

**MOCK TEST PAPER 1**  
**INTERMEDIATE (IPC) (OLD) COURSE: GROUP – II**  
**PAPER – 5: ADVANCED ACCOUNTING**

*Question No. 1 is compulsory.*

*Answer any **five** questions from the remaining **six** questions.*

*Wherever necessary suitable assumptions may be made and disclosed by way of a note.*

*Working Notes should form part of the answer.*

**Time Allowed: 3 Hours**

**Maximum Marks: 100**

1. (a) Suhana Ltd. issued 12% secured debentures of Rs. 100 Lakhs on 01.05.2018, to be utilized as under:

<i>Particulars</i>	<i>Amount (Rs. in lakhs)</i>
Construction of factory building	40
Purchase of Machinery	35
Working Capital	25

In March 2019, construction of the factory building was completed and machinery was installed and ready for its intended use. Total interest on debentures for the financial year ended 31.03.2019 was Rs. 11,00,000. During the year 2018-19, the company had invested idle fund out of money raised from debentures in banks' fixed deposit and had earned an interest of Rs. 2,00,000.

Show the treatment of interest under Accounting Standard 16 and also explain nature of assets.

- (b) A Ltd. has got the license to manufacture particular medicines for 10 years at a license fee of Rs. 200 lakhs. Given below is the pattern of expected production and expected operating cash inflow:

Year	Production in bottles (in lakhs)	Net operating cash flow (Rs. in lakhs)
1	300	900
2	600	1,800
3	650	2,300
4	800	3,200
5	800	3,200
6	800	3,200
7	800	3,200
8	800	3,200
9	800	3,200
10	800	3,200

Net operating cash flow has increased for third year because of better inventory management and handling method. Suggest the amortization method.

- (c) Ram Ltd. purchased machinery for Rs. 80 lakhs. (useful life 4 years and residual value Rs. 8 lakhs). Government grant received is Rs. 32 lakhs. Show the Journal Entry to be passed at the time of refund of grant and the value of the fixed assets in the third year and the amount of depreciation for remaining two years, if the grant has been credited to Fixed Assets A/c.

- (d) ABC Ltd. took a machine on lease from XYZ Ltd., the fair value being Rs. 10,00,000. The economic life of the machine as well as the lease term is 4 years. At the end of each year, ABC Ltd. pays Rs. 3,50,000. The lessee has guaranteed a residual value of Rs. 50,000 on expiry of the lease to the lessor. However, XYZ Ltd. estimates that the residential value of the machinery will be Rs. 35,000 only. The implicit rate of return is 16% and PV factors at 16% for year 1, year 2, year 3 and year 4 are 0.8621, 0.7432, 0.6407 and 0.5523 respectively. You are required to calculate the value of machinery to be considered by ABC Ltd. and the finance charges for each year. **(4 Parts x 5 Marks = 20 Marks)**

2. M/s Xylem Limited has decided to reconstruct the Balance Sheet since it has accumulated huge losses. The following is the summarized Balance Sheet of the company as on 31st March, 2019 before reconstruction:

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
Share Capital		Land & Building	42,70,000
50,000 shares of Rs. 50 each fully paid up	25,00,000	Machinery	8,50,000
1,00,000 shares of Rs. 50 each Rs. 40 paid up	40,00,000	Computers	5,20,000
Capital Reserve	5,00,000	Inventories	3,20,000
8% Debentures of Rs. 100 each	4,00,000	Trade receivables	10,90,000
12% Debentures of Rs. 100 each	6,00,000	Cash at Bank	2,68,000
Trade payables	12,40,000	Profit & Loss Account	29,82,000
Outstanding Expenses	10,60,000		
	<u>1,03,00,000</u>		<u>1,03,00,000</u>

Following is the interest of Mr. A and Mr. B in M/s Xylem Limited:

	Mr. A	Mr. B
8% Debentures	3,00,000	1,00,000
12% Debentures	<u>4,00,000</u>	<u>2,00,000</u>
Total	<u>7,00,000</u>	<u>3,00,000</u>

The following scheme of internal reconstruction was framed and implemented, as approved by the court and concerned parties:

- (1) Uncalled capital is to be called up in full and then all the shares to be converted into Equity Shares of Rs. 40 each.
- (2) The existing shareholders agree to subscribe in cash, fully paid up equity shares of 40 each for Rs. 12,50,000.
- (3) Trade payables are given option of either to accept fully paid equity shares of Rs. 40 each for the amount due to them or to accept 70% of the amount due to them in cash in full settlement of their claim. Trade payables for Rs. 7,50,000 accept equity shares and rest of them opted for cash towards full and final settlement of their claim.
- (4) Mr. A agrees to cancel debentures amounting to Rs. 2,00,000 out of total debentures due to him and agree to accept 15% Debentures for the balance amount due. He also agree to subscribe further 15% Debentures in cash amounting to Rs. 1,00,000.
- (5) Mr. B agrees to cancel debentures amounting to Rs. 50,000 out of total debentures due to him and agree to accept 15% Debentures for the balance amount due.

- (6) Land & Building to be revalued at Rs. 51,84,000, Machinery at Rs. 7,20,000, Computers at Rs. 4,00,000, Inventories at Rs. 3,50,000 and Trade receivables at 10% less to as they are appearing in Balance Sheet as above.
- (7) Outstanding Expenses are fully paid in cash.
- (8) Profit & Loss A/c will be written off and balance, if any, of Capital Reduction A/c will be adjusted against Capital Reserve.

You are required to pass necessary Journal Entries for all the above transactions and draft the company's Balance Sheet immediately after the reconstruction. **(16 Marks)**

3. From the following balances extracted from the books of General Insurance Company Limited as on 31.3.2019 you are required to prepare Revenue Accounts in respect of Fire and marine Insurance business for the year ended 31.3.2019 and a Profit and Loss Account for the same period:

	Rs.		Rs.
Directors' Fees	80,000	Interest received	19,000
Dividend received	1,00,000	Fixed Assets (1.4.2018)	90,000
Provision for Taxation (as on 1.4. 2018)	85,000	Income-tax paid during the year	60,000

	Fire Rs.	Marine Rs.
Outstanding Claims on 1.4. 2018	28,000	7,000
Claims paid	1,00,000	80,000
Reserve for Unexpired Risk on 1.4.2018	2,00,000	1,40,000
Premiums Received	4,50,000	3,30,000
Agent's Commission	40,000	20,000
Expenses of Management	60,000	45,000
Re-insurance Premium (Dr.)	25,000	15,000

The following additional points are also to be taken into account:

- (a) Depreciation on Fixed Assets to be provided at 10% p.a.
- (b) Interest accrued on investments Rs. 10,000.
- (c) Closing provision for taxation on 31.3.2019 to be maintained at Rs. 1,24,138.
- (d) Claims outstanding on 31.3.2019 were Fire Insurance Rs. 10,000; Marine Insurance Rs. 15,000.
- (e) Premium outstanding on 31.3.2019 were Fire Insurance Rs. 30,000; Marine Insurance Rs. 20,000.
- (f) Reserve for unexpired risk to be maintained at 50% and 100% of net premiums in respect of Fire and Marine Insurance respectively.
- (g) Expenses of management due on 31.3.2019 were Rs. 10,000 for Fire Insurance and Rs. 5,000 in respect of marine Insurance. **(16 Marks)**
4. X, Y and Z are in partnership sharing profits and losses in the ratio of 5:4:4. The Balance Sheet of the firm as on 31<sup>st</sup> March, 2019 is as below:

Liabilities	Rs.	Assets	Rs.
X's Capital	60,000	Factory Building	96,640
Y's Capital	40,000	Plant and Machinery	65,100

Z's Capital	50,000	Trade Receivable	21,600
Y's Loan	18,000	Inventories	49,560
Trade Payable	<u>66,000</u>	Cash at Bank	<u>1,100</u>
	<u>2,34,000</u>		<u>2,34,000</u>

On Balance Sheet date, all the three partners have decided to dissolve their partnership. Since the realisation of assets was protracted, they decided to distribute amounts as and when feasible and for this purpose they appoint Z who was to get as his remuneration 1% of the value of the assets realised other than cash at bank and 10% of the amount distributed to the partners.

Assets were realised piecemeal as under:

	Rs.
First instalment	74,600
Second instalment	69,301
Third instalment	40,000
Last instalment	28,000
Dissolution expenses were provided for estimated amount of	Rs. 12,000
The creditors were settled finally for	Rs. 63,600

You are required to prepare a statement showing distribution of cash amongst the partners by "Highest Relative Capital Method". **(16 Marks)**

5. (a) On 31<sup>st</sup> December, 2018 the following balances appeared in the books of Kolkata Branch of an English firm having its HO office in New York:

	Amount in Rs.	Amount in Rs.
Stock on 1 <sup>st</sup> Jan., 2018	2,34,000	
Purchases and Sales	15,62,500	23,43,750
Debtors and Creditors	7,65,000	5,10,000
Bills Receivable and Payable	2,04,000	1,78,500
Salaries and Wages	1,00,000	-
Rent, Rates and Taxes	1,06,250	-
Furniture	91,000	-
Bank A/c	5,68,650	
New York Account	-	5,99,150
	<u>36,31,400</u>	<u>36,31,400</u>

Stock on 31<sup>st</sup> December, 2018 was Rs. 6,37,500.

Branch account in New York books showed a debit balance of \$ 13,400 on 31<sup>st</sup> December, 2018 and Furniture appeared in the Head Office books at \$ 1,750.

The rate of exchange on 31<sup>st</sup> December, 2017 was Rs. 52 and on 31<sup>st</sup> December, 2018 was Rs. 51. The average rate for the year was Rs. 50.

Prepare in the Head Office books the Profit and Loss A/c and the Balance Sheet of the Branch considering branch to be a non-corporate entity.

- (b) Department A sells goods to Department B at a profit of 50% on cost and to Department C at 20% on cost. Department B sells goods to A and C at a profit of 25% and 15% respectively on sales. Department C charges 30% and 40% profit on cost to Department A and B respectively.

Stock lying at different departments at the end of the year are as under:

	Department A	Department B	Department C
	Rs.	Rs.	Rs.
Transfer from Department A	-	45,000	42,000
Transfer from Department B	40,000	-	72,000
Transfer from Department C	39,000	42,000	-

Calculate the unrealized profit of each department and also total unrealized profit.

**(12 + 4 = 16 Marks)**

6. (a) The following was the balance sheet of Mukta Ltd. as on 31<sup>st</sup> March, 2019

Equity & liability	Rs. (in lakhs)	Assets	Rs.(in lakhs)
Authorised Capital:		Fixed Assets	1,12,000
Equity shares of Rs. 10 each	80,000	Investments	24,000
Issued Capital		Cash at Bank	13,200
Equity Shares of Rs.10 each		Trade Receivables	66,000
Fully Paid Up	64,000		
10% Redeemable Preference			
Shares of 10 each, Fully Paid Up	20,000		
Reserves & Surplus:			
Capital Redemption Reserve	8,000		
Securities Premium	6,400		
General Reserve	48,000		
Profit & Loss Account	2,400		
9% Debentures	40,000		
Trade Payables	26,400		
	<u>2,15,200</u>		<u>2,15,200</u>

On 1st April, 2019 the Company redeemed all its Preference Shares at a Premium of 10% and bought back 25% of its Equity Shares at Rs.20 per Share. In order to make Cash available, the Company sold all the Investments for Rs.25,200 Lakhs and raised a Bank Loan amounting to Rs.16,000 lakh on the Security of the Company's Plant.

Give the necessary Journal Entries considering that the buy back is authorised by the articles of company and necessary resolution is passed by the company for this. The amount of Securities premium will be utilized to the maximum extents allowed by law.

- (b) On 1st April, 2018, a company offered 100 shares to each of its 500 employees at Rs. 50 per share. The employees are given a year to accept the offer. The shares issued under the plan shall be subject to lock-in on transfer for three years from the grant date. The market price of shares of the company on the grant date is Rs. 60 per share. Due to post-vesting restrictions on transfer, the fair value of shares issued under the plan is estimated at Rs. 56 per share. On 31<sup>st</sup> March, 2019, 400 employees accepted the offer and paid Rs. 50 per share purchased. Nominal value of each shares is Rs. 10.

Record the issue of shares in the books of the company under the aforesaid plan.

**(12 + 4 = 16 Marks)**

7. Answer any **four** of the following:

- (a) The Accountant of Mobile Limited has sought your opinion with relevant reasons, whether the following transactions will be treated as change in Accounting Policy or not for the year ended

31<sup>st</sup> March, 2019. Please advise him in the following situations in accordance with the provisions of relevant Accounting Standard;

- (i) Provision for doubtful debts was created @ 2% till 31<sup>st</sup> March, 2018. From the Financial year 2018-2019, the rate of provision has been changed to 3%.
  - (ii) During the year ended 31<sup>st</sup> March, 2019, the management has introduced a formal gratuity scheme in place of ad-hoc ex-gratia payments to employees on retirement.
  - (iii) Till the previous year the furniture was depreciated on straight line basis over a period of 5 years. From current year, the useful life of furniture has been changed to 3 years.
  - (iv) Management decided to pay pension to those employees who have retired after completing 5 years of service in the organization. Such employees will get pension of Rs. 20,000 per month. Earlier there was no such scheme of pension in the organization.
- (b) Explain the nature of Limited Liability Partnership. Who can be a designated partner in a Limited Liability Partnership?
- (c) Zoo Ltd. had issued 30,000, 15% convertible debentures of Rs. 100 each on 1<sup>st</sup> April, 2016. The debentures are due for redemption on 1<sup>st</sup> March, 2019. The terms of issue of debentures provided that they were redeemable at a premium of 5% and also conferred option to the debenture holders to convert 20% of their holding into equity shares (Nominal Value Rs. 10) at a price of Rs. 15 per share. Debenture holders holding 2,500 debentures did not exercise the option. Calculate the number of equity shares to be allotted to the Debenture holders exercising the option to the maximum.
- (d) The company had a engineering contract with a foreign government, work to be carried out in foreign country and payments to be received in dollars. The work was completed in the year 2018, and the entire contracted amount was duly recorded in the books of the company at the prevalent exchange rate on the date of completion of the work. However, payments to the extent of Rs. 40 crores could not be released by the Foreign Government because of temporary foreign exchange crisis in that country. This Rs. 40 crores unrealized at the end, if converted at the year end rate would amount to Rs. 40.50 crores. The Company has adopted and follows the following accounting policy:

“In respect of foreign currency transactions, current assets and current liabilities are revalued at year end rates. However, if there is a net loss, due to exchange difference, the same is charged off to the P&L account, but if there is a net gain, the same is ignored in view of the prudent accounting policies of not recording unrealized gains due to exchange rate fluctuations”.

Comment on the appropriateness of the above in line with AS 11.

- (e) Omega Bank Statement of interest on advances in respect of Performing assets and Non-Performing Assets are as follows:- (in lakhs)

	Performing Assets		Non-Performing Assets	
	Interest earned	Interest received	Interest earned	Interest received
Cash credits and overdrafts	1800	1060	450	70
Term Loan	480	320	300	40
Bills purchased and discounted	700	550	350	36

Find out the income to be recognized for the year ended 31<sup>st</sup> March, 20X1.

**(4 Parts x 4 Marks= 16 Marks)**

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**INTERMEDIATE (IPC): GROUP – II**  
**PAPER – 5: ADVANCED ACCOUNTING**  
**SUGGESTED ANSWERS/HINTS**

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

It also states that to the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalisation on that asset should be determined as the actual borrowing costs incurred on that borrowing during the period less any income on the temporary investment of those borrowings.

Thus, eligible borrowing cost  
= Rs. 11,00,000 – Rs. 2,00,000  
= Rs. 9,00,000

Sr. No.	Particulars	Nature of assets	Interest to be capitalized (Rs.)	Interest to be charged to Profit & Loss Account (Rs.)
i	Construction of factory building	Qualifying Asset	$9,00,000 \times 40/100$ = Rs. 3,60,000	NIL
ii	Purchase of Machinery	Not a Qualifying Asset	NIL	$9,00,000 \times 35/100$ = Rs. 3,15,000
iii	Working Capital	Not a Qualifying Asset	NIL	$9,00,000 \times 25/100$ = Rs. 2,25,000
	Total		<u>Rs. 3,60,000</u>	<u>Rs. 5,40,000</u>

- (b) As per AS 26 'Intangibles Assets', the amortization method used should reflect the pattern in which economic benefits are consumed by the enterprise. If pattern cannot be determined reliably, then straight-line method should be used.

In the instant case, the pattern of economic benefit in the form of net operating cash flow vis-à-vis production is determined reliably. A Ltd. should amortize the license fee of Rs. 200 lakhs as under:

Year	Net operating Cash in flow (Rs.)	Ratio	Amortize amount (Rs. in lakhs)
1	900	0.03	6
2	1,800	0.06	12
3	2,300	0.08	16
4	3,200	0.12	24
5	3,200	0.12	24
6	3,200	0.12	24
7	3,200	0.12	24
8	3,200	0.12	24

9	3,200	0.12	24
10	<u>3,200</u>	<u>0.11 (bal.)</u>	<u>22</u>
	<u>27,400</u>	<u>1.00</u>	<u>200</u>

(c) **In the books of Ram Ltd.**

(If the grant is credited to Fixed Assets Account)

1. **Journal Entry (at the time of refund of grant)**

		In lakhs Rs.	In lakhs Rs.
l	Fixed Assets Dr.	32	
	To Bank A/c (Being grant refunded)		32

2. **Value of Fixed Assets after two years but before refund of grant**

Fixed assets initially recorded in the books = Rs. 80 lakhs – Rs. 32 lakhs  
= Rs. 48 lakhs

Depreciation for each year = (Rs. 48 lakhs – Rs.8 lakhs)/4 years  
= Rs. 10 lakhs per year for first two years.

Value of the assets before refund of grant =Rs. 48 lakhs - Rs. 20 lakhs  
= Rs. 28 lakhs

3. **Value of Fixed Assets after refund of grant**

Value of Fixed Assets before refund of grant	Rs. 28 lakhs
Add Refund of grant	<u>Rs. 32 lakhs</u>
	<u>Rs. 60 lakhs</u>

4. **Amount of depreciation for remaining two years**

(Value of the fixed assets after refund of grant –residual value of the assets) / No. of years  
= (Rs. 60 lakhs - Rs. 8 lakhs) / 2  
= Rs. 26 lakhs per annum will be charged for next two years.

- (d) As per AS 19 “Leases”, the lessee should recognize the lease as an asset and a liability at the inception of a finance lease. Such recognition should be at an amount equal to the fair value of the leased asset at the inception of lease. However, if the fair value of the leased asset exceeds the present value of minimum lease payment from the standpoint of the lessee, the amount recorded as an asset and liability should be the present value of minimum lease payments from the standpoint of the lessee.

**Value of machinery**

In the given case, fair value of the machinery is Rs. 10,00,000 and the net present value of minimum lease payments is Rs. 10,07,020 (Refer working Note). As the present value of the machine is more than the fair value of the machine, the machine and the corresponding liability will be recorded at value of Rs.10,00,000.



### Calculation of finance charges for each year

Year	Finance charge (Rs.)	Payment (Rs.)	Reduction in outstanding liability (Rs.)	Outstanding liability (Rs.)
1 <sup>st</sup> year beginning	-	-	-	10,00,000
End of 1 <sup>st</sup> year	1,60,000	3,50,000	1,90,000	8,10,000
End of 2 <sup>nd</sup> year	1,29,600	3,50,000	2,20,400	5,89,600
End of 3 <sup>rd</sup> year	94,336	3,50,000	2,55,664	3,33,936
End of 4 <sup>th</sup> year	53,430	3,50,000	2,96,570	37,366

### Working Note:

#### Present value of minimum lease payments

Annual lease rental x PV factor Rs. 3,50,000 x (0.8621 + 0.7432 + 0.6407 + 0.5523)	Rs. 9,79,405
Present value of guaranteed residual value Rs. 50,000 x (0.5523)	Rs. 27,615
	Rs. 10,07,020

2.

### Journal Entries

		Rs.	Rs.
Bank A/c	Dr.	10,00,000	
To Equity share capital A/c			10,00,000
(Being money on final call received)			
Equity share capital (Rs. 50) A/c	Dr.	75,00,000	
To Equity share capital (Rs. 40) A/c			60,00,000
To Capital Reduction A/c			15,00,000
(Being conversion of equity share capital of Rs. 50 each into Rs. 40 each as per reconstruction scheme)			
Bank A/c	Dr.	12,50,000	
To Equity Share Capital A/c			12,50,000
(Being new shares allotted at Rs. 40 each)			
Trade payables A/c	Dr.	12,40,000	
To Equity share capital A/c			7,50,000
To Bank A/c (4,90,000 x 70%)			3,43,000
To Capital Reduction A/c			1,47,000
(Being payment made to trade payables in shares or cash to the extent of 70% as per reconstruction scheme)			
8% Debentures A/c	Dr.	3,00,000	
12% Debentures A/c	Dr.	4,00,000	
To A A/c			7,00,000
(Being cancellation of 8% and 12% debentures of A)			

A A/c	Dr.	8,00,000	
To 15% Debentures A/c			6,00,000
To Capital Reduction A/c			2,00,000
(Being issuance of new 15% debentures and balance transferred to capital reduction account as per reconstruction scheme)			
Bank A/c	Dr.	1,00,000	
To A A/c			1,00,000
(Being new debentures subscribed by A)			
8% Debentures A/c	Dr.	1,00,000	
12% Debentures A/c	Dr.	2,00,000	
To B A/c			3,00,000
(Being cancellation of 8% and 12% debentures of B)			
B A/c	Dr.	3,00,000	
To 15% Debentures A/c			2,50,000
To Capital Reduction A/c			50,000
(Being issuance of new 15% debentures and balance transferred to capital reduction account as per reconstruction scheme)			
Land and Building	Dr.		
(51,84,000 – 42,70,000)		9,14,000	
Inventories	Dr.	30,000	
To Capital Reduction A/c			9,44,000
(Being value of assets appreciated)			
Outstanding expenses A/c	Dr.	10,60,000	
To Bank A/c			10,60,000
(Being outstanding expenses paid in cash)			
Capital Reduction A/c	Dr.	33,41,000	
To Machinery A/c			1,30,000
To Computers A/c			1,20,000
To Trade receivables A/c			1,09,000
To Profit and Loss A/c			29,82,000
(Being amount of Capital Reduction utilized in writing off P & L A/c (Dr.) balance and downfall in value of other assets)			
Capital Reserve A/c	Dr.	5,00,000	
To Capital Reduction A/c			5,00,000
(Being debit balance of capital reduction account adjusted against capital reserve)			

**Balance Sheet of Xylem Ltd. (as reduced) as on 31.3.2019**

<i>Particulars</i>		<i>Notes</i>	<i>Rs.</i>
	<b>Equity and Liabilities</b>		
<b>1</b>	<b>Shareholders' funds</b>		
	a Share capital	1	80,00,000
<b>2</b>	<b>Non-current liabilities</b>		
	a Long-term borrowings	2	<u>8,50,000</u>
	<b>Total</b>		<b><u>88,50,000</u></b>
	<b>Assets</b>		
<b>1</b>	<b>Non-current assets</b>		
	a Property, Plant and Equipment Tangible assets	3	63,04,000
<b>2</b>	<b>Current assets</b>		
	a Inventories		3,50,000
	b Trade receivables		9,81,000
	c Cash and cash equivalents		<u>12,15,000</u>
	<b>Total</b>		<b><u>88,50,000</u></b>

**Notes to accounts**

		<i>Rs.</i>
<b>1.</b>	<b>Share Capital</b>	
	2,00,000 Equity shares of Rs. 40	80,00,000
<b>2.</b>	<b>Long-term borrowings</b>	
	Secured	
	15% Debentures (assumed to be secured)	8,50,000
<b>3.</b>	<b>Tangible assets</b>	
	Land & Building	51,84,000
	Machinery	7,20,000
	Computers	<u>4,00,000</u>
		63,04,000

**Working Notes:**

1. **Cash at Bank Account**

<i>Particulars</i>	<i>Rs.</i>	<i>Particulars</i>	<i>Rs.</i>
To Balance b/d	2,68,000	By Trade payables A/c	3,43,000
To Equity Share capital A/c	10,00,000	By Outstanding expenses A/c	10,60,000
To Equity Share Capital A/c	12,50,000	By Balance c/d (bal. fig.)	12,15,000
To A A/c	<u>1,00,000</u>		
	<u>26,18,000</u>		<u>26,18,000</u>

2. **Capital Reduction Account**

<i>Particulars</i>	<i>Rs.</i>	<i>Particulars</i>	<i>Rs.</i>
To Machinery A/c	1,30,000	By Equity Share Capital A/c	15,00,000
To Computers A/c	1,20,000	By Trade payables A/c	1,47,000

To Trade receivables A/c	1,09,000	By A A/c	2,00,000
To Profit and Loss A/c	29,82,000	By B A/c	50,000
		By Land & Building	9,14,000
		By Inventories	30,000
		By Capital Reserve A/c	5,00,000
	<u>33,41,000</u>		<u>33,41,000</u>

3. **Form B – RA (Prescribed by IRDA)**

**General Insurance Co. Ltd**

**Revenue Account for the year ended 31<sup>st</sup> March, 2019**

**Fire and Marine Insurance Businesses**

	Schedule	Fire Current Year Rs.	Marine Current Year Rs.
Premiums earned (net)	1	4,27,500	1,40,000
Profit / (Loss) on sale / redemption of investments		—	—
Others (to be specified)			
Interest, Dividends and Rent – Gross		—	—
Total (A)		<u>4,27,500</u>	<u>1,40,000</u>
Claims incurred (net)	2	82,000	88,000
Commission	3	40,000	20,000
Operating expenses related to Insurance business	4	70,000	50,000
Premium Deficiency			
Total (B)		<u>1,92,000</u>	<u>1,58,000</u>
Profit from Fire / Marine Insurance business (A-B)		2,35,500	(18,000)

**Schedules forming part of Revenue Account**

**Schedule –1**

Premiums earned (net)	Fire Current Year Rs.	Marine Current Year Rs.
Premiums from direct business written	4,80,000	3,50,000
Less: Premium on reinsurance ceded	<u>(25,000)</u>	<u>(15,000)</u>
Total Premium earned	4,55,000	3,35,000
Less: Change in provision for unexpired risk	<u>(27,500)</u>	<u>(1,95,000)</u>
	<u>4,27,500</u>	<u>1,40,000</u>
Schedule – 2		
Claims incurred (net)	<u>82,000</u>	88,000
Schedule – 4		
Operating expenses related to insurance business		
Expenses of Management	70,000	50,000

**Form B-PL**

**General Insurance Co. Ltd.**

**Profit and Loss Account for the year ended 31<sup>st</sup> March, 2019**

<i>Particulars</i>	<i>Schedule</i>	<i>Current Year</i>	<i>Previous Year</i>
		<i>Rs.</i>	<i>Rs.</i>
<b>Operating Profit/(Loss)</b>			
(a) Fire Insurance		2,35,500	
(b) Marine Insurance		(18,000)	
(c) Miscellaneous Insurance		—	
<b>Income From Investments</b>			
Interest, Dividend & Rent—Gross		1,29,000*	
<b>Other Income (To be specified)</b>			
Total (A)		<u>3,46,500</u>	
<b>Provisions (Other than taxation)</b>		—	
Depreciation		9,000	
<b>Other Expenses –Director's Fee</b>		<u>80,000</u>	
Total (B)		<u>89,000</u>	
Profit Before Tax		2,57,500	
Provision for Taxation		<u>99,138</u>	
Profit After Tax		<u>1,58,362</u>	

**Working Notes:**

		<i>Fire</i>	<i>Marine</i>
		<i>Rs.</i>	<i>Rs.</i>
1.	Claims under policies less reinsurance		
	Claims paid during the year	1,00,000	80,000
	Add: Outstanding on 31 <sup>st</sup> March, 2019	<u>10,000</u>	<u>15,000</u>
		1,10,000	95,000
	Less: Outstanding on 1 <sup>st</sup> April, 2018	<u>(28,000)</u>	<u>(7,000)</u>
		<u>82,000</u>	<u>88,000</u>
2.	Expenses of management		
	Expenses paid during the year	60,000	45,000
	Add: Outstanding on 31 <sup>st</sup> March, 2019	<u>10,000</u>	<u>5,000</u>
		<u>70,000</u>	<u>50,000</u>
3.	Premiums less reinsurance		
	Premiums received during the year	4,50,000	3,30,000
	Add: Outstanding on 31 <sup>st</sup> March, 2019	<u>30,000</u>	<u>20,000</u>
		4,80,000	3,50,000
	Less: Reinsurance premiums	<u>(25,000)</u>	<u>(15,000)</u>
		<u>4,55,000</u>	<u>3,35,000</u>

4. Reserve for unexpired risks is 50% of net premium for fire insurance and 100% of net premium for marine insurance. Reserve for unexpired risks for fire insurance = Rs. 4,55,000 x 50% = Rs. 2,27,500. Opening Balance in reserves for unexpired risk for fire insurance was Rs. 2,00,000. Hence, additional transfer to reserve for fire insurance in the year will be

\* Interest and dividend in case can't be bifurcated between fire and marine thus taken to profit and loss account

Rs. 27,500. On similar basis of calculation, the additional transfer to reserve for marine insurance will be Rs. 1,95,000

5. **Provision for taxation account**

		Rs.			Rs.
31.3.2019	To Bank A/c		1.4.2018	By Balance b/d	85,000
	(taxes paid)	60,000	31.3.2019	By P & L A/c (Bal Fig)	99,138
31.3.2019	To Balance c/d	1,24,138			
		1,84,138			1,84,138

4. **Statement showing distribution of cash amongst the partners**

		Trade Payable	Y's Loan	X (Rs.)	Y (Rs.)	Z (Rs.)
Balance Due		66,000	18,000	60,000	40,000	50,000
Including 1st Instalment amount with the firm Rs. (1100 + 74,600)	75,700					
Less: Dissolution expenses provided for	<u>(12,000)</u>					
	63,700					
Less: Z's remuneration of 1% on assets realized (74,600 x 1%)	<u>(746)</u>					
	62,954					
Less: Payment made to Trade Payables	<u>(62,954)</u>	<u>(62,954)</u>				
Balance due	Nil	3046				
2nd instalment realised	69,301					
Less: Z's remuneration of 1% on assets realized (69,301 x 1%)	<u>(693)</u>					
	68,608					
Less: Payment made to Trade Payables	<u>(646)</u>	<u>(646)</u>				
Transferred to P&L A/c		2,400				
	67,962					
Less: Payment for Y's loan A/c	<u>(18,000)</u>		<u>(18,000)</u>			
Amount available for distribution to partners	49,962		nil			
Less: Z's remuneration of 10% of the amount distributed to partners (49,962 x 10/110)	<u>(4,542)</u>					
Balance to be distributed to partners on the basis of HRCM	45,420					
Less: Paid to Z (W.N.)	<u>(2,000)</u>					<u>(2,000)</u>
	43,420					48,000
Less: Paid to X and Z in 5:4 (W.N.)	<u>(18,000)</u>			<u>(10,000)</u>	-	<u>(8,000)</u>

Balance due	25,420		50,000	40,000	40,000
Less: Paid to X, Y & Z in 5:4:4	<u>25,420</u>		<u>(9,778)</u>	<u>(7,821)</u>	<u>(7,821)</u>
	Nil				
Amount of 3rd instalment	40,000		40,222	32,179	32,179
Less: Z's remuneration of 1% on assets realized (40,000 x 1%)	<u>(400)</u>				
	39,600				
Less: Z's remuneration of 10% of the amount distributed to partners (39,600 x 10/110)	<u>(3,600)</u>				
	36,000				
Less: Paid to X, Y, Z in 5:4:4 for (W.N.)	<u>(36,000)</u>		<u>(13,846)</u>	<u>(11,077)</u>	<u>(11,077)</u>
	Nil		26,376	21,102	21,102
Amount of 4th and last instalment	28,000				
Less: Z's remuneration of 1% on assets realized (28,000 x 1%)	<u>(280)</u>				
	27,720				
Less: Z's remuneration of 10% of the amount distributed to partners (27,720 x 10/110)	<u>(2,520)</u>				
	25,200				
Less: Paid to X, Y and Z in 5:4:4	<u>(25,200)</u>		<u>(9,692)</u>	<u>(7,754)</u>	<u>(7,754)</u>
	Nil				
Loss suffered by partners			16,684	13,348	13,348

**Working Note:**

- (i) Rs. 1100 added to the first instalment received on sale of assets represents the Cash in Bank
- (ii) The amount due to Creditors at the end of the utilization of First Instalment is Rs. 3046. However, since the creditors were settled for Rs. 63,600 only the balance Rs.646 were paid and the balance Rs. 2400 was transferred to the Profit & Loss Account.

(iii)

**Highest Relative Capital Basis**

	X Rs.	Y Rs.	Z Rs.
Balance of Capital Accounts (A)	60,000	40,000	50,000
Profit sharing ratio	5	4	4
Capital Profit sharing ratio	12,000	10,000	12,500
Capital in profit sharing ratio taking Y's Capital as base (B)	50,000	40,000	40,000
Excess of X's Capital and Z's Capital (A-B) =(C)	10,000	nil	10,000
Again repeating the process			
Profit sharing ratio	5		4
Capital Profit sharing ratio	2,000		2,500

Capital in profit sharing ratio taking X's Capital as base (D)	10,000		8,000
Excess of Z's Capital (C-D) = (E)	nil		2,000

Therefore, firstly Rs.2,000 is to be paid to Z, then X and Z to be paid in proportion of 5:4 upto Rs. 18,000 to bring the capital of all partners X, Y and Z in proportion to their profit sharing ratio. Thereafter, balance available will be paid in the profit sharing ratio 5:4:4 to all partners viz X, Y and Z.

5. (a) **In the books of English Firm (Head Office in New York)**

**Kolkata Branch Profit and Loss Account  
for the year ended 31<sup>st</sup> December, 2018**

	\$		\$
To Opening stock	4,500	By Sales	46,875
To Purchases	31,250	By Closing stock	12,500
To Gross profit c/d	<u>23,625</u>	(6,37,500 / 51)	
	<u>59,375</u>		<u>59,375</u>
To Salaries	2,000	By Gross profit b/d	23,625
To Rent, rates and taxes	2,125		
To Exchange translation loss	2,000		
To Net Profit c/d	<u>17,500</u>		
	<u>23,625</u>		<u>23,625</u>

**Balance Sheet of Kolkata Branch  
as on 31<sup>st</sup> December, 2018**

<i>Liabilities</i>	\$	\$	<i>Assets</i>	\$
Head Office A/c	13,400		Furniture	1,750
Add : Net profit	<u>17,500</u>	30,900	Closing Stock	12,500
Trade creditors		10,000	Trade Debtors	15,000
Bills Payable		3,500	Bills Receivable	4,000
			Cash at bank	11,150
		<u>44,400</u>		<u>44,400</u>

**Working Note:**

**Required for calculation of Exchange Translation Loss  
Kolkata Branch Trial Balance (converted in \$)  
as on 31<sup>st</sup> December, 2018**

	Dr.	Cr.	Conversion	Dr.	Cr.
	Rs.	Rs.	rate	(\$)	(\$)
Stock on 1 <sup>st</sup> Jan., 2018	2,34,000		52	4,500	
Purchases & Sales	15,62,500	23,43,750	50	31,250	46,875
Debtors & creditors	7,65,000	5,10,000	51	15,000	10,000
Bills Receivable and Bills Payable	2,04,000	1,78,500	51	4,000	3,500
Salaries and wages	1,00,000		50	2,000	
Rent, Rates and Taxes	1,06,250		50	2,125	



Furniture	91,000			1,750	
Bank A/c	5,68,650		51	11,150	
New York Account		5,99,150			13,400
Exchange translation loss (bal. fig.)				2,000	
	<u>36,31,400</u>	<u>36,31,400</u>		<u>73,775</u>	<u>73,775</u>

**(b) Calculation of unrealized profit of each department and total unrealized profit**

	Dept. A	Dept. B	Dept. C	Total
	Rs.	Rs.	Rs.	Rs.
Unrealized Profit of:				
Department A		$45,000 \times 50/150 = 15,000$	$42,000 \times 20/120 = 7,000$	22,000
Department B	$40,000 \times .25 = 10,000$		$72,000 \times .15 = 10,800$	20,800
Department C	$39,000 \times 30/130 = 9,000$	$42,000 \times 40/140 = 12,000$		<u>21,000</u>
				<u>63,800</u>

Total unrealized profit is Rs. 63,800.

6. (a)

**Journal entries**

**In the books of Mukta Ltd.**

		Dr.	Cr.
		Rs. in lakhs	
1	Bank A/c Dr. T o Investments A/c T o Profit and Loss A/c (Being Investments sold and, profit being credited to Profit and Loss Account)	25,200	24,000 1,200
2	10% Redeemable Preference Share Capital A/c Dr. Premium payable on Redemption of Preference Shares A/c Dr. T o Preference Shareholders A/c (Being amount payable on redemption of Preference shares, at a Premium of 10%)	20,000 2,000	22,000
3	Securities Premium A/c Dr. T o Premium payable on Redemption of Preference Shares A/c (Being Securities Premium utilised to provide Premium on Redemption of Preference Shares)	2,000	2,000
4	Equity Share Capital A/c Dr. Premium payable on Buyback A/c Dr. T o Equity Share buy back A/c (Being the amount due on buy-back)	16,000 16,000	32,000

5	Securities Premium A/c (6,400 – 2,000) General Reserve A/c (balancing figure) To Premium payable on Buyback A/c (Being premium on buyback provided first out of Securities Premium and the balance out of General Reserves.)	Dr. Dr.	4,400 11,600	16,000
6	Bank A/c To Bank Loan A/c (Being Loan taken from Bank to finance Buyback)	Dr.	16,000	16,000
7	Preference Shareholders A/c Equity Shares buy back A/c To Bank A/c (Being payment made to Preference Shareholders and Equity Shareholders)	Dr. Dr.	22,000 32,000	54,000
8	General Reserve Account To Capital Redemption Reserve Account (Being amount transferred to Capital Redemption Reserve Account to the extent of face value of preference shares redeemed and equity Shares bought back) (20,000 + 16,000)	Dr.	36,000	36,000

(b) Fair value of an option = Rs. 56 – Rs. 50 = Rs. 6

Number of shares issued = 400 employees x 100 shares/employee = 40,000 shares

Fair value of ESOP = 40,000 shares x Rs. 6 = Rs. 2,40,000

Vesting period = 1 month

Expenses recognized in 2018-19 = Rs. 2,40,000

Date	Particulars		Rs.	Rs.
31.03.2019	Bank (40,000 shares x Rs. 50)	Dr.	20,00,000	
	Employees compensation expense A/c To Share Capital (40,000 shares x Rs.10) To Securities Premium (40,000 shares x Rs. 46) (Being option accepted by 400 employees & payment made @ Rs. 56 share)	Dr.	2,40,000	4,00,000 18,40,000
	Profit & Loss A/c To Employees compensation expense A/c (Being Employees compensation expense transferred to Profit & Loss A/c)	Dr.	2,40,000	2,40,000

7. (a) (i) In the given case, Mobile limited created 2% provision for doubtful debts till 31<sup>st</sup> March, 2018. Subsequently in 2018-19, the company revised the estimates based on the changed circumstances and wants to create 3% provision. Thus change in rate of provision of doubtful debt is change in estimate and is not change in accounting policy. This change will affect only current year.
- (ii) As per AS 5, the adoption of an accounting policy for events or transactions that differ in substance from previously occurring events or transactions, will not be considered as a change in accounting policy. Introduction of a formal retirement gratuity scheme by an employer in place of ad hoc ex-gratia payments to employees on retirement is a transaction

which is substantially different from the previous policy, will not be treated as change in an accounting policy.

- (iii) Change in useful life of furniture from 5 years to 3 years is a change in estimate and is not a change in accounting policy.
  - (iv) Adoption of a new accounting policy for events or transactions which did not occur previously should not be treated as a change in an accounting policy. Hence the introduction of new pension scheme is not a change in accounting policy.
- (b) **Nature of Limited Liability Partnership:** A limited liability partnership is a body corporate formed and incorporated under the LLP Act, 2008 and is a legal entity separate from that of its partners. A limited liability partnership shall have perpetual succession and any change in the partners of a limited liability partnership shall not affect the existence, rights or liabilities of the limited liability partnership.

**Designated partners:** Every limited liability partnership shall have at least two designated partners who are individuals and at least one of them shall be a resident in India.

In case of a limited liability partnership in which all the partners are bodies corporate or in which one or more partners are individuals and bodies corporate, at least two individuals who are partners of such limited liability partnership or nominees of such bodies corporate shall act as designated partners

(c) **Calculation of number of equity shares allotted to be debenture holders**

	<i>No. of debenture</i>
Total number of debentures	30,000
Less: Debenture holders not opted for conversion	<u>(2,500)</u>
	<u>27,500</u>
Option for conversion	20%
	5,500
Number of debentures for conversion $(27,500 \times \frac{20}{100})$	
Redemption value at a premium of 5% $(5,500 \times \text{Rs. } 105)$	Rs. 5,77,500
Number of equity shares to be allotted $\frac{\text{Rs. } 5,77,500}{\text{Rs. } 15}$	38,500 shares

- (d) In given case the recoverability of Rs. 40 Crores is not doubtful or uncertain but just deferred temporarily hence it should be translated using exchange rates at the close of the year. Further AS-11 clearly mentions that net difference shall be transferred to profit and loss account. Hence, we can say that exchange difference favourable or unfavorable both shall be considered at the year end rather to ignore the gains and recording just losses.
- (e) Interest on performing assets should be recognised on accrual basis, but interest on NPA should be recognised on cash basis.

	<i>Rs. in lakhs</i>
Interest on cash credits and overdraft :	(1800+70) = 1,870
Interest on Term Loan	(480+40) = 520
Income from bills purchased and discounted :	(700+36) = <u>736</u>
	<u>3,126</u>

**MOCK TEST PAPER 1**  
**INTERMEDIATE (IPC) GROUP – II**  
**PAPER – 6: AUDITING AND ASSURANCE**

**Time Allowed – 3 Hours**

**Maximum Marks – 100**

**Division A- MCQ's-30 Marks**

**Questions (1-20) 1- Mark**

1. Planning an audit involves
  - (a) establishing the overall audit strategy for the engagement and developing an audit plan.
  - (b) establishing the overall audit plan for the engagement and developing an audit strategy.
  - (c) establishing the overall audit plan for the engagement
  - (d) developing an audit strategy.
2. Which of the following is correct :
  - (a) The auditor shall assemble the audit documentation in an audit file and complete the administrative process of assembling the final audit file on a timely basis after the date of the auditor's report.
  - (b) The auditor shall assemble the audit documentation in an audit file and shall not complete the administrative process of assembling the final audit file.
  - (c) The auditor shall assemble the audit documentation in an audit file and complete the administrative process of assembling the final audit file on a timely basis before the date of the auditor's report.
  - (d) The auditor shall not assemble the audit documentation in an audit file.
3. \_\_\_\_\_ refers to the record of audit procedures performed, relevant audit evidence obtained, and conclusions the auditor reached.
  - (a) Audit documentation
  - (b) Audit File
  - (c) Audit Note Book
  - (d) Completion Memorandum
4. Audit evidence includes
  - (a) information contained in the accounting records underlying the financial statements
  - (b) both information contained in the accounting records underlying the financial statements and other information.
  - (c) other information.
  - (d) information contained in the accounting records underlying the financial statements or other information.

5. Most of the auditor's work in forming the auditor's opinion consists of :
  - (a) obtaining audit evidence.
  - (b) evaluating audit evidence.
  - (c) obtaining or evaluating audit evidence.
  - (d) obtaining and evaluating audit evidence.
6. A difference between the amount, classification, presentation, or disclosure of a reported financial statement item and the amount, classification, presentation, or disclosure that is required for the item to be in accordance with the applicable financial reporting framework is :
  - (a) Misstatement
  - (b) Error
  - (c) fraud
  - (d) Any of the above
7. Risk of material misstatement may be defined as the risk
  - (a) that the financial statements are materially misstated after audit.
  - (b) that the financial statements are materially misstated during audit.
  - (c) that the financial statements are materially misstated prior to audit.
  - (d) All of the above
8. Professional skepticism is necessary to the critical assessment of
  - (a) audit documentation
  - (b) audit evidence.
  - (c) audit procedures
  - (d) All of the above
9. The assessment of the risks of material misstatement may be expressed in
  - (a) quantitative terms, such as in percentages, or in non-quantitative terms.
  - (b) quantitative terms, such as in percentages,
  - (c) non-quantitative terms.
  - (d) None of the above
10. SA 315 establishes requirements and provides guidance on identifying and assessing the risks of material misstatement -
  - (a) at the financial statement levels only.
  - (b) at the assertion levels only.
  - (c) at the financial statement and assertion levels.
  - (d) at the financial statement or assertion levels.

11. According to SA 300,
- planning is not a continual and iterative phase of an audit, but rather a discrete process
  - planning is not a discrete phase of an audit, but rather a continual and iterative process
  - planning is not continual and iterative process
  - planning is not a discrete phase of an audit
12. Which of the following is not an analytical procedure?
- Tracing of purchases recurred in the purchase book to purchase invoices.
  - Comparing aggregate wages paid to number of employees
  - Comparing the actual costs with standard costs
  - All of them are analytical procedure
13. Audit evidence is necessary to support the auditor's opinion and report. It is\_\_\_\_\_in nature and is primarily obtained from audit procedures performed during the course of the audit.
- cumulative
  - regressive
  - selective
  - objective
14. Under **sub-section (3) of section 141** along with **Rule 10** of the Companies (Audit and Auditors) Rules, 2014 (hereinafter referred as CAAR), the following persons shall not be eligible for appointment as an auditor of a company, namely-
- a limited liability partnership registered under the Limited Liability Partnership Act, 2008;
  - an officer or employee of the company;
  - a person who is a partner, or who is in the employment, of an officer or employee of the company;
  - a person who, or his relative or partner is holding any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company. It may be noted that the relative may hold security or interest in the company of face value not exceeding Rs. 1,00,000.
- Which of the above is incorrect :
- All statements are incorrect.
  - (i) and (ii)
  - (i) only
  - (iv) only
15. Which of the following is not an advantage of Joint Audit :
- Sharing of expertise.
  - General superiority complexes of some auditors.

- (c) Lower workload.
  - (d) Displacement of the auditor of the company taken over in a take - over often obviated.
16. A company did not disclose accounting policies required to be disclosed under Schedule III or any other provisions of the Companies Act, 2013, the auditor should issue–
- (a) a qualified opinion
  - (b) an adverse opinion
  - (c) a disclaimer of opinion
  - (d) emphasis of matter paragraph.
17. Which of the following is correct as per **section 143(10)** of the Companies Act, 2013 :
- (a) IFAC may prescribe the standards of auditing as recommended by the Institute of Chartered Accountants of India, in consultation with and after examination of the recommendations made by the National Financial Reporting Authority.
  - (b) the International Auditing Standards Board may prescribe the standards of auditing as recommended by the Institute of Chartered Accountants of India, in consultation with and after examination of the recommendations made by the National Financial Reporting Authority.
  - (c) the MCA may prescribe the standards of auditing as recommended by the Institute of Chartered Accountants of India, in consultation with and after examination of the recommendations made by the National Financial Reporting Authority.
  - (d) the Central Government may prescribe the standards of auditing as recommended by the Institute of Chartered Accountants of India, in consultation with and after examination of the recommendations made by the National Financial Reporting Authority.
18. Which of the following is not a duty of auditor to report under section 143 (1)
- (a) whether loans and advances made by the company on the basis of security have been properly secured and whether the terms on which they have been made are prejudicial to the interests of the company or its members;
  - (b) whether transactions of the company which are represented merely by book entries are prejudicial to the interests of the company;
  - (c) where the company not being an investment company or a banking company, whether so much of the assets of the company as consist of shares, debentures and other securities have been sold at a price less than that at which they were purchased by the company;
  - (d) 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 auditors 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;
19. Which of the following is correct :
- (a) Under **section 128** of the Act, books of account of a company must be kept at the registered office.
  - (b) Under **section 128** of the Act, books of account of a company must be kept at the corporate office.

- (c) Under **section 128** of the Act, books of account of a company must be kept at the Head office of the company.
- (d) Under **section 128** of the Act, books of account of a company must be kept at the usual place of business.

20. An Audit report is :

- (a) an opinion drawn on the entity's financial statements to make sure that the records are true and correct representation of the transactions they claim to represent.
- (b) an opinion drawn on the entity's books of accounts to make sure that the records are true and fair representation of the transactions they claim to represent.
- (c) an opinion drawn on the entity's financial statements to make sure that the records are true and fair representation of the transactions they claim to represent.
- (d) an opinion drawn on the entity's books of accounts to make sure that the records are true and correct representation of the transactions they claim to represent. **(20 X1 = 20 Marks)**

**Questions (21-25) 2- Mark**

21. Which of the following is not a Specific Evaluations by the Auditor :

- (a) The financial statements adequately disclose the significant accounting policies selected and applied;
- (b) The accounting policies selected and applied are consistent with the applicable financial reporting framework and are appropriate;
- (c) The accounting estimates made by management are reasonable;
- (d) The sufficient appropriate audit evidence has been obtained;

22. If law or regulation prescribes in sufficient detail the terms of the audit engagement,

- (a) the auditor need not record them in a written agreement, except for the fact that such law or regulation applies and that management acknowledges and understands its responsibilities.
- (b) the auditor need not record them in a written agreement
- (c) the auditor needs to record them in a written agreement
- (d) None of the above

23. If the auditor is unable to obtain sufficient appropriate audit evidence regarding the opening balances,

- (a) the auditor shall express a qualified opinion in accordance with SA 705.
- (b) the auditor shall express a disclaimer of opinion in accordance with SA 705.
- (c) the auditor shall express a qualified opinion or adverse opinion, as appropriate, in accordance with SA 705.
- (d) the auditor shall express a qualified opinion or a disclaimer of opinion, as appropriate, in accordance with SA 705.

24. which of the following is correct :

- (a) Different types of analytical procedures provide different levels of assurance.



- (b) Different types of analytical procedures provide similar levels of assurance.
  - (c) Similar type of analytical procedures provide different levels of assurance.
  - (d) All are correct
25. According to SA 210 "Agreeing the Terms of Audit Engagements", The auditor shall agree the terms of the audit engagement with :
- (a) management
  - (b) those charged with governance
  - (c) management or those charged with governance, as appropriate.
  - (d) Audit committee
- (5 x 2 = 10 Marks)**

**Division B- Descriptive Questions-70 Marks**

Question No. 1 is compulsory.

Attempt any **four** questions from the Rest.

1. Examine with reasons (in short) whether the following statements are correct or incorrect: (Attempt any 7 out of 8)
- (i) If financial statements are misstated, and in the auditor's judgment such misstatement is material and pervasive, he should issue a qualified opinion.
  - (ii) 'Test of Control' may be defined as an audit procedure designed to detect material misstatements at the assertion level
  - (iii) The method which involves dividing the population into groups of items is known as block sampling.
  - (iv) It is necessary for the auditor to maintain professional skepticism throughout the audit.
  - (v) Teeming and lading is one of the techniques of inflating cash payments.
  - (vi) Managing director of A Ltd. himself appointed the first auditor of the company.
  - (vii) The scope of work of an internal auditor may extend even beyond the financial accounting.
  - (viii) There is no relation between Inherent risk, Control risk and Detection risk. **(7 x 2 = 14 Marks)**
2. Discuss the following:
- (a) "An audit is independent examination of financial information of any entity, whether profit oriented or not, and irrespective of its size or legal form, when such an examination is conducted with a view to expressing an opinion thereon."  
Explain stating clearly how the person conducting this task should take care to ensure that financial statements would not mislead anybody. **(4 Marks)**
  - (b) The relationship between auditing and law is very close one. **(4 Marks)**
  - (c) In the course of audit of Steadfast Ltd., a manufacturing company, you find that there is a sharp fall in the rate of gross profit in comparison to the previous year. State the steps you would take to verify the same. **(3 Marks)**
  - (d) Materiality for the financial statements as a whole may need to be revised as a result of a change in circumstances that occurred during the audit. Explain with the help of example. **(3 Marks)**

3. (a) "The auditors should consider the effect of subsequent events on the financial statement and on auditor's report" – Comment according to SA 560. **(4 Marks)**
- (b) Auditors of M/s Tender India (P) Ltd. were changed for the accounting year 2016-17. The closing inventory of the company as on 31.3.2016 amounting to Rs. 100 lacs continued as it is and became closing inventory as on 31.3.2017. The auditors of the company propose to exclude from their audit programme the audit of closing inventory of Rs. 100 lacs on the understanding that it pertains to the preceding year which was audited by another auditor. **(4 Marks)**
- (c) What are the obvious assertions in the following items appearing in the Financial Statements?
- (i) Statement of Profit and Loss  
                     Travelling Expenditure     Rs. 50,000
- (ii) Balance Sheet  
                     Trade receivable                 Rs. 2,00,000 **(3 Marks)**
- (d) "Fraudulent financial reporting involves intentional misstatements including omissions of amounts or disclosures in financial statements to deceive financial statement users." Discuss. **(3 Marks)**
4. (a) In performing an audit of financial statements, the auditor should have or obtain knowledge of the business. Explain in the light of SA 315 "Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment". **(4 Marks)**
- (b) Audit against the propriety seeks to ensure that expenditure conforms to certain principles. **(4 Marks)**
- (c) Discuss which class of companies are specifically exempt from the applicability of CARO 2016. **(3 Marks)**
- (d) What audit points are to be borne in mind in case of issue of "Sweat Equity Shares" by a limited company? **(3 Marks)**
5. (a) Auditor's job becomes simpler in CIS environment, where trial balance always tally. **(4 Marks)**
- (b) XYZ Ltd is engaged in trading of electronic goods and having huge accounts receivables. For analysing the whole accounts receivables, auditor wanted to use sampling technique. In considering the characteristics of the population from which the sample will be drawn, the auditor determines that stratification or value-weighted selection technique is appropriate. SA 530 provides guidance to the auditor on the use of stratification and value-weighted sampling techniques. Advise the auditor in accordance with SA 530. **(4 Marks)**
- (c) State the disclosure requirements in respect of Statement of profit and Loss as per Schedule III of Companies Act, 2013, in case of Employee benefits expenses. **(3 Marks)**
- (d) The auditor A of ABC & Co.- firm of auditors is conducting the audit of XYZ Ltd and while performing testing of additions wanted to verify that all PPE (Property Plant and Equipment) purchase invoices are in the name of the entity he is auditing. For all additions to land, building in particular, the auditor desires to have concrete evidence about ownership. The auditor is worried about whether the entity has valid legal ownership rights over the PPE claimed to be held by the entity and recorded in the financial statements. Advise the auditor. **(3 Marks)**

6. (a) Discuss the provisions of Section 134 of the Companies Act, 2013 regarding the authentication of financial statements. **(4 Marks)**
- (b) What is an Emphasis of Matter paragraph, when it is used, and manner of its use in an audit report? **(4 Marks)**

**OR**

- (c) The general transactions of a hospital include patient treatment, collection of receipts, donations, capital expenditures. You are required to mention special points of consideration while auditing such transactions of a hospital? **(4 Marks)**
- (d) CA. Donald was appointed as the auditor of PS Ltd. at the remuneration of Rs. 30,000. However, after 4 months of continuing his services, he could not continue to hold his office of the auditor as his wife got a government job at a distant place and he needs to shift along with her to the new place. Thus, he resigned from the company and did not perform his responsibilities relating to filing of statement to the company and the registrar indicating the reasons and other facts as may be relevant with regard to his resignation.
- How much fine may he be punishable with under section 140(3) for non-compliance of section 140(2) of the Companies Act, 2013? **(3 Marks)**
- (e) "The remuneration of the auditor of a company shall be fixed in its general meeting or in such manner as may be determined therein." Explain with reference to provisions of the Companies Act, 2013. **(3 Marks)**

**MOCK TEST PAPER 1**  
**INTERMEDIATE (IPC) OLD COURSE: GROUP – II**  
**PAPER – 6 : AUDITING AND ASSURANCE**  
**SUGGESTED ANSWERS/HINTS**

**Division A- MCQ's-30 Marks**

**Questions (1-20) 1- Mark**

1. (a)
2. (a)
3. (a)
4. (b)
5. (d)
6. (a)
7. (c)
8. (b)
9. (a)
- 10 (c)
11. (b)
12. (a)
13. (a)
14. (c)
15. (b)
16. (a)
17. (d)
18. (d)
19. (a)
- 20 (c)

**Questions (21-25) 2- Mark**

21. (d)
- 22 (a)
23. (d)
- 24 (a)
25. (c)

## Division B- Descriptive Questions

1. (i) **Incorrect:** As per SA 705 “Modifications to the Opinion in the Independent Auditor’s Report”, the auditor shall express an adverse opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements. However, the auditor shall express qualified opinion when he concludes that misstatement, individually or in aggregate are material but not pervasive.
  - (ii) **Incorrect:** ‘Substantive procedure’ may be defined as an audit procedure designed to detect material misstatements at the assertion level whereas ‘tests of controls’ is an audit procedure designed to evaluate the operating effectiveness of controls in preventing, or detecting and correcting, material misstatements at the assertion level.
  - (iii) **Incorrect.** The method which involves dividing the population into groups of items is known as cluster sampling whereas block sampling involves the selection of a defined block of consecutive items.
  - (iv) **Correct.** As per SA 200, “Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing”, professional skepticism is an attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence. Thus, it is necessary for the auditor to maintain professional skepticism throughout the audit.
  - (v) **Incorrect:** Teeming and Lading is one of the techniques of suppressing cash receipts and not of inflating cash payments. Money received from one customer is misappropriated and the account is adjusted with the subsequent receipt from another customer and so on.
  - (vi) **Incorrect:** As per section 139(6) of the Companies Act, 2013, the first auditor of a company, other than a government company, shall be appointed by the Board of directors within 30 days from the date of registration of the company.  
  
Therefore, the appointment of first auditor made by the managing director of A Ltd. is in violation of the provisions of the Companies Act, 2013.
  - (vii) **Correct.** The scope of work of an internal auditor may extend even beyond the financial accounting and may include cost investigation, inquiries relating to losses and wastages, production audit, performance audit, etc.
  - (viii) **Incorrect:** There is an inverse relationship between detection risks and the combined level of inherent and control risks. When inherent and control risks are high, acceptable detection risk needs to be low to reduce audit risk to an acceptably low level. When inherent and control risks are low, an auditor can accept a higher detection risk and still reduce audit risks to an acceptably low level.
2. (a) “An audit is independent examination of financial information of any entity, whether profit oriented or not, and irrespective of its size or legal form, when such an examination is conducted with a view to expressing an opinion thereon.”

### Analysis of the Definition

1. Audit is Independent examination of Financial information.
2. of any entity – that entity may be profit oriented or not and irrespective of its size or legal form. For example – Profit oriented – Audit of Listed company engaged in business. On the other hand, Audit of NGO – not profit oriented.
3. The objective of the audit is to express an opinion on the financial statements.

The person conducting this task should take care to ensure that financial statements would not mislead anybody. This he can do honestly by satisfying himself that:

- (i) the accounts have been drawn up with reference to entries in the books of account;
  - (ii) the entries in the books of account are adequately supported by sufficient and appropriate evidence;
  - (iii) none of the entries in the books of account has been omitted in the process of compilation and nothing which is not in the books of account has found place in the statements;
  - (iv) the information conveyed by the statements is clear and unambiguous;
  - (v) the financial statement amounts are properly classified, described and disclosed in conformity with accounting standards; and
  - (vi) the statement of accounts present a true and fair picture of the operational results and of the assets and liabilities.
- (b) The relationship between auditing and law:** The relationship between auditing and law is very close one. Auditing involves examination of various transactions from the view point of whether or not these have been properly entered into. It necessitates that an auditor should have a good knowledge of business laws affecting the entity. He should be familiar with the law of contracts, negotiable instruments, etc. The knowledge of taxation laws is also inevitable as entity is required to prepare their financial statements taking into account various provisions affected by various tax laws. In analysing the impact of various transactions particularly from the accounting aspect, an auditor ought to have a good knowledge about the direct as well as indirect tax laws.
- (c) Decrease in Rate of Gross Profit on Sales:** When rate of Gross Profit on Sales of a manufacturing company has sharply decreased in comparison to the previous year, the auditor should satisfy the reasons for the same. Following factors should be considered which might cause decrease in the gross profit of the manufacturing company-
- (i) Undervaluation of closing inventory or overvaluation of opening inventory either due to wrong valuation of inventory or mistake in inventory taking.
  - (ii) Change in the basis of inventory valuation. For example, opening inventory was valued at market price above cost when closing inventory valued at cost which is below the market price.
  - (iii) Inclusion in the current year, the amount of goods purchased in the previous year that were received and taken in the same year.
  - (iv) Reversal of fictitious sale entries recorded in the previous year to boost up profit.
  - (v) Sales return entry passed two times or entry for purchase return has not been passed whenever goods are returned to suppliers.
  - (vi) Excess provisions for wages or direct expenses have been made.
  - (vii) Goods sent out for sale on approval or on a consignment basis not included in closing inventory.
  - (viii) Value of unusual inventory of consumable stores (fuel and packing materials) are not shown as inventory or not adjusted from corresponding expenses.
  - (ix) Expenses which should be charged in the Profit and Loss Account but wrongly charged to the Trading Account.

- (x) Insurance claim received in respect of goods lost in transit or destroyed by fire, not credited in Trading Account.
  - (xi) Goods sold or given as samples or destroyed, not accounted for.
- (d) **Revision in Materiality level as the Audit Progresses:** Materiality for the financial statements as a whole (and, if applicable, the materiality level or levels for particular classes of transactions, account balances or disclosures) may need to be revised as a result of a change in circumstances that occurred during the audit (for example, a decision to dispose of a major part of the entity's business), new information, or a change in the auditor's understanding of the entity and its operations as a result of performing further audit procedures.

**Example**

If during the audit it appears as though actual financial results are likely to be substantially different from the anticipated period end financial results that were used initially to determine materiality for the financial statements as a whole, the auditor revises that materiality.

If the auditor concludes that a lower materiality for the financial statements as a whole (and, if applicable, materiality level or levels for particular classes of transactions, account balances or disclosures) than that initially determined is appropriate, the auditor shall determine whether it is necessary to revise performance materiality, and whether the nature, timing and extent of the further audit procedures remain appropriate.

3. (a) **Effect of Subsequent Events:** SA 560 "Subsequent Events", establishes standards on the auditor's responsibility regarding subsequent events.

According to it, 'subsequent events' refer to those events which occur between the date of financial statements and the date of the auditor's report, and facts that become known to the auditor after the date of the auditor's report. It lays down the standard that the auditor should consider the effect of subsequent events on the financial statements and on the auditor's report.

The auditor should obtain sufficient appropriate evidence that all events upto the date of the auditor's report requiring adjustment or disclosure have been identified and to identify such events.

**The auditor should-**

- (i) obtain an understanding of any procedures management has established to ensure that subsequent events are identified.
- (ii) inquire of management and, where appropriate, those charged with governance as to whether any subsequent events have occurred which might affect the financial statements.

Examples of inquiries of management on specific matters are:

- Whether new commitments, borrowings or guarantees have been entered into.
- Whether sales or acquisitions of assets have occurred or are planned.
- Whether there have been increases in capital or issuance of debt instruments, such as the issue of new shares or debentures, or an agreement to merge or liquidate has been made or is planned.
- Whether there have been any developments regarding contingencies.
- Whether there have been any developments regarding risk areas and contingencies.
- Whether any unusual accounting adjustments have been made or are contemplated.

- Whether any events have occurred or are likely to occur which will bring into question the appropriateness of accounting policies used in the financial statements as would be the case, for example, if such events call into question the validity of the going concern assumption.
  - Whether any events have occurred that are relevant to the measurement of estimates or provisions made in the financial statements.
  - Whether any events have occurred that are relevant to the recoverability of assets.
- (iii) Read minutes, if any, of the meetings, of the entity's owners, management and those charged with governance, that have been held after the date of the financial statements and inquiring about matters discussed at any such meetings for which minutes are not yet available.
- (iv) Read the entity's latest subsequent interim financial statements, if any.
- (v) Read the entity's latest available budgets, cash flow forecasts and other related management reports for periods after the date of the financial statements.
- (vi) Inquire, or extend previous oral or written inquiries, of the entity's legal counsel concerning litigation and claims.
- (vii) Consider whether written representations covering particular subsequent events may be necessary to support other audit evidence and thereby obtain sufficient appropriate audit evidence.

When the auditor identifies events that require adjustment of, or disclosure in, the financial statements, the auditor shall determine whether each such event is appropriately reflected in those financial statements. If such events have not been considered by the management and which in the opinion of the auditor are material, the auditor shall modify his report accordingly.

**(b) Verification of Inventory:** As per SA 510 "Initial Audit Engagements – Opening Balances", in conducting an initial audit engagement, the objective of the auditor with respect to opening balances is to obtain sufficient appropriate audit evidence about whether-

- (i) Opening balances contain misstatements that materially affect the current period's financial statements; and
- (ii) Appropriate accounting policies reflected in the opening balances have been consistently applied in the current period's financial statements, or changes thereto are properly accounted for and adequately presented and disclosed in accordance with the applicable financial reporting framework.

When the financial statements for the preceding period were audited by predecessor auditor, the current auditor may be able to obtain sufficient appropriate audit evidence regarding opening balances by perusing the copies of the audited financial statements including the other relevant documents relating to the prior period financial statements such as supporting schedules to the audited financial statements. Ordinarily, the current auditor can place reliance on the closing balances contained in the financial statements for the preceding period, except when during the performance of audit procedures for the current period the possibility of misstatements in opening balances is indicated.



General principles governing verification of assets require that the auditor should confirm that assets have been correctly valued as on the Balance Sheet date. The contention of the management that the inventory has not undergone any change cannot be accepted, it forms part of normal duties of auditor to ensure that the figures on which he is expressing opinion are correct and properly valued. Moreover, it is also quite likely that the inventory lying as it is might have deteriorated and the same need to be examined. The auditor is advised not to exclude the audit of closing inventory from his audit programme.

**(c) (i) Travelling Expenditure Rs. 50,000**

- Expenditure has been actually incurred for the purpose of travelling.
- Travelling has been undertaken during the year under consideration.
- Total amount of expenditure incurred is Rs. 50,000 during the year.
- It has been treated as revenue expenditure and charged to Statement of Profit and Loss.

**(ii) Trade receivable Rs. 2,00,000**

- These include all sales transaction occurred during the year.
- These have been recorded properly and occurred during the year.
- These constitute assets of the entity.
- These have been shown at proper value, i.e. after showing the deduction on account of provision for bad and doubtful debts.

**(d) Fraudulent Financial Reporting:** Fraudulent financial reporting involves intentional misstatements including omissions of amounts or disclosures in financial statements to deceive financial statement users. It can be caused by the efforts of management to manage earnings in order to deceive financial statement users by influencing their perceptions as to the entity's performance and profitability. Such earnings management may start out with small actions or inappropriate adjustment of assumptions and changes in judgments by management. Pressures and incentives may lead these actions to increase to the extent that they result in fraudulent financial reporting.

In some entities, management may be motivated to reduce earnings by a material amount to minimize tax or to inflate earnings to secure bank financing.

**Fraudulent financial reporting may be accomplished by the following:**

- (i) Manipulation, falsification (including forgery), or alteration of accounting records or supporting documentation from which the financial statements are prepared.
- (ii) Misrepresentation in or intentional omission from, the financial statements of events, transactions or other significant information.
- (iii) Intentional misapplication of accounting principles relating to amounts, classification, manner of presentation, or disclosure.

Fraudulent financial reporting often involves management override of controls that otherwise may appear to be operating effectively.

**4. (a) Obtaining Knowledge of the Business:** The auditor needs to obtain a level of knowledge of the client's business that will enable him to identify the events, transactions and practices that, in his judgment, may have significant effect on the financial information among other things.

**As per SA 315 – “Identifying and Assessing the Risk of Material Misstatement Through Understanding the Entity and its Environment”,** the auditor shall obtain an understanding of the following:

- (a) Relevant industry, regulatory, and other external factors including the applicable financial reporting framework
- (b) The nature of the entity, including:
  - (i) its operations;
  - (ii) its ownership and governance structures;
  - (iii) the types of investments that the entity is making and plans to make, including investments in special-purpose entities; and
  - (iv) the way that the entity is structured and how it is financed;to enable the auditor to understand the classes of transactions, account balances, and disclosures to be expected in the financial statements.
- (c) The entity’s selection and application of accounting policies, including the reasons for changes thereto. The auditor shall evaluate whether the entity’s accounting policies are appropriate for its business and consistent with the applicable financial reporting framework and accounting policies used in the relevant industry.
- (d) The entity’s objectives and strategies, and those related business risks that may result in risks of material misstatement.
- (e) The measurement and review of the entity’s financial performance.

In addition to the importance of knowledge of the client’s business in establishing the overall audit plan, such knowledge helps the auditor to identify areas of special audit consideration, to evaluate the reasonableness both of accounting estimates and management representations, and to make judgement regarding the appropriateness of accounting policies and disclosures.

**(b) Audit against propriety:** Audit against propriety seeks to ensure that expenditure conforms to these principles which have been stated as follows:

- (1) The expenditure should not be *prima facie* more than the occasion demands. Every public officer is expected to exercise the same vigilance in respect of expenditure incurred from public moneys as a person of ordinary prudence would exercise in respect of expenditure of his own money.
- (2) No authority should exercise its powers of sanctioning expenditure to pass an order which will be directly or indirectly to its own advantage.
- (3) Public moneys should not be utilized for the benefit of a particular person or section of the community unless:
  - (i) The amount of expenditure involved is insignificant; or
  - (ii) A claim for the amount could be enforced in a Court of law; or
  - (iii) The expenditure is in pursuance of a recognized policy or custom; and
  - (iv) The amount of allowances, such as travelling allowances, granted to meet expenditure of a particular type should be so regulated that the allowances are not, on the whole, sources of profit to the recipients.

**(c) CARO 2016 specifically exempts the following class of companies:**

- (i) A banking company as defined in clause (c) of section 5 of the Banking Regulation Act, 1949;
- (ii) An insurance company as defined under the Insurance Act, 1938;
- (iii) A company licensed to operate under section 8 of the Companies Act;
- (iv) A One Person Company as defined under clause (62) of section 2 of the Companies Act;
- (v) A small company as defined under clause (85) of section 2 of the Companies Act; and
- (vi) 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 crores during the financial year as per the financial statements.

**(d) Issue of Sweat Equity Shares:** As per section 54 of the Companies Act, 2013, the employees may be compensated in the form of 'Sweat Equity Shares'.

"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 right in the nature of intellectual property rights or value additions, by whatever name called.

The auditor may see that the Sweat Equity Shares issued by the company are of a class of shares already issued and following conditions are fulfilled-

- (a) The issue is authorized 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 recognized 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 *paripassu* with other equity shareholders.

5. (a) **Audit in a Computerized Information System (CIS) Environment:** Though it is true that in CIS environment the trial balance always tallies, the same cannot imply that the job of an auditor becomes simpler. There can still be some accounting errors like omission of certain entries, compensating errors; duplication of entries, errors of commission in the form of wrong account head is posted. Possibility of "Window Dressing" and/or "Creation of Secret Reserves" where the trial balance tallied. At present, due to complex business environment the importance of trial balance cannot be judged only upto the arithmetical accuracy but the nature of transactions recorded in the books and appear in the trial balance should be focused.

The emergence of new forms of financial instruments like options and futures, derivatives, off balance sheet financing etc. have given rise to further complexities in recording and disclosure of transactions. In an audit, besides the tallying of a trial balance, there are also other issue like estimation of provision for depreciation, valuation of inventories, obtaining audit evidence, ensuring compliance procedure and carrying out substantive procedure, verification of assets & liabilities their valuation etc. which still requires judgment to be exercised by the auditor.

Responsibility of expressing an audit opinion and objectives of an audit are not changed in the audit in CIS environment. Therefore, it can be said that simply because of CIS environment and the trial balance has tallied it does not mean that the audit would become simpler.

- (b) **Stratification and Value-Weighted Selection:** In considering the characteristics of the population from which the sample will be drawn, the auditor may determine that stratification or value-weighted selection technique is appropriate. SA 530 provides guidance to the auditor on the use of stratification and value-weighted sampling techniques.

**Stratification:** Audit efficiency may be improved if the auditor stratifies a population by dividing it into discrete sub-populations which have an identifying characteristic. The objective of stratification is to reduce the variability of items within each stratum and therefore allow sample size to be reduced without increasing sampling risk.

When performing tests of details, the population is often stratified by monetary value. This allows greater audit effort to be directed to the larger value items, as these items may contain the greatest potential misstatement in terms of overstatement. Similarly, a population may be stratified according to a particular characteristic that indicates a higher risk of misstatement, **for example, when testing the allowance for doubtful accounts in the valuation of accounts receivable, balances may be stratified by age.**

The results of audit procedures applied to a sample of items within a stratum can only be projected to the items that make up that stratum. To draw a conclusion on the entire population, the auditor will need to consider the risk of material misstatement in relation to whatever other strata make up the entire population.

For example, 20% of the items in a population may make up 90% of the value of an account balance. The auditor may decide to examine a sample of these items. The auditor evaluates the results of this sample and reaches a conclusion on the 90% of value separately from the remaining 10% (on which a further sample or other means of gathering audit evidence will be used, or which may be considered immaterial).

If a class of transactions or account balance has been divided into strata, the misstatement is projected for each stratum separately. Projected misstatements for each stratum are then combined when considering the possible effect of misstatements on the total class of transactions or account balance.

**Value-Weighted Selection:** When performing tests of details it may be efficient to identify the sampling unit as the individual monetary units that make up the population. Having selected specific monetary units from within the population, **for example, the accounts receivable balance, the auditor may then examine the particular items, for example, individual balances, that contain those monetary units.** One benefit of this approach to defining the sampling unit is that audit effort is directed to the larger value items because they have a greater chance of selection, and can result in smaller sample sizes.

This approach may be used in conjunction with the systematic method of sample selection and is most efficient when selecting items using random selection.

- (c) **Employee benefits expenses:** The Company shall disclose by way of notes additional information regarding aggregate expenditure on the Employee benefits expenses:-
- (i) Salaries and wages.
  - (ii) Contribution to provident and other funds.
  - (iii) Expense on Employee Stock Option Scheme (ESOP) and Employee Stock Purchase Plan (ESPP).
  - (iv) Staff welfare expenses.
- (d) In addition to the procedures undertaken for verifying completeness of additions to PPE during the period under audit, the auditor while performing testing of additions should also verify that all PPE purchase invoices are in the name of the entity that entitles legal title of ownership to the respective entity. For all additions to land, building in particular, the auditor should obtain copies of conveyance deed/ sale deed to establish whether the entity is mentioned to be the legal and valid owner.

The auditor should insist and verify the original title deeds for all immovable properties held as at the balance sheet date. In case the entity has given such immovable property as security for any borrowings and the original title deeds are not available with the entity, the auditor should request the entity's management for obtaining a confirmation from the respective lenders that they are holding the original title deeds of immovable property as security. In addition, the auditor should also verify the register of charges, available with the entity to assess the PPE that has been given as security to any third parties.

6. (a) **Authentication of Financial Statements:** Section 134(1) provides that the financial statements, including consolidated financial statement, if any, shall be approved by the board of directors before they are signed on behalf of the board at least by the following:
- (i) chairperson of the company where he is authorized by the Board; or
  - (ii) By two directors out of which one shall be managing director and the Chief Executive Officer, if he is a director in the company,
  - (iii) The Chief Financial Officer and the company secretary of the company, wherever they are appointed.

However, in the case of a one person company, the financial statement shall be signed by only one director, for submission to the auditor for his report thereon.

According to section 134(7), a signed copy of every financial statement, including consolidated financial statement, if any, shall be issued, circulated or published along with a copy each of

- (i) Any notes annexed to or forming part of such financial statement;
  - (ii) The auditor's report; and
  - (iii) The Board's report
- (b) **Emphasis of Matter paragraph:** Sometimes the auditor considers it necessary to draw users' attention to a matter presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements, the auditor shall include an Emphasis of Matter paragraph in the auditor's report

provided the auditor has obtained sufficient appropriate audit evidence that the matter is not materially misstated in the financial statements.

**Examples - when it is used:**

- ❖ An uncertainty relating to the future outcome of an exceptional litigation or regulatory action.
- ❖ Early application (where permitted) of a new accounting standard that has a pervasive effect on the financial statements in advance of its effective date.
- ❖ A major catastrophe that has had, or continues to have, a significant effect on the entity's financial position.

**Manner of its use in Audit Report:** As per SA 706 "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report", the inclusion of an Emphasis of Matter paragraph in the auditor's report does not affect the auditor's opinion. When the auditor includes an Emphasis of Matter paragraph in the auditor's report, the auditor shall:

- (i) Include it immediately after the Opinion paragraph in the auditor's report;
- (ii) Use the heading "Emphasis of Matter", or other appropriate heading;
- (iii) Include in the paragraph a clear reference to the matter being emphasised and to where relevant disclosures that fully describe the matter can be found in the financial statements; and
- (iv) Indicate that the auditor's opinion is not modified in respect of the matter emphasised.

**OR**

- (c) Special points of consideration while auditing certain transactions of a hospital are stated below-
- (i) **Register of Patients:** Vouch the Register of patients with copies of bills issued to them. Verify bills for a selected period with the patients' attendance record to see that the bills have been correctly prepared. Also see that bills have been issued to all patients from whom an amount was recoverable according to the rules of the hospital.
  - (ii) **Collection of Cash:** Check cash collections as entered in the Cash Book with the receipts, counterfoils and other evidence for example, copies of patients bills, counterfoils of dividend and other interest warrants, copies of rent bills, etc.
  - (iii) **Legacies and Donations:** Ascertain that legacies and donations received for a specific purpose have been applied in the manner agreed upon.
  - (iv) **Reconciliation of Subscriptions:** Trace all collections of subscription and donations from the Cash Book to the respective Registers. Reconcile the total subscriptions due (as shown by the Subscription Register and the amount collected and that still outstanding).
  - (v) **Authorisation and Sanctions:** Vouch all purchases and expenses and verify that the capital expenditure was incurred only with the prior sanction of the Trustees or the Managing Committee and that appointments and increments to staff have been duly authorised.
- (d) Provisions and Explanation: For non-compliance of sub-section (2) of section 140 of the Companies Act, 2013, the auditor shall be punishable with fine, which shall not be less than fifty thousand rupees or the remuneration of the auditor, whichever is less but which may extend to five lakh rupees, under section 140(3) of the said Act.

Conclusion: Thus, the fine under section 140(3) of the Companies Act, 2013 shall not be less than Rs. 30,000 but which may extend to Rs. 5,00,000.

- (e) As per section 142 of the Act, the remuneration of the auditor of a company shall be fixed in its general meeting or in such manner as may be determined therein. However, board may fix remuneration of the first auditor appointed by it.

Further, the remuneration, in addition to the fee payable to an auditor, includes the expenses, if any, incurred by the auditor in connection with the audit of the company and any facility extended to him but does not include any remuneration paid to him for any other service rendered by him at the request of the company. Therefore, it has been clarified that the remuneration to Auditor shall also include any facility provided to him.

**MOCK TEST PAPER 1**  
**INTERMEDIATE (IPC): GROUP – II**  
**PAPER – 7: INFORMATION TECHNOLOGY AND STRATEGIC MANAGEMENT**  
**SECTION – A: INFORMATION TECHNOLOGY**

*Question No. 1 is compulsory.*

*Attempt any **four** questions from the rest.*

**Time Allowed – 1½ Hours**

**Maximum Marks: 50 Marks**

**Division A**

**Multiple Choice Questions**

**Total Marks: 15 Marks**

**Question Nos. 1 to 5 carries 2 marks each.**

1. The hard drive of a system is partitioned in such a way to create two separate hard drives which help devices, applications and users to interact with the virtual resources as if it were a real single logical resource. Which of the following emerging technology is best suited for this example?
  - (a) Virtualization
  - (b) Grid Computing
  - (c) Cloud Computing
  - (d) Electronic Calendaring
2. An enterprise has implemented Telecommuting with flexible working hours and location with its employees, allowing the enterprise for cost saving and better efficiency. In context to above situation, which of the following technology is used by enterprise?
  - (a) Network as a Service
  - (b) Communication as a Service
  - (c) Cloud Computing
  - (d) Mobile Computing
3. Mr. A is working on a specific system in an organization. His major work is to make the monthly report of daily transaction made by different employees of the organization like booking of train/air ticket, hotel room during their outstation visit for official work. These transactions were made electronically with distinguished payment gateway. Which of the following system is A working on?
  - (a) Knowledge Management system
  - (b) Management Information system
  - (c) Operational Management system
  - (d) Transaction Management system
4. ABC Ltd. Company is facing loss in their business. The company has decided to work on Six Sigma strategies to increase customer satisfaction and increase profit. By using statistical methods and graphical display, the company is able to identify the possible cause of process output variation. Which of the following phase of six sigma the company is working on?
  - (a) Control
  - (b) Measure



- (c) Define
  - (d) Analyze
5. Mr. X is the network Engineer of a company. He has been given a task of networking at the new branch of the company at different location. He has set up the network using a single length of wire, or cable that connected number of computers. Which of the following network he has set up there?
- (a) Ring Network
  - (b) Bus Network
  - (c) Mesh Network
  - (d) Star Network

**Question Nos. 6 to 10 carries 1 mark each.**

6. Which of the following is not a business risk of failure of Information Technology in an organization?
- (a) Deficient Project Management
  - (b) Automating Repetitive Business Process
  - (c) Superficial Executive involvement
  - (d) Technological Obsolescence
7. Which of the following is a telecommunication media that uses radio waves ranging from one millimetre to one meter and frequency ranging from 0.3 Ghz and 300 Ghz?
- (a) Radio Wave
  - (b) Infrared wave
  - (c) Micro wave
  - (d) Terrestrial Microwave
8. In terms of Human Resource Management System, which of the following module deals with Recruitment and Salary Administration?
- (a) Employee Self Service
  - (b) Personnel Management
  - (c) Payroll Management
  - (d) Compensation Management
9. Which of the following is not an independent element of computer based information system?
- (a) Database Administrator
  - (b) Software
  - (c) Hardware
  - (d) Procedure
10. Which of the following is not a step involved in Program Development Life Cycle?
- (a) Planning
  - (b) Coding
  - (c) Operation and Maintenance
  - (d) Authorization

**(5 x 1 = 5 Marks)**

**Division B**  
**Descriptive Questions**

**Total Marks: 35 Marks**

**Question No. 1 is compulsory.**

**Attempt any three questions out of remaining four questions.**

1. (a) Explain any three types of cloud in Cloud Computing based on their deployment and usage. **(3 Marks)**  
(b) Define the term "Packet Switching" in switched communication networks. **(2 Marks)**
2. (a) Business application is used to fulfill a person's need for regular occupation or commercial need and can be classified based on various business functions it covers. Describe different business applications based on nature of application. **(6 Marks)**  
(b) Discuss all the phases of Six Sigma life cycle. **(4 Marks)**
3. (a) In an organization, the task of security administrator is to provide data security and to ensure and maintain the data integrity. As a security administrator, you are required to discuss any one of the two:
  - Threat and its categories that are associated with network security.
  - Vulnerability and the facts responsible for its occurrence in the software. **(6 Marks)**(b) Discuss in brief different types of Information Systems that are used for decision-making at different levels in an organization. **(4 Marks)**
4. (a) Accounting Information System (AIS) is defined as a system of collection, storage and processing of financial and accounting data that is used by decision makers. Explain the basic functions of AIS. **(6 Marks)**  
(b) Artificial Intelligence (AI) is the research field that studies the comprehension of intelligent human behavior on a computer. It is used in every area and day to day activity. Determine some commercial applications of AI. **(4 Marks)**
5. (a) Every organization needs Database Management System to manage its information in an appropriate and desired manner. Identify and explain the database model that allows to store and retrieve the data in tabular form. **(6 Marks)**  
(b) Being a team member of Credit card sale promotion; you are required to explain an audience of people the processing of Credit Card. Prepare your reply. **(4 Marks)**

## SECTION – B: STRATEGIC MANAGEMENT

*Question 1 and 2 are compulsory.*

*Attempt any three questions out of remaining four questions.*

**Time Allowed – 1½ Hours**

**Maximum Marks – 50**

1. (i) In response to the changes in the environment organizations in general should:
  - (a) Understand the impact of changes on the strategy and make appropriate modifications.
  - (b) Make efforts that changes are reverted back so that organizations can function smoothly.
  - (c) Ignore the changes.
  - (d) None of the above.
- (ii) The four generic strategic alternatives propounded by Glueck and Jauch are:
  - (a) retirement, combination, stability and expansion
  - (b) retrenchment, combination, stability and expansion
  - (c) retrenchment, termination, retirement and stability
  - (d) retirement, expansion, termination and growth
- (iii) Which of the following competitive position of a firm is not as per ADL Matrix?
  - (a) Dominant
  - (b) Favourable
  - (c) Difficult
  - (d) Tenable
- (iv) Major dimensions while taking strategic decisions includes:
  - (a) top management decisions
  - (b) allocation of large amounts of company resources
  - (c) issues related to future oriented
  - (d) All the above
- (v) Functional managers need \_\_\_\_\_ from the business strategy in order to \_\_\_\_\_.
  - (a) to function, control
  - (b) guidance, make decisions
  - (c) money, purchase raw material
  - (d) motivation, profit
- (vi) Strategic implementation activities includes:
  - (a) Accomplishing annual objectives
  - (b) Measuring performance
  - (c) Preparing a TOWS matrix
  - (d) Conducting research
- (vii) The focus of six sigma is on:
  - (a) Customer
  - (b) Supplier
  - (c) Shareholders

- (d) Government.
- (viii) The term PESTLE analysis is used to describe a framework for analyzing the:
  - (a) Macro Environment
  - (b) Micro Environment
  - (c) Both Macro and Micro Environment
  - (d) None of these
- (ix) What are guidelines, methods, procedures, rules, forms and administrative practices known as?
  - (a) Long-term objectives
  - (b) Policies
  - (c) Annual objectives
  - (d) Strategies
- (x) A \_\_\_\_\_ consists of those rival firms with similar competitive approaches and positions in the market.
  - (a) Business unit
  - (b) Strategic group
  - (c) Strategic fit
  - (d) Cluster
- (xi) Which one of the following is totally an unrelated diversification?
  - (a) conglomerate diversification
  - (b) concentric diversification
  - (c) vertically diversification
  - (d) horizontally diversification
- (xii) The role of human resource manager is significant in building up -----of the firm.
  - (a) Goodwill
  - (b) Reputation
  - (c) Core Competence
  - (d) Market Value
- (xiii) Which of these is true about strategy implementation?
  - (a) It is positioning forces before the action.
  - (b) It focuses on effectiveness.
  - (c) It is primarily an operational process.
  - (d) It is primarily an intellectual process.
- (xiv) TQM is a -----focused managementsystem.
  - (a) People
  - (b) Employer
  - (c) Employee
  - (d) Worker

(xv) TOWS matrix has been developed by:

- (a) Heinz Ulwrick
- (b) Ulwrick Scholes
- (c) Scholes and Jhonson
- (d) Heinz Wehrich

**(15 x 1 = 15 Marks)**

2. Rajiv Arya is owner of an electrical appliance company that specializes in manufacturing of domestic vacuum cleaners. There are four other manufacturers with similar products and sales volume. Current rival firms also own a number of patents related to the product. The supplier base for procurement of raw material is also very large as there are multiple suppliers.

Identify Porter's Five Forces that may be classified as significant for the company? Explain. **(5 Marks)**

3. (a) 'A network structure is suited under unstable environment.' Elaborate. **(5 Marks)**  
(b) How would you analyse the meaning and importance of efficiency and profitability as objectives of business? **(5 Marks)**
4. (a) Discuss the role of information technology in business process reengineering. **(5 Marks)**  
(b) Distinguish between Top-Down and Bottom-Up strategic planning. **(5 Marks)**
5. (a) Write a short note on product life cycle (PLC) and its significance in portfolio diagnosis. **(5 Marks)**  
(b) What does corporate strategy ensure? Explain. **(5 Marks)**
6. (a) Write short note on production system. **(5 Marks)**  
(b) What are the various bases on which an existing firm can diversify strategically? **(5 Marks)**

**MOCK TEST PAPER 1**  
**INTERMEDIATE (IPC): GROUP – II**  
**PAPER – 7: INFORMATION TECHNOLOGY AND STRATEGIC MANAGEMENT**  
**SECTION – A: INFORMATION TECHNOLOGY**  
**ANSWERS**  
**Division A: MULTIPLE CHOICE QUESTIONS**

1. (a) Virtualization
2. (d) Mobile computing
3. (b) Management Information system
4. (d) Analyze
5. (b) Bus Network
6. (b) Automating Repetitive Business Process
7. (c) Micro wave
8. (b) Personnel Management
9. (a) Database Administrator
10. (d) Authorization

**Division B: DESCRIPTIVE QUESTIONS**

1. (a) The cloud computing environment can consist of multiple types of clouds based on their deployment and usage.
  - **Public Clouds:** The public cloud is made available to the general public or a large industry group. They are administrated by third parties or vendors over the Internet, and services are offered on pay-per-use basis. The key benefits are
    - (a) It is widely used in the development, deployment and management of enterprise applications, at affordable costs;
    - (b) It allows organizations to deliver highly scalable and reliable applications rapidly and at more affordable costs.
  - **Private Clouds:** This cloud computing environment resides within the boundaries of an organization and is used exclusively for the organization's benefits. These are also called internal clouds. They are built primarily by IT departments within enterprises who seek to optimize utilization of infrastructure resources within the enterprise by provisioning the infrastructure with applications using the concepts of grid and virtualization. The benefit of a Private Cloud is that it enables an enterprise to manage the infrastructure and have more control, but this comes at the cost of IT department creating a secure and scalable cloud.
  - **Community Clouds:** This is the sharing of computing infrastructure in between organizations of the same community. For example, all Government organizations within India may share computing infrastructure on the cloud to manage data. The risk is that data may be stored with the data of competitors.
  - **Hybrid Clouds:** It is maintained by both internal and external providers. It is a composition of two or more clouds (Private, Community or Public). They have to maintain their unique identity, but are bound together by standardized data and application portability. With a hybrid cloud, organizations might run non-core applications in a public cloud, while maintaining core applications and sensitive data in-house in a private cloud.

- (b) **Packet Switching:** It is a sophisticated means of maximizing transmission capacity of networks. Packet switching refers to protocols in which messages are broken up into small transmission units called packets, before they are sent. Each packet is transmitted individually across the net. The packets may even follow different routes to the destination. Since there is no fixed path, different packets can follow different path and thus they may reach to destination out of order.
2. (a) Some Business Applications are as follows:
- (i) **Accounting Applications:** Accounting applications range from application software such as TALLY and wings to high-and applications such as SAP and Oracle Financials. These are used by business entities for the purpose of day-to-day transactions of accounting and generating financial information such as balance sheet, profit and loss account and cash flow statements. These are classified as accounting applications.
  - (ii) **Office Management Software:** These applications help entities to manage their office requirements like word processors (MS Word), electronic spreadsheets (MS Excel), presentation software (PowerPoint), file sharing systems, etc. The purpose is to automate the day-to-day office work and administration.
  - (iii) **Compliance Applications:** Enterprises need to comply with applicable laws and regulations. India has taken a long stride in adopting e-compliance for its citizens with government promoting e-filing of documents, e-payments taxes, e-storage of data, etc. This has raised the requirements for software which can help any entity achieve compliances. A separate class of business application are available that facilitate meeting the compliance requirements.
  - (iv) **Customer Relationship Management Software:** These are specialized applications catering to the need of organizations largely in FMCG (Fast-Moving Consumer Goods) categories. These entities need to interact with their customers and respond to them. The response may be in the form of service support or may lead to product innovation. These are sought by entities, which deal directly with consumers.
  - (v) **Management Support Software:** These are applications catering to decision-making needs of the management. They may be further classified based on the level of management using them. For example, Management Information System are generally used by middle level manager's for their decision making needs, on the other hand Decision Support Systems are used by top management for their information requirements.
  - (vi) **ERP Software:** These applications called as Enterprise Resource Planning software, which are used by entities to manage resources optimally and to maximize the three Es i.e. Economy, Efficiency and Effectiveness of business operations.
  - (vii) **Product Lifecycle Management Software:** These business applications are used by enterprises that launch new products and are involved in development of new products. The recent trend in auto-sector in India reflects the growing importance and need of this type of software. Each month a new product is launched by auto companies in India, may it be two-wheeler or four-wheeler segment. The top management of all these companies often say that "the life cycle of auto products have significantly reduced".
  - (viii) **Logistics Management Software:** For large logistics managing companies, these are key business applications. These companies need to keep track of products and people across the globe to check whether there are any discrepancies that need action.
  - (ix) **Legal Management Software:** In India, a lot of effort is being put to digitize the legal system. Government of India, is keen to reduce the pendency in courts. As this process goes on legal profession in India shall need such systems. There are big legal firms in India, which are already using such business applications.

- (x) **Industry Specific Applications:** These are industry specific applications focused on a specific industry sector. For example, software designed especially for Banking applications, Insurance applications, Automobile dealer system, billing systems for malls, Cinema ticketing software, Travel industry related software, etc.
- (b) Six Sigma follows a life-cycle having phases: Define, Measure, Analyze, Improve and Control (or DMAIC) which are described as follows
  - (i) **Define:** Customers are identified and their requirements are gathered. Measurements that are critical to customer satisfaction [Critical to Quality, (CTQ)] are identified for further project improvement.
  - (ii) **Measure:** Process output measures that are attributes of CTQs are determined and variables that affect these output measures are identified. Data on current process are gathered and current baseline performance for process output measures are established. Variances of output measures are graphed and process sigma are calculated.
  - (iii) **Analyze:** Using statistical methods and graphical displays, possible causes of process output variations are identified. These possible causes are analyzed statistically to determine root cause of variation.
  - (iv) **Improve:** Solution alternatives are generated to fix the root cause. The most appropriate solution is identified using solution prioritization matrix and validated using pilot testing. Cost and benefit analysis is performed to validate the financial benefit of the solution. Implementation plan is drafted and executed.
  - (v) **Control:** Process is standardized and documented. Before and after analysis is performed on the new process to validate expected results, monitoring system is implemented to ensure process is performing as designed. Project is evaluated and lessons learned are shared with others.
- 3. (a) **Threat:** A Threat is a possible danger that can disrupt the operation, functioning, integrity, or availability of a network or system. Network security threats can be categorized into four broad themes:
  - ◆ **Unstructured Threats** - These originate mostly from inexperienced individuals using easily available hacking tools from the Internet. Many tools available to anyone on the Internet can be used to discover weaknesses in a company's network. These include port-scanning tools, address-sweeping tools, and many others. Most of these kinds of probes are done more out of curiosity than with a malicious intent in mind.
  - ◆ **Structured Threats** - These originate from individuals who are highly motivated and technically competent and usually understand network systems design and the vulnerabilities of those systems. They can understand as well as create hacking scripts to penetrate those network systems. An individual who presents a structured threat typically targets a specific destination or group. Usually, these hackers are hired by industry competitors, or state-sponsored intelligence organizations.
  - ◆ **External Threats** - These originate from individuals or organizations working outside an organization, which does not have authorized access to organization's computer systems or network. They usually work their way into a network from the Internet or dialup access servers.
  - ◆ **Internal Threats** - Typically, these threats originate from individuals who have authorized access to the network. These users either have an account on a server or physical access to the network. An internal threat may come from a discontented former or current employee or contractor. It has been seen that majority of security incidents originate from internal threats.

OR



**Vulnerability:** Vulnerability is an inherent weakness in the design, configuration, or implementation of a network or system that renders it susceptible to a threat. The following facts are responsible for occurrence of vulnerabilities in the software:

- ◆ **Software Bugs** - Software bugs are so common that users have developed techniques to work around the consequences, and bugs that make saving work necessary every half an hour or crash the computer every so often are considered to be a normal part of computing. For example - buffer overflow, failure to handle exceptional conditions, access validation error, input validation errors are some of the common software flaws.
- ◆ **Timing Windows** - This problem may occur when a temporary file is exploited by an intruder to gain access to the file, overwrite important data, and use the file as a gateway for advancing further into the system.
- ◆ **Insecure default configurations** - Insecure default configurations occur when vendors use known default passwords to make it as easy as possible for consumers to set up new systems. Unfortunately, most intruders know these passwords and can access systems effortlessly.
- ◆ **Trusting Untrustworthy information** - This is usually a problem that affects routers, or those computers that connect one network to another. When routers are not programmed to verify that they are receiving information from a unique host, bogus routers can gain access to systems and do damage.
- ◆ **End users** - Generally, users of computer systems are not professionals and are not always security conscious. For example, when the number of passwords of an user increases, user may start writing them down, in the worst case to places from where they are easy to find. In addition to this kind of negligence towards security procedures users do human errors, for example save confidential files to places where they are not properly protected.

(b) The various types of Information Systems are as follows:

- **Strategic-Level Systems:** For strategic managers to track and deal with strategic issues, assisting long-range planning. A principle area is tracking changes in the external conditions (market sector, employment levels, share prices, etc.) and matching these with the internal conditions of the organization.
- **Management-Level Systems:** Used for the monitoring, controlling, decision-making, and administrative activities of middle management. Some of these systems deal with predictions or "what if..." type questions. Tracking current progress in accord with plans is another major function of systems at this level.
- **Knowledge-Level Systems:** These systems support discovery, processing and storage of knowledge and data workers. These further control the flow of paper work and enable group working.
- **Operational-Level Systems:** Support operational managers tracking elementary activities. These can include tracking customer orders, invoice tracking, etc. Operational level systems ensure that business procedures are followed.

4. (a) There are three basic functions of Accounting Information System (AIS) and these are explained here.

1. **Collect and store data:** Collect and store data about organization's business activities and transactions by capturing transaction data from source documents and posting data from journals to ledgers. Source documents are special forms used to capture transaction data such as sales order, sales invoice, order processing, purchase order, etc. Control over data collection is improved by pre-numbering each source document. Accuracy and efficiency in recording transaction data can be further improved if source documents are properly designed.

- II. **Record transaction:** Record transactions data into journals. These journals present a chronological record of what occurred and provide management with information useful for decision making. These documents are in the form of reports like financial statements, managerial reports, etc.
  - III. **Safeguard organisational assets:** Provide adequate controls to ensure that data are recorded and processed accurately by safeguarding organizational assets (data and systems). The two important methods for accomplishing this objective are by providing adequate documentation of all business activities and an effective segregation of duties. Documentation allows management to verify that assigned responsibilities were completed correctly. Segregation of duties refers to dividing responsibility for different portions of a transaction among several people. The functions to be performed by different people are authorizing (approval) transactions, recording (capture) transactions and maintaining custody (protect) of assets, thereby ensuring that business activities are performed efficiently and in accordance with management's objectives.
- (b) Some of the commercial applications of Artificial Intelligence (AI) are as follows:

#### **Decision Support**

- Intelligent work environment that will help you capture the “why” as well as the “what” of engineered design and decision making.
- Intelligent human–computer interface (HCI) systems that can understand spoken language and gestures, and facilitate problem solving by supporting organization wide collaborations to solve particular problems.
- Situation assessment and resource allocation software for uses that range from airlines and airports to logistics centers.

#### **Information Retrieval**

- AI-based Intranet and Internet systems that distill tidal waves of information into simple presentations.
- Natural language technology to retrieve any sort of online information, from text to pictures, videos, maps, and audio clips, in response to English questions.
- Database mining for marketing trend analysis, financial forecasting, and maintenance cost reduction, and more.

#### **Virtual Reality**

- X-ray-like vision enabled by enhanced-reality visualization that allows brain surgeons to “see through” intervening tissue to operate, monitor, and evaluate disease progression.
- Automated animation interfaces that allow users to interact with virtual objects via touch (e.g., medical students can “feel” what it's like to stitch severed aortas).

#### **Robotics**

- Machine-vision inspections systems for gauging, guiding, identifying, and inspecting products and providing competitive advantage in manufacturing.
- Cutting-edge robotics systems, from micro-robots and hands and legs.

5. (a) A **Relational Database Model** allows the definition of data and their structures, storage and retrieval operations and integrity constraints that can be organized in a table structure. A table is a collection of records and each record in a table contains the same fields.

In Relational Database Model, both the hierarchical and network data structures require explicit relationships, or links, between records in the database. Both structures also require that data be

processed one record at a time. The relational database structure departs from both these requirements.

Three key terms are used extensively in relational database models: **Relations, Attributes, and Domains**. A relation is a table with columns and rows. The named columns of the relation are called attributes, and the domain is the set of values the attributes are allowed to take.

All relations (and, thus, tables) in a relational database have to adhere to some basic rules to qualify as relations.

- First, the ordering of columns is immaterial in a table.
- Second, there can't be identical record in a table.
- Third, each record will contain a single value for each of its attributes.

The relationships between records in same table or different tables can also be defined explicitly, by identifying or non-identifying parent-child relationships characterized by assigning cardinality (1:1, 1:M, M:M). Tables can also have a designated single attribute or a set of attributes that can act as a "key", which can be used to uniquely identify each record in the table.

A key that can be used to uniquely identify a row in a table is called a **primary key**. Keys are commonly used to join or combine data from two or more tables. Keys are also critical in the creation of indexes, which facilitate fast retrieval of data from large tables. Any column can be a key, or multiple columns can be grouped together into a compound key.

(b) The processing of Credit Card involves following steps:

- **Step 1: Authorization** – This is the first step in processing a credit card. After a merchant swipes the card, the data is submitted to merchant's bank, called an acquirer, to request authorization for the sale. The acquirer then routes the request to the card issuing bank, where it is authorized or denied, and the merchant is allowed to process the sale.
- **Step 2: Batching** – This is the second step in processing a credit card. At the end of a day, the merchant reviews all the day's sales to ensure they were authorized and signed by the cardholder. It then transmits all the sales at once, called a batch, to the acquirer to receive payment.
- **Step 3: Clearing** – This is the third step in processing a credit card. After the acquirer receives the batch, it sends it through the card network, where each sale is routed to the appropriate issuing bank. The issuing bank then subtracts its interchange fees, which are shared with the card network, and transfers the remaining amount through the network back to the acquirer.
- **Step 4: Funding** – This is the fourth and final step in processing a credit card. After receiving payment from the issuer, minus interchange fees, the acquirer subtracts its discount fee and sends the remainder to the merchant. The merchant is now paid for the transaction, and the cardholder is billed.

Using a credit card to make a purchase over the Internet follows the same scenario. But on the Internet, added steps must be taken to provide for secure transactions and authentication of both buyer and seller. To address these growing security concerns and pave the way for uninhibited growth of electronic commerce on the net, the two leading credit card brands, Visa and MasterCard, teamed up some years ago to develop a common standard to process card transactions on the Internet, called the Secure Electronic Transaction (SET) standard.

## SECTION – B: STRATEGIC MANAGEMENT

### SUGGESTED ANSWERS/HINTS

1.

(i)	(ii)	(iii)	(iv)	(v)	(vi)	(vii)	(viii)	(ix)	(x)
a	b	c	d	b	a	a	a	b	b
(xi)	(xii)	(xiii)	(xiv)	(xv)					
a	c	c	a	d					

2. The competitive rivalry will be a significant force in case of company of Rajiv Arya as all the rivals are similar in sizes and are manufacturing similar products. It is difficult for any single manufacturer to dominate the market. Large number of patents will make it difficult for new entrants to break into the market. Further, as there are a large number of small suppliers the power that suppliers can exert will also be low.

There is no information relating to substitutes and bargaining power of customers in the information given in scenario. However, a domestic vacuum cleaner will directly compete with other options such as house maids. Availability of house maids at low cost can significantly disturb the sales of products.

Further, as the products are similar customers can easily shift from one company to another. This will only enhance competitive rivalry.

The competitive rivalry will be significant in Rajiv Arya's dealing industry as all rivals are similar in sizes and manufacture similar products, making it difficult for anyone manufacturer to dominates the market or gain market share. The large number of patents will make it hard for new entrants to break into the market, while the fact that Rajiv Arya buys from a large number of small suppliers suggests that supplier power is also low. Finally, there is no information relating to substitutes and bargaining power of customers in the information given in scenario.

3. (a) Network structure is a newer and somewhat more radical organizational design. The network structure could be termed a "non-structure" as it virtually eliminates in-house business functions and outsource many of them. An organisation organized in this manner is often called a virtual organization because it is composed of a series of project groups or collaborations linked by constantly changing non-hierarchical, cobweb-like networks. The network structure becomes most useful when the environment of a firm is unstable and is expected to remain so. Under such conditions, there is usually a strong need for innovation and quick response. Instead of having salaried employees, it may contract with people for a specific project or length of time. Long-term contracts with suppliers and distributors replace services that the company could provide for itself.
- (b) Enterprises pursue multiple objectives rather than a single objective. In general, we may identify a set of different business objectives pursued by a large cross-section of enterprises. Efficiency and profitability are two of the important objectives of any business. Efficiency is the relationship between input and output whereas profitability is the relationship between profits and investments.
- ◆ **Efficiency:** Business enterprise seek efficiency in rationally choosing appropriate means to achieve their goals, doing things in the best possible manner and utilising resources in a most suitable combination. In a sense, efficiency is an economic version of the technical objective of productivity – designing and achieving suitable input output ratios of funds, resources, facilities and efforts. Efficiency is a very useful operational objective.
  - ◆ **Profitability:** It is generally asserted that private enterprises are primarily motivated by the objective of profit. Some may go even further and emphasise that profit is the sole motive of business enterprises. All other objectives are facilitative objectives and are meant to be serve the profit motive. It is pointed out that private business enterprises are operated on behalf of

and for the benefit of the owners who have assumed the business risk of investing their funds.

4. (a) **The Role of IT in BPR:** The accelerating pace at which information technology has developed during the past few years had a very large impact in the transformation of business processes. Various studies have conclusively established the role of information technology in the transformation of business processes. Information technology is playing a significant role in changing the business processes.

A reengineered business process, characterized by IT-assisted speed, accuracy, adaptability and integration of data and service points, is focused on meeting the customer needs and expectation quickly and adequately, thereby enhancing his/her satisfaction level. With the help of tools of information technology organizations can modify their processes to make them automatic, simpler, time saving. Thus, IT can bring efficiency and effectiveness in the functioning of business.

- (b) **Top-Down and Bottom-Up Strategic Planning:** Strategic planning determines where an organization is going over the next year or more and the ways for going there. The process is organization-wide or focused on a major function such as a division. As such strategic planning is a top level management function. The flow of planning can be from corporate to divisional level or vice-versa. There are two approaches for strategic planning - top down or bottom up.

Top down strategic planning describes a centralized approach to strategy formulation in which the corporate centre or head office determines mission, strategic intent, objectives and strategies for the organization as a whole and for all parts. Unit managers are seen as implementers of pre-specified corporate strategies.

Bottom up strategic planning is the characteristic of autonomous or semi-autonomous divisions or subsidiary companies in which the corporate centre does not conceptualize its strategic role as being directly responsible for determining the mission, objectives, or strategies of its operational activities. It may prefer to act as a catalyst and facilitator, keeping things reasonably simple and confining itself to perspective and broader strategic intent.

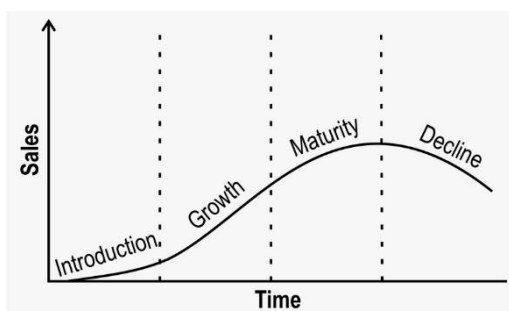
5. (a) Product life cycle is an important concept in strategic choice and S-shaped curve which exhibits the relationship of sales with respect of time for a product that passes through the four successive stages.

The first stage of PLC is the introduction stage in which competition is almost negligible, prices are relatively high and markets are limited. The growth in sales is also at a lower rate.

The second stage of PLC is the growth stage, in which the demand expands rapidly, prices fall, competition increases and market expands.

The third stage of PLC is the maturity stage, where in the competition gets tough and market gets stabilized. Profit comes down because of stiff competition.

The fourth stage is the declining stage of PLC, in which the sales and profits fall down sharply due to some new product replaces the existing product.



**Product Life Cycle**

PLC can be used to diagnose a portfolio of products (or businesses) in order to establish the stage at which each of them exists. Particular attention is to be paid on the businesses that are in the declining stage. Depending on the diagnosis, appropriate strategic choice can be made. For instance, expansion may be a feasible alternative for businesses in the introductory and growth stages. Mature businesses may be used as sources of cash for investment in other businesses which need resources. A combination of strategies like selective harvesting, retrenchment, etc. may be adopted for declining businesses. In this way, a balanced portfolio of businesses may be built up by exercising a strategic choice based on the PLC concept.

- (b) Corporate strategy in the first place ensures the growth of the organisation and ensures the correct alignment of the organization with its environment. It serves as the design for filling the strategic planning gap. It also helps build the relevant competitive advantages. It works out the right fit between the organization and its external environment. Basically, the purpose of corporate strategy is to harness the opportunities available in the environment, countering the threats embedded therein.

Corporate strategy brings methodical responses to the environment. Strategy is the opposite of adhoc responses to the changes in the environment in competition, consumer tastes, technology and other variables. It amounts to long-term, well thought-out and prepared responses to the various environment forces.

- 6. (a) Production system is concerned with the capacity, location, layout, product or service design, work systems, degree of automation, extent of vertical integration, and such factors. Strategies related to production system are significant as they deal with vital issues affecting the capability of the organisation to achieve its objectives.

Strategy implementation would have to take into account the production system factors as they involve decisions which are long-term in nature and influence not only the operations capability of an organisation but also its ability to implement strategies and achieve objectives.

- (b) Diversification endeavours can be related or unrelated to existing businesses of the firm. Based on the nature and extent of their relationship to existing businesses, diversification endeavours have been classified into four broad categories:
  - (i) Vertically integrated diversification
  - (ii) Horizontally integrated diversification
  - (iii) Concentric diversification
  - (iv) Conglomerate diversification