cent, of the aggregate of paid-up capital and free reserves of the company. In case of buy-back of equity shares in any financial year, the reference to twenty-five per cent, in this clause shall be construed with respect to its total paid-up equity capital in that financial year.
- To check that the ratio of the aggregate of secured and unsecured debts owed by the company after buy-back is not more than twice the paid-up capital and its free reserves.

- To check that all the shares or other specified securities for buy-back should be fully paid-up.
- To check whether the buy-back is made as per SEBI regulations in case of buy-back of the shares or other specified securities listed on any recognized stock exchange.
- To check that no offer of buy-back under this sub-section shall be made within a period of one year reckoned from the date of the closure of the preceding offer of buy-back.
- To ensure that buy-back shall be completed within a period of one year from the date of passing of the special resolution, or as the case may be, the resolution passed by the Board under clause (b) of subsection (2).
- Ensure that the buy-back has been done only out of the company's free reserves or its securities premium account or out of the proceeds of any shares or other specified securities other than out of the proceeds of an earlier issue of the same kind of shares or same kind of other specified securities.
- Ascertain that declaration of solvency was filed with the SEBI and/or the Registrar of Companies before making buy-back but subsequent the passing of the special resolution.
- To ensure that company shall extinguish and physically destroy the shares or securities so bought back within seven days of the last date of completion of buy-back.
- To ensure that the company shall not make a further issue of the same kind of shares or other securities including allotment of new shares or other specified securities within a period of six months except by way of a bonus issue.
- Whether the company has maintained any register of the shares or securities so bought.
- Check whether that the after the completion of the buy-back under this section the company file with the Registrar and the Securities and Exchange Board a return containing such particulars relating to the buy-back within thirty days of such completion.

Space to write important points for revision

PRACTICAL QUESTIONS

2010 - Dec [5] {C} Comment on the following statements based on legal provisions:

(e) XYZ India Ltd. has a Branch Office in England. M/s. R.B. Dutta & Co. Chartered Accountants were appointed as Auditor of the Company whereas an Accountant qualified to act as Auditor in England was appointed as Branch Auditor to conduct Audit of that Branch. Indian Auditor opined this was not legally valid. **(2 marks)**

Answer :

As directed in **Companies Act, 2013 u/s 143**, the accounts of the branch office of a company are required to be audited by :

1. The company's auditor appointed **u/s 142** or
2. The person qualified for appointment as contemplated by **Section 141** or
3. Where the branch office is situated in a foreign country, either of the above or by an accountant duly qualified to act as auditor in accordance with the laws of that foreign country **(Section 143)**.

—— Space to write important points for revision ——

2011 - Dec [7] (b) Board of Directors of Evershine Ltd. in its meeting held on 11.08.2011 declared and paid final dividend of 30% for 2010-11. As an Auditor how you will react ? **(2 marks)**

Answer :

As per provisions of **Companies Act, 2013**, on the basis of Board of Director's recommendation the shareholders in the Annual General Meeting declare the final dividend. Board has power to declare interim dividend and not final dividend.

It is presumed :

(i) The company transferred the amount of dividend to a separate bank account within 5 days of declaration.

(ii) Paid or issued dividend warrant to all the entitled shareholders or their mandates within 30 days of declaration.

Since action of the board of directors is not in accordance with the law, the auditor shall check whether expost facto approval of the share holders has been obtained.

The Auditor should qualify his report to this effect.

The Auditor should also to confirm whether the provision for the same has been made in Part II of Schedule III to the **Companies Act, 2013** and all deviations shall be reported/qualified through his audit report without fail.

—— Space to write important points for revision ——

2013 - June [7] (f) ABC Ltd. has two branch offices in Chennai and Hyderabad, for which Branch auditors were engaged. M/s APS & Co. Chartered Accountants being statutory Auditor of ABC Ltd. is responsible in respect of work entrusted to Branch Auditors also. Do you agree? Answer based on rules. **(2 marks)**

Answer :

Section 143 of the **Companies Act, 2013** provides that where the accounts of any branch office are audited by a person other than the company's auditor the company's auditor shall be entitled to visit the branch office, if he deems it necessary to do so for the performance of his duties as auditor. He shall also have access at all times to the books and accounts and vouchers of the company maintained at the branch office.

The Council of the Institute of Chartered Accountants of India has reviewed the relationship between the statutory Auditor and the Branch Auditor and has come to the conclusion that the statutory auditors would not be responsible in respect of work entrusted to the Branch Auditors. So in this case APS & Co. is not responsible.

—— Space to write important points for revision ——

Repeatedly Asked Questions		
No.	**Question**	**Frequency**
1	Audit of a Hospital 14 - Dec [4] (b) (i),17 - June [10] (a)	2 Times
2	Benefits offered by Joint Audit 15 - June [4] (b) (i), 17 - June [10] (d)	2 Times
3	Difference between Statutory Audit and Internal Audit 17 - June [10] (b), 18 - Dec - [10] (d)	2 Times

Table Showing Marks of Compulsory Questions

Year	**14 J**	**14 D**	**15 J**	**15 D**	**16 J**	**16 D**	**17 J**	**17 D**	**18 J**	**18 D**
Descriptive	2									
Total	2									

15 OBJECTIVE QUESTIONS

2017 - June [6] (a) Identify the correct alternative:

(i) Which of the following is not an audit risk?
- (a) Inherent Risk
- (b) Detection Risk
- (c) Control Risk
- (d) Omission Risk

(ii) 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.

(iii) Permanent Audit File does not contain
- (a) a record of study and evaluation of internal control system.
- (b) significant audit observations of earlier years.
- (c) copies of management letters.
- (d) analysis of significant ratios and trends.

(iv) Audit Procedures to obtain audit evidences include
- (a) Compliance Procedure
- (b) Substantive Procedure
- (c) Both (a) and (b)
- (d) Neither (a) nor (b)

(v) A Cost Auditor submits his report to
- (a) Board of Directors
- (b) Government
- (c) Shareholders
- (d) Statutory Auditor

(vi) The first Auditor of a Company shall be appointed by the Board of Directors within
   (a) 30 days from the date of registration.
   (b) 90 days from the date of registration.
   (c) 30 days from the date of first AGM.
   (d) 1 year from the date of registration. **(1 × 6 = 6 marks)**

Answer:

(i) (d) Omission Risk
(ii) (c) profit on revaluation of any fixed assets
(iii) (c) copies of management letters
(iv) (c) Both (a) and (b)
(v) (a) Board of Directors
(vi) (a) 30 days from the date of registration

—— Space to write important points for revision ——

2017 - June [6] (b) Match the following items in Column 'A' with items shown in Column 'B':

	Column 'A'		**Column 'B'**
1.	Responsibility of Joint Auditor	A.	Qualified Audit Report
2.	Unable to form and overall conclusion on Financial Statement	B.	SA 230
3.	Audit Report with reservations	C.	SA 299
4.	Audit Documentation	D.	Disclaimer of Opinion

(1 × 4 = 4 marks)

Answer:

	Column 'A'		**Column 'B'**
1.	Responsibility of Joint Auditor	C.	SA 299
2.	Unable to form an overall conclusion on Financial Statement	D.	Disclaimer of Opinion

3.	Audit Report with reservations	A.	Qualified Audit Report
4.	Audit Documentation	B.	SA 230

—— Space to write important points for revision ——

2017 - June [6] (c) State whether the following statements are True or False:
(i) Audit Programme is a part of Current Audit File.
(ii) Internal audit is conducted by the staff of the entity or by an independent professional appointed for that purpose.
(iii) The first auditor of a company is appointed by the shareholders of the company at the general meeting.
(iv) A company auditor can render actuarial services to his client.

(1 × 4 = 4 marks)

Answer:
(i) True
(ii) True
(iii) False
(iv) False

—— Space to write important points for revision ——

2017 - Dec [6] (a) Identify the correct alternative:
(i) 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.
(ii) In case of a company other than a Government Company, any casual vacancy in the post of auditor is to be filled by the
  (a) Board of Directors
  (b) Managing Director
  (c) Comptroller and Auditor General (CAG)
  (d) Shareholders

(iii) An Audit Committee should have a minimum of ______ number of directors.
(a) 4
(b) 3
(c) 5
(d) 6

(iv) SA 530 stands for
(a) Audit Documentation
(b) Audit Sampling
(c) Responsibility of Joint Auditor
(d) Agreeing the terms of Audit Engagements

(v) 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

(vi) 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 **(1 × 6 = 6 marks)**

Answer:

(i) C
(ii) A
(iii) B
(iv) B
(v) C
(vi) D

2017 - Dec [6] (b) Match the following items in Column 'A' with items shown in Column 'B':

	Column 'A'		Column 'B'
1.	Appointment of Company Auditor	A.	Current Audit File
2.	Remuneration of a Company Auditor	B.	Section 139 of Companies Act, 2013
3.	Different accounting schedules such as schedule of debtors and creditors	C.	Permanent Audit File
4.	Analysis of significant ratios and trends	D.	Section 142 of Companies Act, 2013

(1 × 4 = 4 marks)

Answer:

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

—— Space to write important points for revision ——

2017 - Dec [6] (c) State whether the following statements are true or false:

(i) As per Section 138 of Companies Act, 2013, no private company or unlisted company is required to appoint an internal auditor.

(ii) Audit Memorandum is a detailed plan of audit work clearly specifying the responsibilities of the audit staff and time allotted to perform the same.

(iii) Substantive procedure is also known as test of control.

(iv) Cut-off procedures are adopted to allocate revenues and costs to the proper accounting period. **(1 × 4 = 4 marks)**

Answer:

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

—— Space to write important points for revision ——

2018 - June [6] (a) Identify the correct alternative in each of the following cases:

(i) If the Debentures are issued as collateral security either to Banks or Creditors the Auditor needs to ensure that such issue is approved by
(a) Shareholders
(b) Board of Directors
(c) Debenture Trustee
(d) Audit Committee

(ii) As per SQC 1, Audit working papers should be retained for a period of
(a) 2 years
(b) 5 years
(c) 7 years
(d) 10 years

(iii) Current Audit files contains
(a) Articles of Association and Memorandum of Association
(b) Analysis of significant ratios and trends
(c) Notes regarding significant Accounting policies
(d) Audit Programme

(iv) Form for maintenance of Cost Records of a Company is
(a) CRA - 1
(b) CRA - 2
(c) CRA - 3
(d) CRA - 4

(v) Secretarial Audit is applicable to every Public Company having a turnover of
(a) ₹ 100 crores
(b) ₹ 150 crores
(c) ₹ 250 crores
(d) ₹ 200 crores

(vi) Statutory Auditor is appointed by the Shareholders in the
(a) General Meeting
(b) Statutory Meeting
(c) EGM
(d) Board Meeting **(1 × 6 = 6 marks)**

Answer:

(i) (b)
(ii) (c)
(iii) (d)
(iv) (a)
(v) (c)
(vi) (a)

—— Space to write important points for revision ——

2018 - June [6] (b) Match the following items in Column 'A' with items shown in Column 'B':

	Column 'A'		Column 'B'
1.	Independent appraisal activity	A	Secretarial Audit Report
2.	SA 700	B	Section 123
3.	Form MR 3	C	Internal Audit
4.	Declaration of dividend	D	Forming an opinion and reporting on Financial Statements

(1 × 4 = 4 marks)

Answer:

(1) (c)
(2) (d)
(3) (a)
(4) (b)

—— Space to write important points for revision ——

2018 - June [6] (c) State whether the following statements are True or False:

(i) Section 70 deals with the Audit of Debenture.
(ii) An Audit Committee should have 4 directors.
(iii) CARO - Companies (Auditor's Report) Order, 2016 is applicable to Banking Companies.
(iv) Internal Check is part of Accounting Control. **(1 × 4 = 4 marks)**

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

—— Space to write important points for revision ——

2018 - Dec [6] (a) Identify the correct alternative in each of the following cases:

(i) Internal Auditor is appointed by
   (a) Audit Committee
   (b) Shareholders in General Meeting
   (c) Extraordinary General Meeting
   (d) Board of Directors

(ii) Cost Audit Report is submitted to Board of Directors in Form No.
   (a) CRA - 1
   (b) CRA - 2
   (c) CRA - 3
   (d) CRA - 4

(iii) Check list contains the instruction to be followed by the
   (a) Internal Auditor
   (b) External Auditor
   (c) Audit Assistants
   (d) Employee of the organisation

(iv) Form for Secretarial Audit Report is
   (a) MR - 2
   (b) MR - 3
   (c) MR - 4
   (d) MR - 5

(v) 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.

(vi) Audit of debenture is covered under section
   (a) 70
   (b) 71
   (c) 72
   (d) 73 **(1×6=6 marks)**

2018 - Dec [6] (b) Match the following items in Column 'A' with items shown in Column 'B':

	Column 'A'		Column 'B'
(i)	The authority for Government Audit	(a)	Audit Programme
(ii)	Details of Audit work to be performed	(b)	Comptroller and Auditor General
(iii)	Removal of Statutory Company Auditor	(c)	Audit Note Book
(iv)	Details about Name and Organisation Structure	(d)	Section 140
		(e)	No match found

(1×4=4 marks)

2018 - Dec [6] (c) State whether the following statements are *True* or *False*:

(i) The Branch Auditor shall prepare report on the Accounts of the Branch examined by him and send it to Audit Committee.

(ii) Maintenance of Cost Accounting Standards is mandatory as per Section 143 of Companies Act.

(iii) Routine checking is a substitute of vouching.

(iv) Casual vacancy in the office of Cost Auditor is filled by Board of Directors. **(1×4=4 marks)**

June - 2018
CMA Inter Gr. II Paper - 12
Company Accounts and Audit

Section – A (Company Accounts)

Answer Question No. **1** *and* any three *from* Question Nos. **2, 3, 4** *and* **5.**

1. (a) Choose the correct alternative:
   - (i) Premium on redemption of redeemable preference shares can be paid out of
     - (a) Capital Redemption Reserve Account
     - (b) Existing Shares Premium Account
     - (c) Proceed of fresh issue of shares
     - (d) All of the above
   - (ii) Which of the following is not a component of Cash Flow Statement?
     - (a) Cash payments to suppliers for goods and services
     - (b) Charging of Depreciation
     - (c) Cash advances and loans made to third parties
     - (d) Cash repayments of amounts borrowed
   - (iii) The Electricity Act, 2003 replaced which of the following three existing legislations?
     - (a) The Indian Electricity Act, 1910
     - (b) The Electricity (Supply) Act, 1948
     - (c) The Electricity Regulatory Commissions Act, 1998
     - (d) All of the above
   - (iv) General Ledger of a Banking Company does not contain
     - (a) Control Accounts of all personal ledgers
     - (b) Assets Accounts
     - (c) Contra Accounts
     - (d) Balance Sheet
   - (v) Which of the following is a principle of insurance?
     - (a) Principle of indemnity
     - (b) Insurable interest
     - (c) Principle of *uberrimae fidei*
     - (d) All of the above

(vi) Underwriting commission payable on the shares taken up by the promoters is
(a) 2.5%
(b) 2%
(c) 5%
(d) Nil (1 × 6 = 6 marks)

(b) Match the following items in Column 'A' with items shown in Column 'B':

	Column 'A'		Column 'B'
1.	Government Grants	A.	Capital Redemption Reserve
2.	Redemption of Debentures	B.	AS 16
3.	Un-guaranteed Residual Value	C.	AS 12
4	Borrowing Cost	D.	AS 19

(1 × 4 = 4 marks)

(c) State whether the following statements are True or False:
(i) Marked applications are those applications which bear the stamp of an underwriter.
(ii) In order to spread the risk of under- subscription, the principal underwriters may enter into subsidiary agreements with sub-leasees.
(iii) When debentures are issued at discount, it is prudent to write off the loss during the life of debentures.
(iv) Any surplus cash may be utilized by the company for buy-back and avoid the payment of dividend tax. (1 × 4 = 4 marks)

2. (a) On 01.01.2017 Jay Ltd. had 2,000, 12% Debentures of ₹ 100 each. On 01.05.2017 the company purchased 400 own Debentures at ₹ 97 cum-interest in the open market. Interest on debentures is payable on 30^{th} June and 31^{st} December each year.
Required: Give the necessary journal entries assuming that the own Debentures purchased were retained as investments till 31.12.2017, on which date they were cancelled.
Assume that the company follows English Calendar Year.
(6 marks)

(b) M/s. Ayush Ltd. began construction of a new building on 1st January, 2017. It obtained ₹ 3,00,000 lakh special loan to finance the construction of the building on 1st January ,2017 at an interest rate of 12% p.a. The company's other outstanding two non-specific loans were:

Amount	Rate of Interest
₹ 6,00,000	11% p.a.
₹ 11,00,000	13% p.a.

The expenditure that were made on the building project were as follows:

	Amount (₹)
January, 2017	3,00,000
April, 2017	3,50,000
July, 2017	5,50,000
December, 2017	1,50,000

Building was completed on 31st December, 2017. Following the principles prescribed in AS 16 on 'Borrowing Cost', calculate the amount of interest to be capitalized and pass one Journal entry for capitalizing the cost and borrowing in respect of the building.

(6 marks)

3. (a) The following are the summarized Balance Sheets of ABC Limited as on 31st March, 2016 and 2017:

Liabilities	31.03.16	31.03.17	Assets	31.03.16	31.03.17
	₹	₹		₹	₹
Share Capital	4,60,000	4,60,000	Land and Building	3,00,000	3,00,000
Profit and Loss Balance	32,000	46,000	Machinery	1,04,000	1,40,000
Reserve	1,20,000	1,20,000	Investments	2,20,000	1,48,000
8% Debentures	1,80,000	1,40,000	Stock	1,64,000	2,12,000

Depreciation Fund	80,000	88,000	Debtors	1,34,000	86,000
Creditors	2,06,000	1,92,000	Cash	1,80,000	1,80,000
Outstanding expenses	26,000	24,000	Prepaid expenses	2,000	4,000
	11,04,000	10,70,000		11,04,000	10,70,000

Additional Information :

(i) 10% Dividend was paid during 2016-17.

(ii) Old Machinery costing ₹ 24,000 (accumulated depreciation ₹ 12,000) was sold for ₹ 8,000.

(iii) 40,000 8% Debenture were redeemed by purchase from open market at ₹ 96 for a debenture of ₹ 100 on 31.03.2017.

(iv) Investments worth ₹ 72,000 were sold at book value.

(v) Bad debt written off during the year ₹ 10,000.

Prepare a Statement of Cash Flow for the year ended 31.3.2017.

(8 marks)

(b) Given below are details of interest on advance of a Commercial Bank as on 31.3.2017:

Particulars	**Interest Earned**	**Interest Received**
	(₹ **in Crore**)	(₹ **in Crore**)
Performing Assets		
Term Loan	120	80
Cash Credit and Overdraft	750	620
Bills Purchased and Discounted	150	150
Non-Performing Assets		
Term Loan	75	5
Cash Credit and Overdraft	150	12
Bills Purchased and Discounted	100	20

Find out the income to be recognized for the year ended 31st March, 2017.

(4 marks)

4. ABC Limited has an authorized capital of ₹ 5,00,000 divided into 5,000 equity shares of ₹ 100 each. On 31.3.2018, 2,500 shares were fully called up.

The following are the balance extracted from the ledger of the company as on 31.3.2018:

	₹		₹
Inventory	50,000	Advertisement	3,800
Sales	4,25,000	Bonus	10,500
Purchases	3,00,000	Accounts receivable	38,700
Productive wages	70,000	Accounts payable	35,200
Discount allowed	4,200	Plant and Machinery	80,500
Discount received	3,150	Furniture	17,100
Insurance (year up to 30.06.2018)	6,720	Cash at bank	1,30,000
Salaries	18,500	Cash in hand	4,700
Rent	6,000	Reserves	25,000
General expenses	8,950	Loan from Managing Director	15,700
Profit and Loss A/c (cr.)	6,220	Bad debts	3,200
Printing and Stationary	2,400	Calls in arrears	5,000
		Share capital	2,50,000

Also the following information are given:

(a) Closing inventory is ₹ 91,500

(b) Depreciation to be charged on plant and furniture at 15% and 10% respectively

(c) Outstanding liabilities—wages at ₹ 5,200, salaries at ₹ 1,200 and rent at ₹ 600

(d) Salesman are entitled to a commission of 1% on sales

(e) ₹ 4,000 are to be transferred to General reserves

(f) Dividend on paid up share capital is to be provided @ 5%

You are required to prepare Profit and Loss Statement for the year ended 31.03.2018 and the Balance Sheet as on that date in accordance with the Companies Act, 2013 in the Vertical Form along with the Notes on Accounts. (12 marks)

5. Write short notes on *(any three)*:
   (a) Geographical Segment as per AS-17
   (b) Advantages of buy-back of shares
   (c) Distinguish between Life and Non-Life Insurance
   (d) Share Application money pending allotment. (4 × 3 = 12 marks)

Section - B
(Auditing)

Answer Question No. 6 and *any three* from Question Nos. 7, 8, 9 and 10.

6. (a) Identify the correct alternative in each of the following cases:
   (i) If the Debentures are issued as collateral security either to Banks or Creditors the Auditor needs to ensure that such issue is approved by
   (a) Shareholders
   (b) Board of Directors
   (c) Debenture Trustee
   (d) Audit Committee
   (ii) As per SQC 1, Audit working papers should be retained for a period of
   (a) 2 years
   (b) 5 years
   (c) 7 years
   (d) 10 years
   (iii) Current Audit files contains
   (a) Articles of Association and Memorandum of Association
   (b) Analysis of significant ratios and trends
   (c) Notes regarding significant Accounting policies
   (d) Audit Programme
   (iv) Form for maintenance of Cost Records of a Company is
   (a) CRA - 1
   (b) CRA - 2
   (c) CRA - 3
   (d) CRA - 4

(v) Secretarial Audit is applicable to every Public Company having a turnover of
   (a) ₹ 100 crores
   (b) ₹ 150 crores
   (c) ₹ 250 crores
   (d) ₹ 200 crores

(vi) Statutory Auditor is appointed by the Shareholders in the
   (a) General Meeting
   (b) Statutory Meeting
   (c) EGM
   (d) Board Meeting (1 × 6 = 6 marks)

(b) Match the following items in Column 'A' with items shown in Column 'B':

	Column 'A'		Column 'B'
1.	Independent appraisal activity	A	Secretarial Audit Report
2.	SA 700	B	Section 123
3.	Form MR 3	C	Internal Audit
4.	Declaration of dividend	D	Forming an opinion and reporting on Financial Statements

(1 × 4 = 4 marks)

(c) State whether the following statements are True or False:
   (i) Section 70 deals with the Audit of Debenture.
   (ii) An Audit Committee should have 4 directors.
   (iii) CARO - Companies (Auditor's Report) Order, 2016 is applicable to Banking Companies.
   (iv) Internal Check is part of Accounting Control. (1 × 4 = 4 marks)

7. (a) Distinguish between Permanent and Current Audit File.
(6 marks)

(b) "Internal Audit is an important tool for the management." - Discuss.
(6 marks)

8. (a) Discuss the provisions of Companies Act, 2013 as regards reporting of frauds by Company Auditor. (6 marks)
   (b) Discuss about the manner in which rotation of Auditors may be done by the company on expiry of their term. (6 marks)
9. (a) What is the procedure to be followed for fixing the remuneration of a Cost Auditor? (5 marks)
   (b) Distinguish between 'Audit Report' and 'Audit Certificate'. (7 marks)
10. Write short notes (*any three*):
    (a) Responsibility of a Joint Auditor
    (b) Elements of 'cost of inventory' as per AS 2
    (c) Audit of Education Institutions
    (d) Auditor's duty regarding Issue of Debentures. (4 × 3 = 12 marks)

December - 2018
CMA Inter Gr. II Paper - 12
Company Accounts and Audit

Section – A
(Company Accounts)

Question No. **1** and any **three** from Question Nos. **2, 3, 4** and 5.

1. (a) Choose the correct alternative:
   (i) Which of the following reserves cannot be used for the purpose of issuing bonus shares?
      (a) Revaluation Reserve
      (b) Dividend Equalization Reserve
      (c) Capital Redemption Reserve
      (d) General Reserve

(ii) In Case of Life Insurance Business, Bonus may be of
(a) One type
(b) Two types
(c) Three types
(d) None of the above

(iii) Instalment of principal amount of long-term loan payable within next 12 months is shown under Balance Sheet of a company under the heading
(a) Non-current Assets
(b) Non-current Liabilities
(c) Current Assets
(d) Current Liabilities

(iv) 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 date of passing of special resolution .

(v) A banking company is required to maintain _______ provision on unsecured portion of doubtful advances.
(a) 25%
(b) 40%
(c) 50%
(d) 100%

(vi) Which of the following is correct?
(a) Debenture carries a fixed rate of dividend.
(b) A company limited by shares may issue irredeemable preference shares.
(c) Unmarked applications are those applications that bear the stamp of the underwriter.
(d) Except as provided in Section 54, a company shall not issue shares at a discount. (1 × 6 = 6 marks)

(b) Match the following items in **Column 'A'** with items shown in **Column 'B'**:

	Column 'A'		Column 'B'
(i)	Functional Currency	(a)	Electricity Company
(ii)	Surrender Value	(b)	AS 19
(iii)	Service Line Development Charges	(c)	AS 11
(iv)	Contingent Rent	(d)	Insurance Company
		(e)	No match found

(1 × 4 = 4 marks)

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

(i) The profit on forfeiture and re-issue of equity shares are credited to Capital Redemption Reserve.

(ii) As per Companies Act 2013, companies are not permitted to buy back their own shares out of securities premium.

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

(iv) Interest on loan is included in 'other operating expenses' under the Statement of Profit and Loss. (1 × 4 = 4 marks)

2. (a) Following is the extract of the Balance Sheet of Xeta Ltd. as at 31st March, 2017:

Authorised Capital:	
50,000 12% Preference shares of ₹ 10 each	5,00,000
4,00,000 Equity shares of ₹ 10 each	40,00,000
	45,00,000
Issued and Subscribed Capital:	
24,000 12% Preference shares of ₹ 10 each fully paid	2,40,000
2,70,000 Equity shares of ₹ 10 each, ₹ 8 paid up	21,60,000

Reserves and Surplus:	
General Reserve	3,60,000
Securities Premium	1,00,000
Profit and Loss Account	6,00,000

On 1st April, 2017, the Company has made final call @ 2 each on 2,70,000 Equity shares. The call money was received by 20th April, 2017. 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 30th April, 2017 after bonus issue. (7 marks)

(b) An enterprise operates through six segments, namely, A, B, C, D, E and F. The relevant information about these segments are given in the following table (amounts in ₹.' 000):

	A	B	C	D	E	F	Total (segment)
1. Segment Revenue							
(a) External Sales	-	550	250	150	50	50	1050
(b) Inter Segment Sales	100	100	50	200	-	50	500
2. Segment Results-Profit/ (Loss)	(90)	25	(5)	(15)	5	10	-
3. Segment Assets	30	50	10	20	10	5	

Identify the reportable segments under (i) segment revenue criterion, (ii) segment result criterion and (iii) segment asset criterion as per AS17. (5 marks)

3. (a) Following are the summarized Balance Sheets of Beta Ltd.

Liabilities	31.03.17 ₹	31.03.18 ₹	Assets	31.03.17 ₹	31.03.18 ₹
Equity Share Capital (₹ 10)	4,00,000	5,00,000	Land & Building	4,00,000	3,80,000
General Reserve	1,00,000	1,20,000	Plant and Machinery	3,00,000	3,38,000
Profit & Loss (Cr.)	61,000	61,200	Inventory	2,00,000	1,48,000
Bank Loan	1,40,000	_	Trade Receivable	1,60,000	1,28,400
Trade Payable	3,00,000	2,70,400	Cash in hand	1,000	1,200
Provision for Taxation	60,000	70,000	Cash at Bank	-	16,000
			Goodwill	-	10,000
	10,61,000	**10,21,600**		**10,61,000**	**10,21,600**

Additional Information:

(i) Dividend paid during the year ₹ 46,000.

(ii) Net profit for the year ₹ 1,32,200.

(iii) Depreciation written-off on building ₹ 20,000 and on machinery ₹ 28,000.

(iv) Income tax paid during the year ₹ 56,000.

(v) The following assets of another company were purchased for a consideration of ₹ 1,00,000 and paid in shares.
Assets were: Inventory ₹ 40,000 and Machinery ₹ 50,000.

(vi) Further machinery was purchased for ₹ 50,000 during the year. There was a sale of Machinery.

You are required to prepare a Cash Flow Statement as per AS 3.

(9 marks)

(b) From the following information calculate return on equity as per Regulation 21 of the Central Electricity Regulatory Commission (Terms and Conditions of Tariff) Regulation 2004:

(i) Date of commercial operation of COD = 01.04.2014

(ii) Approved opening capital cost as on 01.04.2014 = ₹ 30,00,000

(iii) Details of allowed additional capital expenditure:

Year	1	2	3	4
Additional Capital Expenditure (₹)	2,00,000	60,000	40,000	20,000

(3 marks)

4. The following is the Trial Balance of Omega Limited as on 31.03.2018:

(**Figures in ₹.'000**)

	Debit		**Credit**
Land at cost	220	Equity Capital (Shares of ₹ 10 each)	300
Plant and Machinery at cost	770	10% Debentures	200
Trade Receivables	96	General Reserve	130
Inventories (31.03.18)	86	Profit and Loss A/c	72
Bank	20	Securities Premium	40
Adjusted Purchases	320	Sales	700
Factory Expenses	60	Trade Payables	52
Administration Expenses	30	Provision for Depreciation	172
Selling Expenses	30	Suspense Account	4
Debenture Interest	20		
Interim Dividend Paid	18		
	1,670		**1,670**

Additional Information:

(i) The Authorised Share Capital of the Company is 40,000, shares of ₹ 10 each.

(ii) The Company on the advice of independent valuer wish to revalue the land at ₹ 3,60,000.

(iii) Declared final dividend @ 10% (over Interim Dividend of ₹ 18,000).

(iv) Suspense account of ₹ 4,000 represents cash received for the sale of some of the machinery on 01.04.2017. The cost of the machinery was ₹ 10,000 and the accumulated depreciation thereon being ₹ 8,000.

(v) Depreciation is to be provided on plant and machinery at 10% on cost.

You are required to prepare Omega Limited's Profit and Loss Statement for the year ended 31.03.2018 and the Balance Sheet as on that date in accordance with the Companies Act, 2013 in the Vertical Form along with the Notes on Accounts. Ignore previous years' figures and taxation.

(12 marks)

5. Write short notes on (*any three*):
   (a) Related Party as per AS 18
   (b) Re-insurance
   (c) Forfeiture of Shares *vis-a-vis* reissue of Forfeited Shares
   (d) Schedule III disclosure requirement in respect of cash and cash equivalents. (4 × 3 = 12 marks)

Section – B
(Auditing)

Answer Question No. 6 and *any three* from Question Nos. 7, 8, 9 and 10

6. (a) Identify the correct alternative in each of the following cases:
   (i) Internal Auditor is appointed by
      (a) Audit Committee
      (b) Shareholders in General Meeting
      (c) Extraordinary General Meeting
      (d) Board of Directors
   (ii) Cost Audit Report is submitted to Board of Directors in Form No.
      (a) CRA - 1
      (b) CRA - 2
      (c) CRA - 3
      (d) CRA - 4

(iii) Check list contains the instruction to be followed by the
- (a) Internal Auditor
- (b) External Auditor
- (c) Audit Assistants
- (d) Employee of the organisation

(iv) Form for Secretarial Audit Report is
- (a) MR - 2
- (b) MR - 3
- (c) MR - 4
- (d) MR - 5

(v) 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.

(vi) Audit of debenture is covered under section
- (a) 70
- (b) 71
- (c) 72
- (d) 73 (1×6=6 marks)

(b) Match the following items in Column 'A' with items shown in Column 'B':

	Column 'A'		Column 'B'
(i)	The authority for Government Audit	(a)	Audit Programme
(ii)	Details of Audit work to be performed	(b)	Comptroller and Auditor General
(iii)	Removal of Statutory Company Auditor	(c)	Audit Note Book
(iv)	Details about Name and Organisation Structure	(d)	Section 140
		(e)	No match found

(1×4=4 marks)

(c) State whether the following statements are *True* or *False*:
   (i) The Branch Auditor shall prepare report on the Accounts of the Branch examined by him and send it to Audit Committee.
   (ii) Maintenance of Cost Accounting Standards is mandatory as per Section 143 of Companies Act.
   (iii) Routine checking is a substitute of vouching.
   (iv) Casual vacancy in the office of Cost Auditor is filled by Board of Directors. (1×4=4 marks)

7. (a) Discuss the method of obtaining Audit Evidences. (6 marks)
   (b) Distinguish between Internal Control and Internal Check. (6 marks)

8. (a) Discuss the functions and power of the Audit Committee. (6 marks)
   (b) Discuss the procedure for appointment for first Auditor of the Company and his tenure. (6 marks)

9. (a) Discuss the relevant provisions of Companies (Cost Records and Audit) Rules 2014 on applicability of Cost Audit to different sectors. (6 marks)
   (b) What is a qualified Audit Report? Discuss the circumstances when an Auditor shall qualify his report. (2+4=6 marks)

10. Write short notes (*any three*):
   (a) Auditor's duty regarding unclaimed dividend
   (b) Physical verification of inventory and Auditor's responsibility thereof
   (c) Audit of Co-operative Society
   (d) Difference between Statutory Audit and Internal Audit

(4×3=12 marks)

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FOR NOTES

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