

Test Series: February, 2014

MOCK TEST PAPER – 1
INTERMEDIATE (IPC): 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) Explain briefly the accounting treatment needed in the following cases as per AS 11:
- (i) Trade receivables include amount receivable from Tug, U.S., ₹ 5,00,000 recorded at the prevailing exchange rate on the date of sales, transaction recorded at \$1 = ₹ 38.70
 - (ii) Long term loan taken from a U.S. Company, amounting to ₹ 60,00,000. It was recorded at \$1 = ₹ 35.60, taking exchange rate prevailing at the date of transactions.
Exchange rates at the end of the year were as under:
\$1 Receivable = ₹ 45.80
\$ 1 Payable = ₹ 45.90
- (b) X Co. Ltd. has its share capital divided into equity shares of ₹ 10 each. On 1.4.2012 it granted 16,000 employees' stock option at ₹ 50 per share, when the market price was ₹ 120 per share. The options were to be exercised between 15th March, 2013 and 31st March, 2013. The employees exercised their options for 16,000 shares. The company closes its books on 31st March every year. Show Journal entries (with narration) as would appear in the books of the company up to 31st March, 2013.
- (c) The company has to pay delayed cotton clearing charges over and above the negotiated price for taking delayed delivery of cotton from suppliers' godown. Upto 2012-13, the company has regularly included such charges in the valuation of closing stock. This being in the nature of interest the company has decided to exclude it from closing stock valuation for the year 2013-14. This would result into decrease in profit by ₹ 7.60 lakhs. State, how would you deal with the above in the annual accounts of a company for the year ended 31st March, 2014?
- (d) Hera Ltd. has got the license to manufacture particular medicines for 10 years at a license fee of ₹ 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 (₹ 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.

(4 x 5 = 20 Marks)

2. X, Y and Z share profits and losses in the ratio of 5:3:2. Their firm was dissolved due to misconduct of Y and their balance sheet on that date was as under:

Balance Sheet as at 31-3-2011

Liabilities		₹	Assets		₹
Capital Accounts :			Land and Building		2,00,000
X	3,00,000		Plants		2,00,000
Y	2,00,000		Trade receivables		1,00,000
Z	<u>1,00,000</u>	6,00,000	Inventories		1,50,000
Current Accounts:			Cash		1,00,000
X	50,000		Current Account:		
Y	<u>30,000</u>	80,000	Z		50,000
Trade payables		1,20,000			
		<u>8,00,000</u>			<u>8,00,000</u>

The whole business of the firm was sold to Omega Limited, on that day on the following terms:

- (i) Omega Limited will issue the following securities in consideration for transfer of business:

10,000 equity shares @ ₹ 15 each, 15,000 preference shares @ ₹ 15 each; and 20,000 debentures @ ₹ 14.725.

(ii) The agreed value of assets and liabilities of partnership firm are as follows:

Land & Building – ₹ 3,00,000, Plants – ₹ 1,50,000, Inventory – ₹ 1,40,000, Trade Receivable – ₹ 97,500, and Trade Payable – ₹ 1,18,000.

It is mutually decided that preference shares and debentures will be distributed in profit sharing ratio and cash brought in by the partner (if any) will be shared equally by the remaining partners before distribution of equity shares. Equity shares are distributed on residual basis at the end.

Prepare the necessary accounts, to close the books of the firm. (16 Marks)

3. The following was the Balance Sheet of C Ltd. as on 31st March ,2014.

Equity & Liabilities	₹ Lakhs	Assets	₹ Lakhs
Share Capital:		Fixed Assets	14,000
Equity shares of ₹ 10 each Fully Paid Up	8,000	Investments	3,000
10% Redeemable Pref. Shares of ₹ 10 each Fully Paid Up	2,500	Cash at Bank	1,650
Reserves & Surplus		Other Current Assets	8,250
Capital Redemption Reserve	1,000		
Securities Premium	800		
General Reserve	6,000		
Profit & Loss Account	300		
Secured Loans:			
9% Debentures	5,000		
Current Liabilities:			
Trade payables	2,300		
Sundry Provisions	<u>1,000</u>		
	<u>26,900</u>		<u>26,900</u>

On 1st April, 2014 the Company redeemed all its Preference Shares at a Premium of 10% and bought back 15% of its Equity Shares at ₹ 20 per Share. In order to make cash available, the Company sold all the Investments for ₹ 3,150 lakhs and raised a Bank Loan amounting to ₹ 400 lakh on the Security of the Company's Plant.

You are required to

(i) pass journal entries for the above and

(ii) prepare the Company's Balance sheet immediately thereafter. (16 Marks)

4. (a) Department L sells goods to Department M at a profit of 25% on cost and to Department N at 10% profit on cost. Department M sells goods to L and N at a profit of 15% and 20% on sales, respectively. Department N charges 20% and 25% profit on cost to Department L and M, respectively.

Department Managers are entitled to 10% commission on net profit subject to unrealised profit on departmental sales being eliminated. Departmental profits after charging Managers' commission, but before adjustment of unrealised profit are as under :

	₹
Department L	1,08,000
Department M	81,000
Department N	54,000

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

	Dept. L ₹	Dept. M ₹	Dept. N ₹
Transfer from Department L	—	45,000	33,000
Transfer from Department M	42,000	—	36,000
Transfer from Department N	18,000	15,000	—

Find out the correct departmental Profits after charging Managers' commission.

- (b) Using the Stock and Debtors system, find out the profit or loss made at the Raipur Branch in 2013.

	₹
Stock (1 st January) invoice price	12,000
Debtors (1 st January)	6,200
Goods sent to the Branch (invoice price)	35,000
Goods returned by the Branch (invoice price)	1,000
Sales:	
Credit	21,000
Cash	20,000
Goods returned by customers	600
Cash received from debtors	19,800
Discount allowed to them	300
Cash sent for expenses at the Branch	6,100
Shortage of goods at the Branch (invoice price)	400

Goods are invoiced to the Branch at the selling price so as to show a profit of 30% on invoice price. (8 + 8=16 Marks)

5. (a) All India Motels Ltd. absorbed the business of West India Motels Ltd. as on 31st March, 2013. Their respective positions of assets and liabilities as on that date of absorption were as under:

	All India	West India
	₹	₹
Share Capital	6,00,00,000	6,00,00,000
Reserves and Surplus	5,40,00,000	3,60,00,000
Debentures	8,00,00,000	9,60,00,000
Trade payables	2,20,00,000	4,80,00,000
Goodwill	4,48,00,000	3,20,00,000
Buildings	11,60,00,000	11,20,00,000
Machinery	1,80,00,000	1,60,00,000
Trade receivables	60,00,000	5,60,00,000
Inventory	80,00,000	2,00,00,000
Cash	32,00,000	40,00,000
Investments	2,00,00,000	—

The intrinsic value of West India shares has to be determined. Equivalent intrinsic value worth of ₹ 10 fully paid up shares of All India are to be issued to the shareholders of West India. 50% of trade receivables of All India comprises of moneys due from West India. Inventory of West India includes goods worth ₹ 30 lakhs sold by All India at cost plus 20% value. Called and paid up on All India shares is ₹ 8 per share whilst it is ₹ 5 per share in case of West India. Face value of shares of both the companies is ₹ 10. Investments were valued at ₹ 2,60,00,000.

Indicate the necessary journal entries to record the above transactions assuming amalgamation in the nature of purchase.

- (b) From the following information of STP Bank Ltd. pertaining to the financial year 2012-13, compute the provisions to be made in the Profit and Loss Account:

	₹ in lakh
Assets	
Standard	30,000
Sub-standard	20,000
Doubtful:	

For one year (secured)	8,000
For two years and three years (secured)	2,500
For more than three years (secured by mortgage of Plant & Machinery ₹ 500 lakh)	2,000
Loss Assets	1,700

(12 +4= 16 Marks)

6. (a) The following particulars are presented to you by Perfect General Insurance Company regarding its fire insurance business for the year ended 31st March, 2013:

	₹	₹
Reserve for unexpired risk on 31 st March, 2012		
(i) 50% of net premium income for 2011-2012	3,12,500	
(ii) Additional reserve on 31 st March, 2012	62,500	3,75,000
Claims paid		1,75,000
Commission paid		50,000
Expenses of management		1,81,250
Reinsurance premium paid		43,750
Premiums received		8,00,000
Claims outstanding on 31 st March, 2012		62,500
Commission earned on reinsurance ceded		36,875
Estimated liability on 31 st March, 2013 in respect of claims due or intimated		1,25,000

Prepare the Fire Revenue Account for the year ended 31st March, 2013 in the format prescribed by Schedule B given under IDRA Regulations along with necessary schedules. On 31st March, 2013 the company decides to keep total additional reserve for unexpired risk equal to 10% of the net premium income for the year.

- (b) The liquidation of a joint stock company commenced on 1st April, 2013. Certain creditors could not receive payment out of realization of assets and the contributions from A list contributories. The following are the details of certain transfers which took place:

Shareholder's name	No. of shares transferred	Date of ceasing to be a member	Creditors remaining unpaid and outstanding on the date of each transfer ₹
A	2,000	2 nd March, 2012	5,000
B	1,500	3 rd May, 2012	3,300
C	1,000	1 st Sept., 2012	4,300
D	500	23 rd Nov., 2012	4,600
E	300	1 st Feb., 2013	6,000

All the shares were of the face value of ₹ 10 each, ₹ 8 per share paid up.

Show the amount to be realized from the various persons listed above, ignoring expenses and remuneration to liquidator. (8 + 8 = 16 Marks)

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

- (a) Mohan started a business on 1st April 2012 with ₹ 12,00,000 represented by stock of 60,000 units of ₹ 20 each. During the financial year ending on 31st March, 2013 he sold the entire stock for ₹ 30 each. In order to maintain the capital intact, calculate the maximum amount, which can be withdrawn by Mohan in the year 2012-13 if Financial Capital is maintained at historical cost.
- (b) Viva Ltd. received a specific grant of ₹ 30 lakhs for acquiring the plant of ₹ 150 lakhs during 2010-11 having useful life of 10 years. The grant received was credited to deferred income in the balance sheet. During 2013-14, due to non-compliance of conditions laid down for the grant, the company had to refund the whole grant to the Government. Balance in the deferred income on that date was ₹ 21 lakhs and written down value of plant was ₹ 105 lakhs.
 - (i) What should be the treatment of the refund of the grant and the effect on cost of the fixed asset and the amount of depreciation to be charged during the year 2013-14 in profit and loss account?
 - (ii) What should be the treatment of the refund, if grant was deducted from the cost of the plant during 2010-11 assuming plant account showed the balance of ₹ 84 lakhs as on 1.4.2013?
- (c) A company is in a dispute involving allegation of infringement of patents by a competitor company who is seeking damages of a huge sum of ₹ 900 lakhs. The directors are of the opinion that the claim can be successfully resisted by the company. How would you deal with the same in the annual accounts of the company?

- (d) Explain the concept of 'weighted average number of equity shares outstanding during the period'. State how would you compute, based on AS 20, the weighted average number of equity shares in the following case:

		No. of shares
1 st April, 2012	Balance of equity shares	7,20,000
31 st August, 2012	Equity shares issued for cash	2,40,000
1 st February, 2013	Equity shares bought back	1,20,000
31 st March, 2013	Balance of equity shares	8,40,000

- (e) In May, 2011, Speed Ltd. took a bank loan to be used specifically for the construction of a new factory building. The construction was completed in January, 2012 and the building was put to its use immediately thereafter. Interest on the actual amount used for construction of the building till its completion was ₹ 18 lakhs, whereas the total interest payable to the bank on the loan for the period till 31st March, 2012 amounted to ₹ 25 lakhs. Can ₹ 25 lakhs be treated as part of the cost of factory building and thus be capitalized on the plea that the loan was specifically taken for the construction of factory building? (4 x 4 = 16 Marks)

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SUGGESTED ANSWERS/HINTS

1. (a) The problem focuses on determination of effect of foreign exchange fluctuations on balance sheet date and accounting for the same.

AS 11 'The Effects of changes in Foreign Exchange Rates' provides that exchange differences attributable to monetary items should be taken to Profit and Loss Statement. In case the option under para 46A is exercised, the exchange differences arising on long-term foreign currency monetary items can be adjusted in the cost of the depreciable capital asset or in other cases transferred in Foreign Currency Monetary Item Translation Difference Account (FCMITD) and amortised.

- (i) Trade receivables:

Particulars	Foreign currency	Rate	₹
Initial recognition	US \$ 12,919.90	38.70	5,00,000
Rate on B/S date		45.80	
Exchange Difference	US \$ 12,919.90	7.10	91,731
Gain or loss			Gain
Treatment			Credit P&L A/c ₹ 91,731

- (ii) Long Term loan:

Particulars	Foreign currency	Rate	₹
Initial recognition	US \$ 1,68,539.33	35.60	60,00,000
Rate on B/S date		45.90	
Exchange Difference	US \$ 1,68,539.33	10.30	17,35,955
Gain or loss			Loss
Treatment			Debit P&L A/c ₹ 17,35,955 or transfer to FCMITD A/c and amortise.

- (b) **In the books of X Co. Ltd.**
Journal Entries

			₹	₹
15.03.2013	Bank A/c	Dr.	8,00,000	
to 31.3.13	Employee compensation expense A/c	Dr.	11,20,000	

	To Equity share capital A/c		1,60,000
	To Securities premium A/c		17,60,000
	(Being shares issued to the employees against the options vested to them in pursuance of Employee Stock Option Plan)		
31.3.13	Profit and Loss A/c	Dr.	11,20,000
	To Employee compensation expenses A/c		11,20,000
	(Being transfer of employee compensation transfer to Profit and Loss Account)		

- (c) Para 29 of AS 5 (Revised), 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies', states that a change in an accounting policy should be made only if the adoption of a different accounting policy is required by statute or for compliance with an accounting standard or if it is considered that the change would result in a more appropriate presentation of the financial statements of an enterprise.

Therefore, the change in the method of stock valuation is justified in view of the fact that the change is in line with the recommendations of Accounting Standards and would result in more appropriate preparation of the financial statements.

Also, appropriate disclosure of the change and the amount by which any item in the financial statements is affected by such change is necessary as per Accounting Standards. Therefore, the under mentioned note should be given in the annual accounts.

"In compliance with the Accounting Standards, delayed cotton clearing charges which are in the nature of interest have been excluded from the valuation of closing stock unlike preceding years. Had the company continued the accounting practice followed earlier, the value of closing stock as well as profit before tax for the year would have been higher by ₹ 7.60 lakhs."

- (d) As per para 72 of 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. Hera Ltd. should amortize the license fee of ₹ 200 lakhs as under:

Year	Net operating Cash in flow (₹)	Ratio	Amortize amount (₹ 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>

2.

Realisation A/c

	₹	₹		₹
To Land & Building		2,00,000	By Trade Payables	1,20,000
To Plant		2,00,000	By Omega Limited (W.N.1)	6,69,500
To Inventories		1,50,000		
To Trade Receivable		1,00,000		
To Cash		1,00,000		
To Profit transferred to Capital A/c:				
X	19,750			
Y	11,850			
Z	<u>7,900</u>	39,500		
		<u>7,89,500</u>		<u>7,89,500</u>

Omega Limited

	₹		₹
To Realisation A/c	6,69,500	By Equity Shares in Omega Ltd. A/c	1,50,000
		By Preference Shares in Omega Ltd. A/c	2,25,000
		By Debentures in Omega Ltd.	2,94,500
	<u>6,69,500</u>		<u>6,69,500</u>

Equity Shares in Omega Ltd. A/c

	₹		₹
To Omega Limited	1,50,000	By X's Capital in Omega Ltd. A/c	87,000
		By Y's Capital A/c	63,000
	1,50,000		1,50,000

Preference Shares in Omega Ltd. A/c

	₹		₹
To Omega Limited	2,25,000	By X's Capital A/c	1,12,500
		By Y's Capital A/c	67,500
		By Z's Capital A/c	45,000
	2,25,000		2,25,000

Debenture in Omega Ltd. A/c

	₹		₹
To Omega Limited	2,94,500	By X's Capital A/c	1,47,250
		By Y's Capital A/c	88,350
		By Z's Capital A/c	58,900
	2,94,500		2,94,500

Cash A/c

	₹		₹
To Z's Capital A/c	46,000	By X's Capital A/c	23,000
		By Y's Capital A/c	23,000
	46,000		46,000

Partners' Current Accounts

	X ₹	Y ₹	Z ₹		X ₹	Y ₹	Z ₹
To Balance b/d	-		50,000	By Balance b/d	50,000	30,000	-
To X's Capital A/c	69,750			By Realisation A/c	19,750	11,850	7,900
To Y's Capital A/c		41,850		By Z's Capital A/c			42,100
	69,750	41,850	50,000		69,750	41,850	50,000

Partners' Capital Accounts

	X ₹	Y ₹	Z ₹		X ₹	Y ₹	Z ₹
To Z's Current A/c	-	-	42,100	By Balance b/d	3,00,000	2,00,000	1,00,000
To Preference Shares in Omega Ltd. A/c	1,12,500	67,500	45,000	By X's Current A/c	69,750		
To Debentures A/c	1,47,250	88,350	58,900	By Y's Current A/c		41,850	
To Cash A/c	23,000	23,000	-	By Cash A/c (bal. fig.)			46,000
To Equity Shares A/c	87,000	63,000	-				
	<u>3,69,750</u>	<u>2,41,850</u>	<u>1,46,000</u>		<u>3,69,750</u>	<u>2,41,850</u>	<u>1,46,000</u>

Working Notes:

1. Calculation of Purchase consideration

Net Payment Method

		₹
Equity Shares	= 10,000 @ ₹ 15	1,50,000
Preference Shares	= 15,000 @ ₹ 15	2,25,000
Debentures	= 20,000 @ ₹ 14.725	<u>2,94,500</u>
		<u>6,69,500</u>

2. As whole business of the firm was sold to Omega Limited, cash balance of the firm ₹1,00,000 is also transferred to realisation account. Cash brought in by Z equal to Dr. balance appearing in his account, after distribution of preference shares and debentures in profit sharing ratio would be shared by X and Y equally. The balance amount payable to X and Y would be settled by transfer of equity shares in Omega Company.

3. (i) Journal Entries in the books of C Ltd. (₹ in lakhs)

Particulars				
1	Bank A/c	Dr.	3,150	
	To Investments A/c			3,000
	To Profit and Loss A/c			150
	(Being investment sold on profit for the purpose of buy-back)			

2	10% Redeemable Preference Share Capital A/c Premium on Redemption of Preference Shares A/c To Preference Shareholders A/c (Being redemption of preference share capital at premium of 10%)	Dr. Dr.	2,500 250	2,750
3	Securities Premium A/c To Premium on Redemption of Preference Shares A/c (Being premium on redemption of preference shares adjusted through securities premium)	Dr	250	250
4	Equity Share Capital A/c Premium on buyback To Equity buy-back A/c (Being Equity Share bought back, Share Capital cancelled, and Premium on Buyback accounted for)	Dr. Dr.	1,200 1,200	2,400
5	Securities Premium A/c (800-250) General Reserve A/c To Premium on Buyback A/c (Being premium on buyback provided first out of securities premium and the balance out of general reserves.)	Dr	550 650	1,200
6	Bank A/c To Bank Loan A/c (Being loan taken from bank to finance buyback and redemption of shares)		400	400
7	Preference Shareholders A/c Equity buy-back A/c To Bank A/c (Being payment made to preference shareholders and equity shareholders)		2,750 2,400	5,150
8	General Reserve Account To Capital Redemption Reserve Account (Being amount transferred to capital redemption reserve account towards face value of preference shares redeemed and equity shares bought back)		3,700	3,700

(ii) Balance Sheet of C Ltd. (after Redemption and Buyback) (₹ Lakhs)

	Particulars	Note No	Amount
	EQUITY AND LIABILITIES		₹
(I)	Shareholders' Funds:		
	(a) Share Capital	1	6,800
	(b) Reserves and Surplus	2	6,800
(2)	Non-Current Liabilities:		
	(a) Long Term Borrowings	3	5,400
(3)	Current Liabilities:		
	(a) Trade payables		2,300
	(b) Short Term Provisions		<u>1,000</u>
	Total		<u>22,300</u>
(II)	ASSETS		
(1)	Non-Current Assets		
	Fixed Assets		14,000
	Current Assets:		
	(a) Cash and Cash equivalents (W N)		50
	(b) Other Current Assets		<u>8,250</u>
			<u>22,300</u>

Notes to Accounts

		₹ in Lakhs	
1.	Share Capital		
	680 lakh Equity Shares of ₹ 10 each Fully Paid up (120 lakh Equity Shares bought back)		6,800
2.	Reserves and Surplus		
	General Reserve	6,000	
	Less: Adjustment for premium paid on buy back	(650)	
	Less: Transfer to CRR	<u>(3,700)</u>	1,650
	Capital Redemption Reserve	1,000	
	Add: Transfer due to buy-back of shares from Gen. res.	<u>3,700</u>	4,700
	Securities premium	800	

	Less: Adjustment for premium paid on redemption of preference shares	(250)		
	Less: Adjustment for premium paid on buy back	<u>(550)</u>	-	
	Profit & Loss A/c	300		
	Add: Profit on sale of investment	<u>150</u>	<u>450</u>	6,800
3.	Long-term borrowings			
	Secured			
	9 % Debentures		5,000	
	Term Loans – From Banks		<u>400</u>	5,400

Working Note

Bank Account

Receipts	Amount (₹ Lakhs)	Payments	Amount (₹ Lakhs)
To balance b/d	1,650	By Preference Shareholders A/c	2,750
To Investment A/c (sale Proceeds)	3,150	By Equity Shareholders A/c	2,400
To Bank Loan A/c (Loan received)	400	By Balance c/d (Balancing figure)	<u>50</u>
	<u>5,200</u>		<u>5,200</u>

4. (a) Calculation of Correct Profit

	Department L	Department M	Department N
	₹	₹	₹
Profit after charging managers' commission	1,08,000	81,000	54,000
Add back : Managers' commission (1/9)	<u>12,000</u>	<u>9,000</u>	<u>6,000</u>
	1,20,000	90,000	60,000
Less: Unrealised profit on stock (Working Note)	<u>(12,000)</u>	<u>(13,500)</u>	<u>(6,000)</u>
Profit before Manager's commission	1,08,000	76,500	54,000
Less :Commission for Department Manager @10%	<u>(10,800)</u>	<u>(7,650)</u>	<u>(5,400)</u>
Departmental net profit	<u>97,200</u>	<u>68,850</u>	<u>48,600</u>

Working Note:

Calculation of unrealised profit on stock

	Dept. L	Dept. M	Dept N	Total
	₹	₹	₹	₹
Department L		$\frac{25}{125} \times 45,000 = 9,000$	$\frac{10}{110} \times 33,000 = 3,000$	12,000
Department M	$42,000 \times 15\% = 6,300$		$36,000 \times 20\% = 7,200$	13,500
Department N	$\frac{20}{120} \times 18,000 = 3,000$	$\frac{25}{125} \times 15,000 = 3,000$		6,000

(b) Branch Stock Account

Particulars	₹	Particulars	₹
To Balance b/d	12,000	By Cash A/c (Cash sales)	20,000
To Goods sent to Branch A/c	35,000	By Branch Debtors (credit sales)	21,000
To Branch Debtors (Sales Returns)	600	By Goods sent to Branch A/c (Returns)	1,000
		By Shortage of goods	400
		By Balance c/d (Bal. fig.)	5,200
	47,600		47,600

Branch Debtors Account

Particulars	₹	Particulars	₹
To Balance b/d	6,200	By Branch stock A/c (Sales Returns)	600
To Branch Stock (Credit sales)	21,000	By Cash A/c	19,800
		By Discount	300
		By Balance c/d (Bal. fig.)	6,500
	27,200		27,200

Branch Expenses Account

Particulars	₹	Particulars	₹
To Cash A/c	6,100	By Branch P/L A/c (Bal. fig.)	6,400
To Discount A/c	300		
	6,400		6,400

Goods Sent to Branch Account			
<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Branch Stock A/c (Returns)	1,000	By Branch Stock A/c	35,000
To Branch Adjustment A/c (Loading) (35,000 × 30%)	10,500	By Branch Adj. A/c (Loading) (1,000 × 30%)	300
To Trading A/c (Bal. fig.)	23,800		
	35,300		35,300
Branch Adjustment Account			
<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Shortage of goods (Loading) (400 × 30%)	120	By Branch Stock Reserve (12,000 × 30%)	3,600
To Branch Stock Reserve A/c (5,200 × 30%)	1,560	By Goods sent to Branch (Net loading) (10,500 – 300)	10,200
To Gross profit transferred to P/L A/c (Bal. fig.)	12,120		
	13,800		13,800
Branch Profit and Loss Account			
<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Branch Expenses A/c	6,400	By Gross Profit transferred from Branch Adjustment A/c	12,120
To Shortage of Goods (cost) (400 × 70%)	280		
To Net Profit	5,440		
	12,120		12,120

5. (a) **Calculation of Intrinsic Value of Shares of West India Motels Ltd.**

		₹
Goodwill		3,20,00,000
Buildings		11,20,00,000
Machinery		1,60,00,000
Trade receivables		5,60,00,000
Inventory		2,00,00,000
Cash		<u>40,00,000</u>
		24,00,00,000
Less: Trade payables	4,80,00,000	
Debentures	<u>9,60,00,000</u>	<u>(14,40,00,000)</u>
Net assets available for shareholders		<u>9,60,00,000</u>

Share Capital		<u>6,00,00,000</u>
Paid-up value per share		₹ 5
Number of shares $\left(\frac{₹ 6,00,00,000}{₹ 5}\right)$		1,20,00,000
Intrinsic value per share $\left(\frac{₹ 9,60,00,000}{1,20,00,000}\right)$		₹ 8

Calculation of Intrinsic Value of Shares of All India Motels Ltd.

		₹
Goodwill		4,48,00,000
Buildings		11,60,00,000
Machinery		1,80,00,000
Trade receivables		60,00,000
Inventory		80,00,000
Cash		32,00,000
Investments		2,60,00,000
		<u>22,20,00,000</u>
Less: Debentures	8,00,00,000	
Trade payables	<u>2,20,00,000</u>	<u>(10,20,00,000)</u>
Value of Net assets available for shareholders		<u>12,00,00,000</u>
Paid-up value per share		₹ 8
Share Capital		6,00,00,000
Number of shares (₹ 6,00,00,000 ÷ 8)		75,00,000
Intrinsic value per share $\left(\frac{₹ 12,00,00,000}{75,00,000}\right)$		₹ 16

Intrinsic value of Rs. 8 paid up value per share is ₹16. Therefore, intrinsic value of ₹ 10 paid up share will be ₹ 20 $\left(\text{i.e., } \frac{16}{8} \times ₹ 10\right)$.

Calculation of purchase consideration

Total number of shares of West India Motels Ltd.	1,20,00,000 shares
Intrinsic value of 1,20,00,000 shares @ ₹ 8	₹ 9,60,00,000
Shares to be issued by All India Motels Ltd. @ ₹ 20	48,00,000 shares

In the Books of All India Motels Ltd.

Journal Entries

Date	Particulars		Dr. Amount ₹	Cr. Amount ₹
2013				
March	Business Purchase A/c To Liquidators of West India Ltd. (Being business purchased)	Dr.	9,60,00,000	9,60,00,000
31	Goodwill (Bal. fig.)	Dr.	3,20,00,000	
	Buildings A/c	Dr.	11,20,00,000	
	Machinery A/c	Dr.	1,60,00,000	
	Trade receivables A/c	Dr.	5,60,00,000	
	Inventory A/c	Dr.	2,00,00,000	
	Cash A/c	Dr.	40,00,000	
	To Debentures A/c			9,60,00,000
	To Trade payables A/c			4,80,00,000
	To Business Purchase A/c			9,60,00,000
	(Being assets and liabilities of West India Motels Ltd. taken over)			
	Liquidators of West India Motels Ltd. To Share Capital A/c To Securities Premium A/c	Dr.	9,60,00,000	4,80,00,000 4,80,00,000
	(Being payment of purchase price by issue of 48,00,000 shares of ₹ 10 each at a premium of ₹ 10 per share)			
	Trade payables A/c To Trade receivables A/c (Being the adjustment of mutual indebtedness)	Dr.	30,00,000	30,00,000
	Goodwill A/c To Inventories A/c (Being the adjustment of unrealized profit on stock = ₹ 30,00,000 × $\frac{20}{120}$)	Dr.	5,00,000	5,00,000

(b) Calculation of amount of provision to be made in the Profit and Loss Account

Classification of Assets	Amount of Advances	% age of provision	Amount of provision
	(₹ in lakhs)		% (₹ in lakhs)
Standard assets	30,000	0.40	120
Sub-standard assets *	20,000	15	3,000
Doubtful assets:			
For one year (secured)	8,000	25	2,000
For two to three years (secured)	2,500	40	1,000
For more than three years:			
unsecured	1,500	100	1,500
secured	500	100	500
Loss Assets	1,700	100	<u>1,700</u>
Total provision required			<u>9,820</u>

*Considered as fully secured

6. (a) Form B-RA

Name of Insurer: Perfect General Insurance Company

Registration No. and Date of Registration with IRDA

Fire Revenue Account for the year ended 31st March, 2013

	Schedule	Current year ₹
Premium earned (Net)	1	<u>6,77,500</u>
Total (A)		<u>6,77,500</u>
Claims incurred (net)	2	2,37,500
Commission	3	13,125
Operating expenses relating to insurance business	4	<u>1,81,250</u>
Total (B)		<u>4,31,875</u>
Operating Profit from General Insurance Business C=(A)-(B)		<u>2,45,625</u>

Schedule 1: Premium Earned (Net)

			₹
Premium received			8,00,000

Less: Reinsurance premium			<u>(43,750)</u>
Net premium			7,56,250
Adjustment for change in reserve for unexpired risk:			
Total opening provisions		3,75,000	
Closing provision:			
50% of net premium	3,78,125		
Additional provision @ 10%	<u>75,625</u>	<u>(4,53,750)</u>	<u>(78,750)</u>
Premium Earned (Net)			<u>6,77,500</u>

Schedule 2: Claims Incurred (Net)

	₹
Claims paid	1,75,000
Add: Claims outstanding at the end of the year	<u>1,25,000</u>
	3,00,000
Less: Claims outstanding at the beginning of the year	<u>(62,500)</u>
	<u>2,37,500</u>

Schedule 3: Commission

	₹
Commission paid	50,000
Less: Commission earned in reinsurance ceded	<u>(36,875)</u>
	<u>13,125</u>

Schedule 4: - Operating expenses

Expenses of management	₹ 1,81,250
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(b) Statement showing liability of B List Contributories

Name of shareholders	Shares	Maximum liability @ ₹ 2	3.5.2012	1.9.2012	23.11.12	1.2.13	Total
		₹	₹	₹	₹	₹	₹
B	1,500	3,000	1,500	-	-	-	1,500
C	1,000	2,000	1,000	555	-	-	1,555

D	500	1,000	500	278	188	-	966
E	<u>300</u>	<u>600</u>	<u>300</u>	<u>167</u>	<u>112</u>	<u>21</u>	<u>600</u>
	<u>3,300</u>	<u>6,600</u>	<u>3,300</u>	<u>1,000</u>	<u>300</u>	<u>21</u>	<u>4,621</u>

Working Notes:

1. Ratio of distribution

Date	Cumulative liability	Increase in liability	Ratio for distribution as per the maximum liability
3-5-2012	3,300	-	30:20:10:6
1-9-2012	4,300	1,000	20:10:6
23-11-2012	4,600	300	10:6
1-2-2013	6,000	1,400	Only E

- Liability of shareholder 'E' is restricted to ₹ 600. Therefore, the amount payable by 'E' on 1.2.2013 is restricted to ₹ 21 only.
- Shareholder 'A' is not liable as he had transferred his shares prior to one year preceding the date of winding up.

7. (a)

Particulars	Financial Capital Maintenance at Historical Cost ₹
Closing equity (₹ 30 x 60,000 units)	18,00,000 represented by cash
Opening equity	60,000 units x ₹ 20 = 12,00,000
Permissible drawings to keep Capital intact	6,00,000 (18,00,000 – 12,00,000)

- (b)** As per para 21 of AS-12, 'Accounting for Government Grants', "the amount refundable in respect of a grant related to specific fixed asset should be recorded by reducing the deferred income balance. To the extent the amount refundable exceeds any such deferred credit, the amount should be charged to profit and loss statement.
- In this case the grant refunded is ₹ 30 lakhs and balance in deferred income is ₹ 21 lakhs, ₹ 9 lakhs shall be charged to the profit and loss account for the year 2013-14. There will be no effect on the cost of the fixed asset and

depreciation charged will be on the same basis as charged in the earlier years.

- (ii) If the grant was deducted from the cost of the plant in the year 2010-11 then, para 21 of AS-12 states that the amount refundable in respect of grant which relates to specific fixed assets should be recorded by increasing the book value of the assets, by the amount refundable. Where the book value of the asset is increased, depreciation on the revised book value should be provided prospectively over the residual useful life of the asset. Therefore, in this case, the book value of the plant shall be increased by ₹ 30 lakhs. The increased cost of ₹ 30 lakhs of the plant should be amortized over 7 years (residual life). Depreciation charged during the year 2013-14 shall be $(84 + 30)/7$ years = ₹ 16.286 lakhs presuming the depreciation is charged on SLM.
- (c) As per para 14 of AS 29, 'Provisions, Contingent Liabilities and Contingent Assets', a provision should be recognised when
- an enterprise has a present obligation as a result of a past event;
 - it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and
 - a reliable estimate can be made of the amount of the obligation. If these conditions are not met, no provision should be recognised.

If these conditions are not met, no provision should be recognised.

In the given situation the directors of the company are of the opinion that the claim can be successfully resisted by the company, therefore there will be no outflow of the resources. The company will disclose the same as contingent liability by way of the following note:

“Litigation is in process against the company relating to a dispute with a competitor who alleges that the company has infringed patents and is seeking damages of ₹ 900 lakhs. However, the directors are of the opinion that the claim can be successfully resisted by the company”.

- (d) As per para 16 of AS 20, “Earnings Per Share”, the weighted average number of equity shares outstanding during the period reflects the fact that the amount of shareholders’ capital may have varied during the period as a result of a larger or less number of shares outstanding at any time. For the purpose of calculating basic earnings per share, the number of equity shares should be the weighted average number of equity shares outstanding during the period.

Weighted average number of equity shares

7,20,000 X 5/12	= 3,00,000 shares
9,60,000 X 5/12	= 4,00,000 shares
8,40,000 X 2/12	= 1,40,000 shares
	<u>= 8,40,000 shares</u>

- (e) AS 16 "Borrowing Costs", clearly states that capitalization of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use are completed. Therefore, interest on the amount that has been used for the construction of the building upto the date of completion (January, 2012) i.e. ₹ 18 lakhs alone can be capitalized. It cannot be extended to ₹ 25 lakhs.

Test Series: February, 2014

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

Question No.1 is compulsory.

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

Time Allowed – 3 Hours

Maximum Marks – 100

1. Give your comments and observations on the following:
 - (a) "Independence is the keystone upon which the respect and dignity of a profession is based." Explain with reference to auditing and accounting profession. (5 Marks)
 - (b) A company has not provided depreciation on machinery on the plea that the machinery has been maintained in excellent condition and is as good as new.
(5-Marks)
 - (c) M/s R. R. Hospital, a partnership firm, running a nursing home have decided to discontinue you as an auditor for the next year and requests you to handover all the relevant working papers of the previous year. (5 Marks)
 - (d) "The concept of True and fair is a fundamental concept in Auditing" Explain.(5 Marks)
2.
 - (a) Define Internal Check. What are the special steps involved in framing a system of Internal Check? (2 + 8 = 10 Marks)
 - (b) Explain briefly the Precautions to be taken in applying test check technique. (6 Marks)
3. As an auditor, comment on the following situation/statements or give your answer as per requirement of the question-:
 - (a) Mr. Lalit is a full time practising chartered accountant. During the year 2012-13, he has taken ₹ 300000 housing loan from OBC and the management of the OBC wants to appoint Mr. Lalit as its statutory auditor for the financial year 2012-13. (4 Marks)
 - (b) The Board of Directors of Flexible Ltd failed to appoint its first auditors within one month of the date of registration. (4 Marks)
 - (c) At the Annual General Meeting of the Company, a resolution was passed by the entire body of shareholders restricting some of the powers of the Statutory Auditors. Whether powers of the Statutory Auditors can be restricted? (4 Marks)
 - (d) G S & Company are the appointed auditors of SET Ltd. After completing the audit but before issuing report, the auditor has come to the conclusion that an unqualified opinion cannot be expressed but that the effect of the disagreement with the

management is not so material and pervasive as would require an adverse opinion
Advise in detail how should he report ? (4 Marks)

- 4 How will you verify/vouch the following?
- (a) Loss of stock by theft.
 - (b) Stock lying with subcontractor for fabrication.
 - (c) Sale of empties.
 - (d) Expenditure for advertisement in newspaper. (4 x 4 = 16 Marks)
5. (a) Explain in detail the duties of Comptroller and Auditor General of India. (8 Marks)
- (b) What are the special steps involved in conducting the audit of an Educational Institution? (8 Marks)
6. (a) Comment on the "Interest on share capital was paid to the shareholders as the company had a long gestation period before it could become operational". (8 Marks)
- (b) "The interest of a director in a transaction, entered into by the company has not been disclosed in the records maintained by the company". Comment. (8 Marks)
- 7 Write short note on any four of the following:
- (a) Going Concern Concept
 - (b) Audit Trail
 - (c) Advantages of CAAT
 - (d) Cut-off arrangement.
 - (e) Impairment of Assets. (4 x 4 = 16 Marks)

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

1. (a) Independence stands for the strength of individuals to adopt an unbiased view on the matters undaunted by any favour or frown. In all matters relating to the assignment, independence in mental attitude is to be maintained. Only so long as the auditor maintains a high standard of independence and impartiality, the audit reports will continue to be accepted and respected by business, financial institutions, Government and investors. Professional integrity and independence are essential characteristics of all the learned professions but are more so in the case of accounting profession. Independence is a state of mind and personal character and an enlightened view of the professional duties involved. Independence is much affected by the state of the profession, *i.e.*, the ability and willingness to enforce a proper code of ethics as well as its ability to withstand pressures. The more the esteem for the profession in the public eyes because of the standards of independence prescribed by it for its members, greater the reliance there would be on the reports and opinions given by the members of the profession. Independence, as has been stated earlier, is a qualitative condition but rules are often framed by professional bodies to help and guide members in preserving independence in variety of complex circumstances. It is quite clear from the above that Independence is the keystone upon which the respect and dignity of a profession is based.
- (b) Non-Provision of Depreciation: The machinery is as good as new. The plea of the management of the company not to provide for depreciation on its assets in a particular year on account of the reason that the company has maintained the machinery in an excellent way during the year is not acceptable because as per the definition of depreciation given in AS 6 on “Depreciation Accounting”, “depreciation is a measure of the wearing out, consumption or other loss of value of a depreciable asset arising from use, effluxion of time or obsolescence through technology and market changes”.
- Thus, depreciation also arises due to efflux of time and, therefore, depreciation should be provided irrespective of whether the assets were maintained very well during the year. Hence, the mere fact that the assets have been maintained excellently during the year is not an acceptable ground for the management not to provide for depreciation.
- (c) As per SA 230 on “Audit Documentations” the working papers are the property of the auditor and the auditor has right to retain them. He may at his discretion can make available working papers to his client. The auditor should retain them long enough to meet the needs of his practice and legal or professional requirement.

Working papers are the important records of the auditor. They serve as evidence of the auditor's exercise of due care and conclusion reached regarding significant matters. The client does not have a right to access the working papers and it is up to the discretion of the auditor to make them available or not to others including the client.

Hence in the instant case, management of M/s R.R. Hospital can't insist upon the auditor to handover the working papers of the previous year.

- (d) The concept of true and fair is a fundamental concept in auditing. The phrase "true and fair" in the auditor's report signifies that the auditor is required to express his opinion as to whether the state of affairs and the results of the entity as ascertained by him in the course of his audit are truly and fairly represented in the accounts under audit. This requires that the auditor should examine the accounts with a view to verify that all assets, liabilities, income and expenses are stated as amounts which are in accordance with accounting principles and policies which are relevant and no material amount, item or transaction has been omitted. What constitutes "true and fair," however, has not been defined in any legislation. In the context of audit of a company, however, section 211(5) of the Companies Act provides that the accounts of a company shall be deemed as not disclosing a true and fair view, if they do not disclose any matters which are required to be disclosed by virtue of provisions of Revised Schedule VI to that Act, or by virtue of a notification or an order of the Central Government modifying the disclosure requirements. Therefore, the auditor will have to see that the accounts are drawn up in conformity with the provisions of Revised Schedule VI and whether they contain all the matters required to be disclosed therein. In case of companies which are governed by special Acts, the auditor should see whether the disclosure requirements of the governing Act are complied with. Section 209(3) of the Companies Act, 1956 also contemplates that a company shall not be deemed to be maintaining proper books of account to show a true and fair accrual basis of accounting. It must be noted that the disclosure requirements laid down by the law are the minimum requirements. If certain information is vital for showing a true and fair view, the accounts should disclose it even though there may not be a specific legal provision to do so. Thus, what constitutes a 'true and fair' view is a matter of an auditor's judgment in the particular circumstances of a case.

In more specific terms, to ensure true and fair view, an auditor has to see:

- (i) that the assets are neither undervalued or overvalued, according to the applicable accounting principles,
- (ii) no material asset is omitted;
- (iii) the charge, if any, on assets are disclosed;
- (iv) material liabilities should not be omitted;

- (v) the profit and loss account discloses all the matters required to be disclosed by Part II of Revised Schedule VI and the balance sheet has been prepared in accordance with Part I of Revised Schedule VI;
- (vi) accounting policies have been followed consistently; and
- (vii) all unusual, exceptional or non-recurring items have been disclosed separately.

The Council of the Institute while issuing a clarification regarding authority attached to documents issued by the Institute also observed that, "The Companies Act 1956, as well as many other statutes requires that the financial statements of an enterprise should give a true and fair view of its financial position and working results. This requirement is implicit even in the absence of a specific statutory provision to this effect. However, what constitutes 'true and fair' view has not been defined either in the Companies Act, 1956 or in any other statute. The pronouncements of the Institute seek to describe the accounting principles and the methods of applying these principles in the preparation and presentation of financial statements so that they give a true and fair view. The pronouncements issued by the Institute include various statements, standards and guidance notes.

Directors Responsibility Statement under section 217(2AA) requires that the Board's Report shall state that, "that the directors had selected such accounting policies and applied them consistently and made judgments and estimates that are reasonable and prudent so as to give a true and fair view of the state of affairs of the company at the end of the financial year and of the profit or loss of the company for that period".

- 2. (a) The term "internal check" is defined as the "checks on day to day transactions which operate continuously as part of the routine system whereby the work of one person is proved independently or is complementary to the work of another, the object being the prevention or early detection of errors or fraud". The following aspects should be considered in framing a system of internal check:
 - (1) No single person should have an independent control over any important aspect of the business. The work done by one person should automatically be checked by another person in routine course.
 - (2) The duties/work of members of the staff should be changed from time to time without any previous notice so that the same officer or subordinate does not, without a break, perform the same function for a considerable length of time.
 - (3) Every member of the staff should be encouraged to go on leave at least once in a year so that frauds successfully concealed by such a person can be detected in his absence.
 - (4) Persons having physical custody of assets must not be permitted to have access to the books of accounts.

- (5) There should be an accounting control in respect of each important class of assets, in addition, these should be periodically inspected so as to establish their physical condition.
 - (6) The system of Budgetary Control should be introduced.
 - (7) For stock-taking, at the close of the year, trading activities should, if possible, be suspended. The task of stock-taking, and evaluation should be done by staff belonging to other than stock section.
 - (8) The financial and administrative powers should be sub divided very judiciously and the effect of such division should be reviewed periodically.
 - (9) Finally, the system must be capable of being expanded or contracted to correspond to the size of the concern.
- (b)** The following precautions may be taken in applying test check techniques:
- (i) Transactions of the concern should be classified under appropriate heads and may be stratified if wide variations are there between transactions of same kind.
 - (ii) Study and evaluation of internal control system should be exercised for its efficiency, soundness and capability for producing reliable accounting and financial data.
 - (iii) System of authorization, documentation, recording and evidencing of transaction should be examined.
 - (iv) A properly thought - out test check plan should be prepared to match with the audit objective and avoid mix-up in the objective.
 - (v) Selection of transactions should be made in such manner so that bias cannot enter in the selection.
 - (vi) Identification of the area where the check may not be done.
 - (vii) The number of transaction to be selected for each test check plan should be predetermined based on degree of reliance that should be placed on test check result and confidence that can be placed.
 - (viii) Materiality of the error as a result of test check must be pre-determined and criteria be fixed to judge the same. Only the material errors may be properly and thoroughly investigated.
- 3. (a)** As per sub-section (3)(d) of Section 226, a person who is indebted to the company for more than Rs 1000 or who has given any guarantee or provided any security in connection with the indebtedness of any third person to the company for more than ₹ 1000 is not qualified for appointment as auditor of that company.
- It is further laid down in sub-section (4) of Section 226 that a person is not eligible

for appointment as auditor of any company, if he is disqualified from acting as auditor of that company's subsidiary or holding company or of any other subsidiary of the same holding company.

Sub-section (5) of Section 226 provides that if an auditor, after his appointment, becomes subject to any of the disqualification specified in sub-sections (3) and (4), he shall be deemed to have automatically vacated his office.

In the present case, Mr. Lalit, Chartered Accountant, an individual has taken a housing loan from the Bank and the Bank wishes to appoint him statutory auditor but from the above paragraphs it is clear that Mr. Lalit would be disqualified to be appointed as statutory auditor of OBC.

- (b) The first auditor of a company can be appointed by the Board of Directors within one month of the date of registration of the company to hold office till the conclusion of the first annual general meeting. If the Board fails to appoint the first auditor, the company in general meeting is empowered to make the appointment. The first auditor or auditors to hold office, until the conclusion of the first annual general meeting, should be appointed by the Board of directors within one month of the date of registration of the company.

If the first auditor(s) is not appointed by the directors, within one month of registration, the company in general meeting may appoint the first auditor. The auditor of a company normally is appointed by the shareholders by passing a resolution at the annual general meeting; once appointed, he holds office from the conclusion of that meeting to the conclusion of the next annual general meeting. An auditor once appointed may be re-appointed in the next annual general meeting or a new auditor may be appointed in his place. It is obligatory on the part of a company to annually make such an appointment, as well as to give, within seven days of the appointment, intimation thereof to every auditor so appointed or re-appointed.

The point wise answer to the question is explained hereunder:

1. The first auditors are generally to be appointed by the Board of Directors by means of a resolution within one month of the date of registration of the company.
2. The auditors so appointed shall hold office until the conclusion of the first annual general meeting.
3. If the Board of Directors fails to appoint the first auditors, the company at a general meeting may do so.

- (c) **Restrictions on Powers of Statutory Auditors:** Section 227(1) of the Companies Act, 1956 provides that an auditor of a company shall have right of access at all times to the books and accounts and vouchers of the company whether kept at the Head Office or other places and shall be entitled to require from the offices of the company such information and explanations as the auditor may think necessary for

the purpose of his audit. These specific rights have been conferred by the statute on the auditor to enable him to carry out his duties and responsibilities prescribed under the Act, which cannot be restricted or abridged in any manner. Hence' any such resolution even if passed by entire body of shareholders is ultra vires and therefore void. In the case of Newton vs. Birmingham Small Arms Co., it was held that any regulations which preclude the auditors from availing themselves of all the information to which they are entitled under the Companies Act, are inconsistent with the Act.

- (d) A qualified opinion should be expressed when the auditor concludes that an unqualified opinion cannot be expressed but that the effect of any disagreement with management is not so material and pervasive as to require an adverse opinion, or limitation on scope is not so material and pervasive as to require a disclaimer of opinion. A qualified opinion should be expressed as being 'subject to' or 'except for' the effects of the matter to which the qualification relates.

An adverse opinion should be expressed when the effect of a disagreement is so material and pervasive to the financial statements that the auditor concludes that a qualification of the report is not adequate to disclose the misleading or incomplete nature of the financial statements.

Whenever the auditor expresses an opinion that is other than unqualified, a clear description of all the substantive reasons should be included in the report and, unless impracticable, a quantification of the possible effect(s), individually and in aggregate, on the financial statements should be mentioned in the auditor's report. In circumstances where it is not practicable to quantify the effect of modifications made in the audit report accurately, the auditor may do so, on the basis of estimates made by the management after carrying out such audit tests as are possible and clearly indicate the fact that the figures are based on management estimates. Ordinarily, this information would be set out in a separate paragraph preceding the opinion or disclaimer of opinion and may include a reference to a more extensive discussion, if any, in a note to the financial statements.

4. (a) Loss of Stock by Theft:

- (i) The most important evidence for verification will be the First Information Report (FIR) filed with the police for this theft.
- (ii) The contents of the FIR will be cross checked with the financial books and stock records.
- (iii) If no FIR is lodged, then deeper analysis will be required including satisfaction of the reasons for not filing FIR.
- (iv) The quantity and value of the stolen stock is not included in the closing stock will be ensured.

- (v) Verify whether such stock was insured and whether theft claim was lodged with the insurance company.
- (b) Stock lying with sub-contractors for fabrication:**
- (i) The stock lying with the sub contractor for processing should be confirmed by the confirmation letter obtained from the sub contractors.
 - (ii) The necessity of holding stock by them should be vouched. If the stock is lying with them for long, the reason for the same should be ascertained. The condition of the stock should be confirmed by the management.
 - (iii) The stock should be valued at cost or net realizable value whichever is less. The processing charges incurred should be added to the cost. The provision for the liability towards unpaid processing charges should be created.
 - (iv) The stock should be disclosed under the head current assets under the sub head inventory.
 - (v) Adjustment in accounts should be made for any discrepancies between stock confirmed and stock sent out as per memorandum records.
- (c) Sale of Empties:** When the empties or containers in which goods necessarily have to be supplied are costly, the manufacturer normally agrees to purchase them back at a reduced price as compared to the one charged for them. Therefore check whether:
- (i) Separate account of issue and receipt of empties has been prepared.
 - (ii) In separate maintained a/c check how many empties lies in warehouse and how many are with customers.
 - (iii) Check how many empties customers may return after the close of the year.
 - (iv) Check whether proper provision has been made against the contingency of the containers being returned by customers and that for the wear and tear.
 - (v) Check the amount of sale with entry in cash book.
 - (vi) See the sold empties are reduced from the stock.
 - (vii) If the empties are sold on credit, ask for direct confirmation from purchasing party and confirm the sale.
- (d) Expenditure for Advertisement in News paper:**
- (i) Vouch the copy of the newspaper sent by the newspaper/advertisement agency to ensure that advertisement actually appeared in the newspaper.
 - (ii) See the date of advertisement which appeared in the newspaper should fall in the current accounting year.

- (iii) Contents of advertisement should be verified to ascertain that the advertisement was of the entity and was for the business and not of personal nature.
 - (iv) Ensure the rate charged with the offer received for rates from newspaper and ensure that the size and placement i.e. page is in accordance with the rate charged.
 - (v) Ensure deduction of TDS and service tax wherever applicable.
 - (vi) Ensure that it is printed in all issues of the newspaper for which newspaper has charged.
5. (a) **Duties of C&AG:** The Comptroller & Auditor General's (Duties, Powers and Conditions of Service) Act, 1971 lays down duties of the C&AG as under:
- (i) *Compile and submit Accounts of Union and States* - The C&AG shall be responsible for compiling the accounts of the Union and of each State from the initial and subsidiary accounts rendered to the audit and accounts offices under his control by treasuries, offices or departments responsible for the keeping of such account.
 - (ii) *General Provisions Relating to Audit* - It shall be the duty of the C&AG –
 - (a) to audit and report on all expenditure from the Consolidated Fund of India and of each State and of each Union Territory having a Legislative Assembly and to ascertain whether the moneys shown in the accounts as having been disbursed were legally available for and applicable to the service or purpose to which they have been applied or charged and whether the expenditure conforms to the authority which governs it;
 - (b) to audit and report all transactions of the Union and of the States relating to Contingency Funds and Public Accounts;
 - (c) to audit and report on all trading, manufacturing profit and loss accounts and balance-sheets and other subsidiary accounts kept in any department of the Union or of a State.
 - (iii) *Audit of Receipts and Expenditure* - Where any body or authority is substantially financed by grants or loans from the Consolidated Fund of India or of any State or of any Union Territory having a Legislative Assembly, the Comptroller and Auditor General shall, subject to the provisions of any law for the time being in force applicable to the body or authority, as the case may be, audit all receipts and expenditure of that body or authority and to report on the receipts and expenditure audited by him.
 - (iv) *Audit of Grants or Loans* - Where any grant or loan is given for any specific purpose from the Consolidated Fund of India or of any State or of any Union Territory having a Legislative Assembly to any authority or body, not being a

foreign State or international organisation, the Comptroller and Auditor General shall scrutinise the procedures by which the sanctioning authority satisfies itself as to the fulfillment of the conditions subject to which such grants or loans were given and shall for this purpose have right of access, after giving reasonable previous notice, to the books and accounts of that authority or body.

- (v) *Audit of Receipts of Union or States* - It shall be the duty of the Comptroller and Auditor General to audit all receipts which are payable into the Consolidated Fund of India and of each State and of each Union Territory having a Legislative Assembly and to satisfy himself that the rules and procedures in that behalf are designed to secure an effective check on the assessment, collection and proper allocation of revenue and are being duly observed and to make this purpose such examination of the accounts as he thinks fit and report thereon.
 - (vi) *Audit of Accounts of Stores and Stock* - The Comptroller and Auditor General shall have authority to audit and report on the accounts of stores and stock kept in any office or department of the Union or of a State.
 - (vii) *Audit of Government Companies and Corporations* - The duties and powers of the Comptroller and Auditor General in relation to the audit of the accounts of government companies shall be performed and exercised by him in accordance with the provisions of the Companies Act, 1956.
- (b) The special steps involved in the audit of an educational institution are the following:
- (i) Examine the Trust Deed, or Regulations in the case of school or college and note all the provisions affecting accounts. In the case of a university, refer to the Act of Legislature and the Regulations framed there under.
 - (ii) Read through the minutes of the meetings of the Managing Committee or Governing Body, noting resolutions affecting accounts to see that these have been duly complied with, specially the decisions as regards the operation of bank accounts and sanctioning of expenditure.
 - (iii) Check names entered in the Students' Fee Register for each month or term, with the respective class registers, showing names of students on rolls and test amount of fees charged; and verify that there operates a system of internal check which ensures that demands against the students are properly raised.
 - (iv) Check fees received by comparing counterfoils of receipts granted with entries in the cash book and tracing the collections in the Fee Register to confirm that the revenue from this source has been duly accounted for.
 - (v) Total up the various columns of the Fees Register for each month or term to ascertain that fees paid in advance have been carried forward and the arrears

that are irrecoverable have been written off under the sanction of an appropriate authority.

- (vi) Check admission fees with admission slips signed by the head of the institution and confirm that the amount had been credited to a Capital Fund, unless the Managing Committee has taken a decision to the contrary.
- (vii) See that free studentship and concessions have been granted by a person authorised to do so, having regard to the prescribed Rules.
- (viii) Confirm that fines for late payment or absence, etc., have either been collected or remitted under proper authority.
- (ix) Confirm that hostel dues were recovered before students' accounts were closed and their deposits of caution money refunded.
- (x) Verify rental income from landed property with the rent rolls, etc.
- (xi) Vouch income from endowments and legacies, as well as interest and dividends from investment; also inspect the securities in respect of investments held.
- (xii) Verify any Government or local authority grant with the relevant papers of grant. If any expense has been disallowed for purposes of grant, ascertain the reasons and compliance thereof.
- (xiii) Report any old heavy arrears on account of fees, dormitory rents, etc, to the Managing Committee.
- (xiv) Confirm that caution money and other deposits paid by students on admission have been shown as liability in the balance sheet and not transferred to revenue.
- (xv) See that the investments representing endowment funds for prizes are kept separate and any income in excess of the prizes has been accumulated and invested along with the corpus.
- (xvi) Verify that the Provident Fund money of the staff has been invested in appropriate securities.
- (xvii) Vouch donations, if any, with the list published with the annual report. If some donations were meant for any specific purpose, see that the money was utilised for the purpose.
- (xviii) Vouch all capital expenditure in the usual way and verify the same with the sanction for the Committee as contained in the minute book.
- (xix) Vouch in the usual manner all establishment expenses and enquire into any unduly heavy expenditure under any head.

- (xx) See that increase in the salaries of the staff have been sanctioned and minuted by the Committee.
- (xxi) Ascertain that the system ordering inspection on receipt and issue of provisions, foodstuffs, clothing and other equipment is efficient and all bills are duly authorised and passed before payment.
- (xxii) Verify the inventories of furniture, stationery, clothing, provision and all equipment, etc. These should be checked by reference to Stock Register and values applied to various items should be test checked.
- (xxiii) Confirm that the refund of taxes deducted from the income from investment (interest on securities, etc.) has been claimed and recovered since the institutions are generally exempted from the payment of income-tax.
- (xxiv) Verify the annual statements of accounts and while doing so see that separate statements of account have been prepared as regards Poor Boys Fund, Games Fund, Hostel and Provident Fund of Staff, etc.

6. (a) Payment of interest out of capital:

Section 208 of the Companies Act, 1956 permits payment of interest to shareholders out of capital, where there is a long gestation period. Payment of interest on capital is, however, capitalised as part of cost of construction of the project. The auditor should ensure that following conditions have been complied whenever such interest has been paid:

- (i) Payment is authorised by the Articles or by special resolution of shareholders in general meeting;
- (ii) Payment is approved by the Central Government;
- (iii) It is paid only for the period determined by the Central Government not exceeding six months after the half-year in which the project has been completed.
- (iv) The rate shall not exceed 12% p.a. or such other rate as may be prescribed by the Government.
- (v) The payment of interest shall not operate as a reduction of the amount paid-up on the shares in respect of which it is paid.

(b) Non-disclosure of interest of directors in records maintained by the company:

A company is required to maintain a register under section 301 in terms of section 297 of the Companies Act, 1956. While auditing the company accounts, the CARO 2003 requires the auditor to verify such transactions.

It is quite likely that there may be situations where the company has not properly maintained the register required to be maintained by it under section 301.

In such a case, the auditor should obtain the necessary information regarding the loans taken by the company from companies, firms or other parties in which the directors are interested, from the management of the company. However, while reporting on this clause, the auditor should clearly mention the fact of non-maintenance/improper maintenance of the aforesaid register.

If the interest of a director in a transaction, entered into by the company has not been disclosed in the record maintained by the company, as required by Section 301 of the Companies Act, 1956 the auditor would not be responsible for failure to track down the frauds, provided also that there did not exist any circumstances to arouse his suspicion that some information had been held back deliberately and had duly reported the violation of the legal requirements. So long as there is no such suspicion, he is only expected to exercise normal caution and care.

7. (a) **Going Concern Concept:** AS 1, "Disclosure of Accounting Policies", lays down that the "Going Concern", is one of the fundamental accounting assumption underlying financial statements. This Going Concern concept envisages that the entity will continue for the foreseeable future. Accounts are prepared on this concept unless there are indication that going concern concept is not holding good for a particular entity. On account of this basic concept of going concern, assets and liabilities are recorded on the basis that the entity will be able to realise its assets and discharge its liabilities in the normal course of business. If this assumption is unjustified, the entity may not be able to realise its assets at the recorded amounts and there may be changes in the amounts and maturity dates of liabilities. AS 1, "Disclosure of Accounting Policies", also requires that no specific disclosure is required in case the same has been followed in the preparation of financial statements. In case this assumption is not followed, the fact should be disclosed.

SA 570 "Going Concern", establishes standards on the auditor's responsibilities in the audit of financial statements regarding the appropriateness of the going concern assumption as a basis for the preparation of the financial statements.

- (b) **Audit Trail:** An audit trail refers to a situation where it is possible to relate 'one-to-one' basis, the original input along with the final output. The work of an auditor would be hardly affected if "Audit Trail" is maintained i.e. if it were still possible to relate, on a 'one-to-one' basis, the original input with the final output. A simplified representation of the documentation in a manually created audit trail.

For example, the particular credit notes may be located by the auditor at any time he may wish to examine them, even months after the balance sheet date. He also has the means, should he so wish, of directly verifying the accuracy of the totals and sub-totals that feature in the control listing, by reference to individual credit notes. He can, of course, check all detailed calculations, casts and postings in the accounting records, at any time.

In first and early second-generation computer systems, such a complete and trail was generally available, no doubt, to management's own healthy scepticism of what the new machine could be relied upon to achieve – an attitude obviously shared by the auditor.

It is once iterated that there is an abundance of documentation upon which the auditor can use his traditional symbols of scrutiny, in the form of colored ticks and rubber stamps. Specifically:

- (i) The output itself is as complete and as detailed as in any manual system.
- (ii) The trail, from beginning to end, is complete, so that all documents may be identified by located for purposes of vouching, totalling and cross-referencing.

Any form of audit checking is possible, including depth testing in either direction.

(c) Advantages of CAAT:

(i) **Audit effectiveness:** The effectiveness and efficiency of auditing procedures will be improved through the use of CAAT in obtaining and evaluating audit evidence, for example –

- (a) Some transactions may be tested more effectively for a similar level of cost by using the computer.
- (b) In applying analytical review procedures, transactions or balance details of unusual items may be reviewed and reports got printed more efficiently by using the computer.

(ii) **Savings in time:** The auditor can save time by reviewing the EDP controls using CAAT than through other audit procedures.

(iii) **Effective test checking and examination in depth:** CAAT permits effective examination in depth of selected transactions since the auditor constructs the lost audit trail.

(d) **Cut-off arrangement:** Accounting is a continuous process because the business never comes to halt. It is, therefore, necessary that transactions of one period would be separated from those in the ensuing period so that the results of the working of each period can be correctly ascertained. The arrangement that is made for this purpose is technically known as "cut-off arrangement". It essentially forms part of the internal control system of the organization. Accounts, other than sales, purchase and stock are not usually affected by the continuity of the business and therefore, this arrangement is generally applied only to sales, purchase and stock. The auditor satisfies by examination and test-checks that the cut-off procedures are adequately followed and ensure that:

- (i) Goods purchased, property in which passed on to the client, have in fact been included in the inventories and that the liability has been provided for in case credit purchase.
- (ii) Goods sold have been excluded from the inventories and credit has been taken for the sales. If the value of sales is to be received, the concerned party has been debited.

The auditor may examine a sample of documents, evidencing the movement of stock into and out of stores, including documents pertaining to period shortly before and after the cut-off date and check whether stocks represented by those documents were included or excluded as appropriate during stock taking for perfect and correct presentation in the financial statements.

- (e) **Impairment of assets:** Besides charging annual depreciation on assets by the reason of normal wear and tear, afflux ion of time and obsolescence to re-instate the correct value of the assets considering the future cash flows that the assets can generate, impairment loss needs to be provided. The difference between the carrying amount of an asset and recoverable amount is termed as impairment loss. The treatment of impairment loss is similar to depreciation except the fact that it can be re-instated in future, if the recoverable amount of the asset exceeds the carrying amount.

The auditor must ensure that provisions of AS 28 "Impairment of assets" are followed.

Test Series: February, 2014

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 **five** questions from the rest.*

Time Allowed – 1½ Hours

Maximum Marks – 50

1. Answer all the following questions in brief.
 - (i) System Software
 - (ii) Operating System
 - (iii) Intranet
 - (iv) File Transfer Protocol
 - (v) Application Server
 - (vi) Repeater
 - (vii) Business-to-Customer (B2C)
 - (viii) Database Administrator
 - (ix) Computer Network
 - (x) Voice over Internet Protocol (VoIP) *(1 x 10 = 10 Marks)*
2.
 - (a) Discuss Ring topology, its advantages and disadvantages in detail. *(4 Marks)*
 - (b) What are the advantages of EDI? Explain in brief. *(4 Marks)*
3.
 - (a) Define the concept of Multiprocessing. *(4 Marks)*
 - (b) Discuss the Internet's role in E-Commerce. *(4 Marks)*
4.
 - (a) What are the factors that are considered in determining the best file organization. *(4 Marks)*
 - (b) What are the advantages and concerns in using Data Warehouse? *(4 Marks)*
5.
 - (a) What is Communication media? Discuss its various types. *(4 Marks)*
 - (b) Discuss different tools, which are available for the protection of information and systems against compromise, intrusion or misuse. *(4 Marks)*

6. Draw a flow chart to compute and print income-tax and surcharge on the income of a person, where income is to be read from terminal and tax is to be calculated as per the following rates:

Upto ₹ 40,000	No tax
Upto ₹ 60,000	@ 10% of amount above ₹ 40,000
Upto ₹ 1,50,000	₹ 2,000 + 20% of amount above ₹ 60,000
Above ₹ 1,50,000	₹ 20,000 + 30% of amount above ₹ 1,50,000

Charge surcharge @ 2% on the amount of total tax, if the income of a person exceeds ₹ 2,00,000. (8 Marks)

7. Write short notes on any **four** of the following.

- (a) Text Editor
- (b) Primary Key
- (c) MODEM
- (d) Telnet
- (e) Single Tier Systems

(4 × 2 = 8 Marks)

Test Series: February, 2014

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

Question No.1 is compulsory.

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

Time Allowed – 1½ Hours

Maximum Marks – 50

1. (a) Globalization means different things to different people. Discuss. (3 Marks)
- (b) Do you agree that control systems run parallel with strategic levels? How? (3 Marks)
- (c) How Portfolio analysis helps the strategists in identifying and evaluating various businesses of a company. (3 Marks)
- (d) Explain briefly the role of culture in promoting better strategy execution. (3 Marks)
- (e) Does HRM function play a role in organizational strategy? (3 Marks)
2. (a) State with reasons which of the following statements is correct/incorrect:
 - (i) Strategic management is a bundle of tricks and magic.
 - (ii) Marketers alone can deliver superior value to customers. (2 × 2 = 4 Marks)
- (b) Explain the meaning of the following concepts:
 - (i) Kieretsus
 - (ii) Market penetration
 - (iii) Opportunity (3 × 1 = 3 Marks)
3. Write short notes on the following:
 - (a) Synchro-marketing (2 Marks)
 - (b) Cost leadership strategy (2 Marks)
 - (c) Ethnic mix (3 Marks)
4. Explain how technological factors present an opportunity as well as threat to a particular business organization. (7 Marks)
5. Many organizations in order to achieve quick growth use strategies such as mergers and acquisitions. Explain. Discuss various types of mergers. (7 Marks)

6. Define each of the following and analyse its role in strategic implementation:
- (1) B.P.R.
 - (2) ERP
 - (3) Benchmarking *(7 Marks)*
7. Define corporate culture. Also elucidate the statement "Culture is a strength that can also be a weakness". *(7 Marks)*

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

1. (i) **System Software:** System software is computer software designed to operate the computer hardware and to provide and maintain a platform for running application software.
- (ii) **Operating System:** An operating system is a program designed to run other programs on a computer. It is system software; act as an interface between hardware and user.
- (iii) **Intranet:** Intranet is a type of information system that facilitates communication within the organization, among widely dispersed departments, divisions, and regional locations using Web Browsers, Web Servers and Data Warehouses in a single view.
- (iv) **File Transfer Protocol:** The File Transfer Protocol (FTP) is used widely on the Internet for transferring files to and from a remote host. FTP is commonly used for uploading pages to a Web site and for providing online file archives. An FTP URL has the basic form: ftp://user:pass@host/directory/file.
- (v) **Application Server:** An application server is a server program that resides in the server (computer) and provides the business logic for the application program. The server can be a part of the network and server program is a program that provides its services to the client program that resides either in the same computer or on another computer connected through the network.
- (vi) **Repeater:** These are devices that solve the snag of signal degradation which results as data is transmitted along the various cables. The repeater boosts or amplifies the signal before passing it through to the next section of cable.
- (vii) **Business-to-Customer (B2C):** It is defined as the exchange of services, information and/or products from a business to a consumer. B2C electronic commerce is a form of electronic commerce in which products or services are sold from a firm to a consumer.
- (viii) **Database Administrator:** A Database Administrator is a person responsible for the design, implementation, maintenance and repair of an organization's database.
- (ix) **Computer Network:** A computer network is a collection of computers and terminal devices connected together by a communication system to share resources and information.

- (x) **Voice over Internet Protocol (VoIP):** Voice over IP (VoIP) commonly refers to the communication protocols, technologies, methodologies, and transmission techniques involved in the delivery of voice communications and multimedia sessions over Internet Protocol (IP) networks, such as the Internet.
2. (a) **Ring Topology:** In this topology, the network cable passes from one node to another until all nodes are connected in the form of a loop or ring. There is a direct point-to-point link between two neighboring nodes. These links are unidirectional which ensures that transmission by a node traverses the whole ring and comes back to the node, which made the transmission.

Advantages:

- Ring networks offer high performance for a small number of workstations or for larger networks where each station has a similar workload.
- Ring networks can span longer distances than other types of networks.
- Ring networks are easily extendable.

Disadvantages:

- Relatively expensive and difficult to install.
- Failure of one computer on the network can affect the whole network.
- It is difficult to trouble shoot a ring network.
- Adding or removing computers can disrupt the network.

(b) **Advantages of EDI**

- (i) **Issue and receive orders faster** - Since most purchasing transactions are routine, they can be handled automatically, utilizing the staff for more demanding and less routine tasks.
- (ii) **Make sales more easily**- Quotes, estimates, order entry and invoicing will proceed more smoothly and efficiently. Orders received electronically ensure that information is available immediately, so that an organization can respond faster and be more competitive.
- (iii) **Get paid sooner**- Invoices received electronically can be reconciled automatically, which means they are earmarked for payment in one's trading partner's accounting department sooner. And, in turn, your own purchasing department is in a position to negotiate for better terms including faster payment.
- (iv) **Minimize capital tied up in inventory**- For manufacturing organizations with a just-in-time strategy, the right balance is crucial but every organization stands to benefit from reducing order lead times.

- (v) **Reduce letters and memos-** Letters and memos do not follow rigid rules for formatting. They can be handled by an electronic mail system.
 - (vi) **Decrease enquiries-** Customers or suppliers can make direct on-line enquiries on product availability, or other non-sensitive information instead of consuming the staff's precious time.
 - (vii) **Make bulk updates of catalogues and parts listings-** One can provide updates of data files, such as catalogues to customers or part listings to franchisees.
3. (a) **Multiprocessing:** Multiprocessing (or parallel processing) refers to the use of two or more Central Processing Units, linked together, to perform coordinated work simultaneously. Instructions are executed simultaneously because the available CPUs can execute different instructions of the same program or of different programs at any given time.

Multiprocessing offers data-processing capabilities that are not present when only one CPU is used. Many complex operations can be performed at the same time. CPU can function on complementary units to provide data and control for one another.

Multiprocessing is used for nation's major control applications such as rail road control, traffic control, or airways etc. Because of the availability of cheaper but more powerful processors, many computer manufacturers are now designing hardware and software systems to do multiprocessing. Since several machines can work as a team and operate in parallel, jobs can be processed much more rapidly than on a single machine.

(b) **The Internet's Role in commerce**

- (i) **Universality**—Any business using the Internet can interact with any other business using the Internet. This is by no means true of earlier networking technologies that allowed businesses to ship goods to only those companies connected to the same network.
- (ii) **Reach**—The Internet is everywhere: large cities and small towns throughout the modern and developing world.
- (iii) **Performance**—Unlike many other public networks, the Internet can handle visual images, audio clips, and other large electronic objects. It provides its users with a high-function window to the world, in addition to handling everyday networking tasks such as electronic mail.
- (iv) **Reliability**--The design concepts for the Internet came out of U.S. Department of Defense. Hence, Internet technology is highly robust and reliable, in spite of significant differences in the extent to which various Internet service providers actually implement and ensure this reliability.

- (v) **Cost**—Compared with alternative networking technologies, Internet costs are surprisingly low.
- (vi) **Momentum**—Tens of millions of individuals are already connected to the Internet and business use is increasing at a dramatic rate.
4. (a) **The Best File Organization:** The factors that must be considered in determining the best file organization for a particular application are as follows:
- (i) **File volatility:** It refers to the number of additions and deletions to the file in a given period of time. The payroll file for a construction company where the employee roster is constantly changing is a highly volatile file. An ISAM file would not be a good choice in this situation, since additions would have to be placed in the overflow area and constant reorganization of the file would have to occur. Other direct access methods would be better. Perhaps even sequential file organization would be appropriate if there were no interrogation requirements.
- (ii) **File activity:** It is the proportion of master file records that are actually used or accessed in a given processing run. At one extreme is the real-time file where each transaction is processed immediately and hence at a time, only one master record is accessed. This situation obviously requires a direct access method. At the other extreme is a file, such as a payroll master file, where almost every record is accessed when the weekly payroll is processed. There, a sequentially ordered master file would be more efficient.
- (iii) **File interrogation:** It refers to the retrieval of information from a file. If the retrieval of individual records must be fast to support a real-time operation such as airline reservation then some kind of direct organization is required. If, on the other hand, requirements for data can be delayed, then all the individual requests or information can be batched and run in a single processing run with a sequential file organization.
- (iv) **File size:** Large files that require many individual references to records with immediate response must be organized under some type of direct access method. On the other hand, with small files, it may be more efficient to search the entire file sequentially or, with a more efficient binary search, to find an individual record than to maintain complex indexes or complex direct addressing scheme.
- (b) (i) **Advantages of using data warehouse:** There are many advantages to using a data warehouse, some of them are as follows:
- Enhances end-user access to reports and analysis of information.
 - Increases data consistency.
 - Increases productivity and decreases computing costs.

- Is able to combine data from different sources, in one place. (Provides a common data model).
- It provides an infrastructure that could support changes to data and replication of the changed data back into the operational systems.

(ii) **Concerns in using data warehouse**

- Extracting, cleaning and loading data could be time consuming.
- Data warehouses can get outdated relatively quickly.
- Problems with compatibility with systems already in place e.g. transaction processing system.
- Providing training to end-users.
- Security could develop into a serious issue, especially if the data warehouse is web accessible.
- A data warehouse is usually not static and maintenance costs are high.

5. (a) Communication media comprises different types of cables and wireless techniques that are used to connect network devices in a Local Area Network (LAN), Wireless Local Area Network (WLAN) or Wide Area Network (WAN). Choice of correct type of media is very important for the implementation of any network. Communication or Transmission media is divided into two groups:

- (i) **Guided Media:** Guided Transmission Media or Bound Media uses a "cabling" system that guides the data signals along a specific path. Some of the common examples of guided media are Twisted Pair, Coaxial cable and Optical fiber.

The types of guided media are described as follows:

- **Twisted-Pair Cables:** Twisted-Pair cables contain pairs of insulated copper wires twisted together to reduce the impact of interferences. There are two types of twisted-pair cables called Unshielded Twisted-Pair (UTP) cable and Shielded Twisted-Pair (STP) cable. Twisted-Pair cables can carry data at a speed of 10 Mbps, 100 Mbps and 1000 Mbps and can transmit data up to 100 meters.
- **Co-axial cables:** Also called as Coax, these contain central copper wire as its core that is surrounded by two layers of protective shielding that reduces electromagnetic interference. Co-axial cables used in computer networks are of two types - Thick co-axial and Thin co-axial cable. Coax can transmit data at a maximum speed of 10 Mbps up to 500 meters without using repeaters.

- **Optical Fiber:** An optical fiber (or fiber) is a glass or plastic fiber that carries light along its length. Optical fibers are widely used in fiber-optic communications, which permits transmission over longer distances and at higher data rates (called bandwidth), than other forms of communications. Fibers are used instead of metal wires because signals travel along them with less loss, and they are immune to electromagnetic interference.
- (ii) **Unguided Media:** Unguided transmission media or Unbound Media consists of a means for the data signals to travel but nothing to guide them along a specific path. The data signals are not bound to a cabling media. Some of the common examples of unguided media are Radio wave, Microwave and Infrared wave. These are described as follows:
- **Radio Waves:** Radio waves are an invisible form of electromagnetic radiation that varies in wavelength from around a millimeter to 100,000 km, making it one of the widest ranges in the electromagnetic spectrum. Radio waves are most commonly used transmission media in the wireless Local Area Networks.
 - **Micro Waves:** Microwaves are radio waves with wavelengths ranging from as long as one meter to as short as one millimeter, or equivalently, with frequencies between 300 MHz (0.3 GHz) and 300 GHz. These are used for communication, radar systems, radio astronomy, navigation and spectroscopy.
 - **Infrared Waves:** Infrared light is used in industrial, scientific, and medical applications. Night-vision devices using infrared illumination allow people or animals to be observed without the observer being detected. Infrared tracking, also known as Infrared Homing, refers to a passive missile guidance system which uses the emission from a target of electromagnetic radiation in the infrared part of the spectrum to track it.
- (b) The tools which are available for the protection of information and systems against compromise, intrusion or misbehave are as follows:
- (i) **Firewalls** are systems that control the flow of traffic between the Internet and the firm's internal LANs and systems. They are usually packaged as turnkey hardware/software packages, and are set up to enforce the specific security policies that are desired. A firewall is a proven, effective means of protecting the firm's internal resources from unwanted intrusion.

(ii) **Encryption** allows information to transit the Internet while being protected from interception by eavesdroppers. There are two basic approaches to encryption:

- ◆ Hardware encryption devices are available at a reasonable cost, and can support high- speed traffic. If the Internet is being used to exchange information among branch offices or development collaborators, for instance, use of such devices can ensure that all traffic between these offices is secure.
- ◆ Software encryption is typically employed in conjunction with specific applications. Certain electronic mail packages, for example, provide encryption and decryption for message security.

The free flow of encryption technology is being stifled due to legal constraints that disallow the export of technology that may impact the national interest of a country. The resolution of these export restriction issues will have a major impact on the growth of electronic commerce from an international perspective.

(iii) **Message authentication** makes sure that a message is really from whom it purports to be and that it has not been tampered with. Regardless of a company's individual needs, clearly defined Internet security policies and procedures should always be part of any corporate Internet security strategy.

(iv) **Site Blocking** is a software-based approach that prohibits access to certain Web sites that are deemed inappropriate by management. For example, sites that contain explicit objectionable material can be blocked to prevent employee's from accessing these sites from company Internet servers. In addition to blocking sites, companies can also log activities and determine the amount of time spent on the Internet and identify the sites visited.

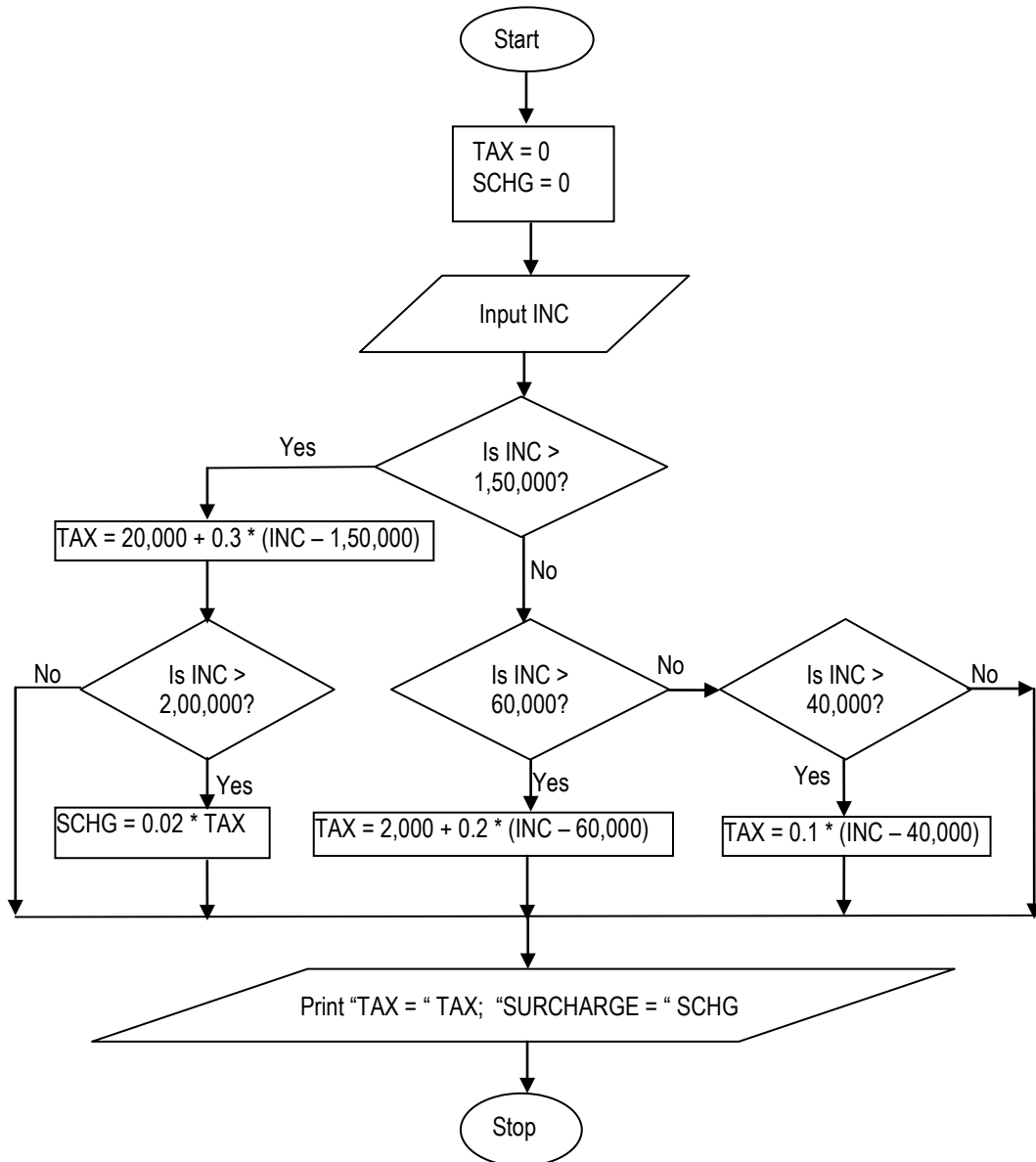
6. Let us define the variables:

SCHG: Surcharge on the income of a person;

TAX: Income Tax of a person;

INC: Income of a person

The required flow chart is as follows:



7. (a) **Text Editor:** Text Editor is a program that allows text in a file to be created and modified. These utilities are probably most useful to professional programmers, who constantly face the problems of cutting and pasting programs together, changing data files by eliminating certain data fields, changing the order of certain data fields,

adding new data fields, and changing the format of data.

- (b) **Primary Key:** The primary key of any table is any candidate key of that table which the database designer arbitrarily designates as "primary". The primary key may be selected for convenience, comprehension, performance, or any other reasons. It is entirely proper to change the selection of primary key to another candidate key.
- (c) **MODEM:** MODEM stands for **Modulator/Demodulator** and is defined as an encoding as well as decoding device used in data transmission. Data communication could be achieved due to the development of encoding/decoding devices. These units convert the code format of computers to those of communication channels for transmission, then reverse the procedure when data are received. These communication channels include telephone lines, microwave links or satellite transmission.
- (d) **Telnet:** Telnet is a protocol that allows us to connect to remote computers (called hosts) over a TCP/IP network (such as the Internet). We use software called a telnet client on our computer to make a connection to a telnet server (i.e., the remote host). Once our telnet client establishes a connection to the remote host, our client becomes a virtual terminal, allowing us to communicate with the remote host from our computer. In most cases, we will need to log into the remote host, which requires that we have an account on that system.
- (e) **Single Tier Systems:** A single computer that contains a database and a front-end (GUI) to access the database is known as Single Tier System. A single-tier system requires only one stand-alone computer. It also requires only one installation of proprietary software which makes it the most cost-effective system available. However major disadvantage is that it can be used by only one user at a time. A single tier system is impractical for an organization which requires two or more users to interact with the organizational data stores at the same time.

MOCK TEST PAPER – 1
INTERMEDIATE (IPC): GROUP – II
PAPER – 7: INFORMATION TECHNOLOGY AND STRATEGIC MANAGEMENT
SECTION – B: STRATEGIC MANAGEMENT
SUGGESTED ANSWERS/HINTS

1. (a) Globalization refers to the process of integration of the world into one huge market. Such unification calls for removal of all trade barriers among countries. Globalization is an opportunity for organizations to expand their markets and reach out to different customers. Globalization can also have other meanings. For some it is a new paradigm - a set of fresh beliefs, working methods, and economic, political and socio-cultural realities in which the previous assumptions are no longer valid. For developing countries, it means integration with the world economy.
- (b) There are three strategic levels – corporate, business and functional. Control systems are required at all the three levels. At the top level, strategic controls are built to check whether the strategy is being implemented as planned and the results produced by the strategy are those intended. Down the hierarchy management controls and operational controls are built in the systems. Operational controls are required for day-to-day management of business.
- (c) A business portfolio is a collection of businesses and products that make up the organisation. Portfolio analysis is a tool by which management identifies and evaluates its various businesses. In portfolio analysis top management views its product lines and business units as a series of investments from which it expects returns. The best business portfolio is the one that best fits its strengths and weaknesses to the opportunities and threats in the environment. Through portfolio analysis, organisations are able to compare its various businesses and categorize them in various strata as promising, growing, without good future and so on.
- (d) Strong cultures promote good strategy execution when there's fit and hurt execution when there's negligible fit. A culture grounded in values, practices, and behavioral norms that match what is needed for good strategy execution helps energize people throughout the organization to do their jobs in a strategy-supportive manner. A culture built around such business principles as listening to customers, encouraging employees to take pride in their work, and giving employees a high degree of decision-making responsibility. This is very conducive to successful execution of a strategy of delivering superior customer service.

A work environment where the culture matches the conditions for good strategy execution provides a system of informal rules and peer pressure regarding how to conduct business internally and how to go about doing one's job.

A strong strategy-supportive culture makes employees feel genuinely better about their jobs and work environment and the merits of what the company is trying to accomplish. Employees are stimulated to take on the challenge of realizing the organizational vision, do their jobs competently and with enthusiasm, and collaborate with others.

- (e) The role of human resources in enabling the organization to effectively deal with the external environmental challenges, the human resource management function has been accepted as a strategic partner in the formulation of organization's strategies and in the implementation of such strategies through human resource planning, employment, training, appraisal and rewarding of personnel. An organization's recruitment, selection, training, performance appraisal, and compensation practices can have a strong influence on employee competence is very important.
2. (a) (i) **Incorrect:** No, Strategic management is not a bundle of tricks and magic. It is much more serious affair. It involves systematic and analytical thinking and action. Although, the success or failure of a strategy is dependent on several extraneous factors, it can not be stated that a strategy is a trick or magic. Formation of strategy requires careful planning and requires strong conceptual, analytical, and visionary skills.
- (ii) **Incorrect:** A marketer alone cannot deliver superior value to the customers. It needs to work in coordination with other departments to accomplish this. It is important to be part of organization chain & marketer needs to work in coordination with other departments in the search for competitive advantages. Organisations need to look at the value chain network along with its own chain of activities and the chain of suppliers, distributors and ultimately customers.
- (b) (i) *Kieretsus* is a loosely-coupled group of companies, usually in related industries. It is a Japanese term which is used for large cooperative networks of businesses. *Kieretsus* members are peers and may own significant amounts of each other's stock and have many board members in common.
- (ii) Market penetration is a growth strategy where the business focuses on selling existing products into existing markets. It is achieved by making more sales to present customers without changing products in any major way. Penetration might require greater spending on advertising or personal selling.
- (iii) An opportunity is a favourable condition in the organization's environment which enables it to consolidate and strengthen its position. An example of an opportunity is growing demand for the products or services that a company provides.
3. (a) When the demand for the product is irregular causing idle capacity or over-worked capacities, synchro-marketing can be used to find ways to alter the pattern of demand so that it equates more suitably with the pattern of supply. It can be done

through flexible pricing, promotion, and other incentives.

- (b) A number of cost elements affect the relative attractiveness of generic strategies. A successful cost leadership strategy usually permeates the entire firm, as evidenced by high efficiency, low overhead cost, and waste reduction. The low cost leadership should be such that no competitors are able to imitate so that it can result in sustainable competitive advantage to the cost leader firm.
- (c) Ethnic mix reflects the changes in the ethnic make-up of a population and has implications both for a company's potential customers and for the workforce. Issues that should be addressed include:
 - What do changes in the ethnic mix of the population imply for product and service design and delivery?
 - Will new products and services be demanded or can existing ones be modified?
 - Managers prepared to manage a more culturally diverse workforce?

How can the company position itself to take advantage of increased workforce heterogeneity?

4. Technology is the most dynamic of all the environmental factors. An individual enterprise is concerned with the dynamics of its product and process technology, research and development activities in the industry and elsewhere, innovations in products and processes, technological obsolescence and so on. Changes in technology vitally affect the enterprise's costs, profitability, plant location decisions, product lines, growth and development.

The technology and business are highly interrelated and interdependent also. Technology is patronized by business. Technology also drives business and makes a total change on how it is carried out.

Technology can act as both opportunity and threat to a business. It can act as opportunity as business can take advantage of adopting technological innovations to their strategic advantage. However, at the same time technology can act as threat if organisations are not able to adopt it to their advantage. For example, an innovative and modern production system can act as weakness if the business is not able to change their production system. New entrants or existing competitors can always use availability of technological improvements in products or production methods that can be a threat to a business.

Technological opportunities and threats are not limited to the product or production. Technology permeates whole gambit of business. It can transform how a business acts and functions.

5. Many organizations in order to achieve quick growth, expand or diversify use strategies such as mergers and acquisitions. This also helps in deploying surplus funds.

Merger and Acquisition Strategy

Merger and acquisition in simple words are defined as a process of combining two or more organizations together. There is a thin line of difference between the two terms but the impact of combination is completely different in both the cases.

Some organizations prefer to grow through mergers. Merger is considered to be a process when two or more organizations join together to expand their business operations. In such a case the deal gets finalized on friendly terms. Owners of pre-merged entities have right over the profits of new entity. In a merger two organizations combine to increase their strength and financial gains.

When one organization takes over the other organization and controls all its business operations, it is known as acquisition. In the process of acquisition, one financially strong organization overpowers the weaker one. Acquisitions often happen during recession in economy or during declining profit margins. In this process, one that is financially stronger and bigger establishes its power. The combined operations then run under the name of the powerful entity. A deal in case of an acquisition is often done in an unfriendly manner, it is more or less a forced association where the powerful organization takes over a weaker entity.

Types of Mergers

1. **Horizontal merger:** Horizontal mergers are combinations of firms engaged in the same industry. It is a merger with a direct competitor. The principal objective behind this type of mergers is to achieve economies of scale in the production process by shedding duplication of installations and functions, widening the line of products, decrease in working capital and fixed assets investment, getting rid of competition and so on. For example, formation of Brook Bond Lipton India Ltd. through the merger of Lipton India and Brook Bond.
2. **Vertical merger:** It is a merger of two organizations that are operating in the same industry but at different stages of production or distribution system. This often leads to increased synergies with the merging firms. If an organization takes over its supplier/producers of raw material, then it leads to backward integration. On the other hand, forward integration happens when an organization decides to take over its buyer organizations or distribution channels. Vertical merger results in operating and financial economies. Vertical mergers help to create an advantageous position by restricting the supply of inputs or by providing them at a higher cost to other players.
3. **Co-generic merger:** In co-generic merger two or more merging organizations are associated in some way or the other related to the production processes, business markets, or basic required technologies. Such merger include the extension of the

product line or acquiring components that are required in the daily operations. It offers great opportunities to businesses to diversify around a common set of resources and strategic requirements. For example, an organization manufacturing refrigerators can diversify by merging with another organization having business in kitchen appliances.

4. **Conglomerate merger:** Conglomerate mergers are the combination of organizations that are unrelated to each other. There are no linkages with respect to customer groups, customer functions and technologies being used. There are no important common factors between the organizations in production, marketing, research and development and technology. In practice, however, there is some degree of overlap in one or more of these factors.
6. (1) **BPR:** BPR stands for business process reengineering. It refers to the analysis and redesign of workflows both within and between the organisation and the external entities. Its objective is to improve performance in terms of time, cost, quality, and responsiveness to customers. It implies giving up old practices and adopting the improved ones. It is an effective tool of realising new strategies.

Improving business processes is paramount for businesses to stay competitive in today's marketplace. New technologies are rapidly bringing new capabilities to businesses, thereby raising the strategic options and the need to improve business processes dramatically. Even the competition has become harder. In today's market place, major changes are required to just stay even.

- (2) **ERP:** ERP stand for enterprise resource planning which is an IT based system linking isolated information centers across the organisation into an integrated enterprise wide structured functional and activity bases. ERP is successor to MRP systems (material requirements and manufacturing resource planning systems). ERP is used for strengthening the procurement and management of input factors.

Modern ERP systems deliver end-to-end capabilities to support the entire performance management of an organisation. It helps in consolidated financial reporting, financial management, planning, budgeting, performance management and so on.

- (3) **Benchmarking:** It is a process of finding the best practices within and outside the industry to which an organisation belongs. Knowledge of the best helps in standards setting and finding ways to match or even surpass own performances with the best performances.

Benchmarking is a process of continuous improvement in search for competitive advantage. Firms can use benchmarking process to achieve improvement in diverse range of management function like maintenance operations, assessment of total manufacturing costs, product development, product distribution, customer services, plant utilisation levels and human resource management

7. The phenomenon which often distinguishes good organizations from bad ones could be summed up as 'corporate culture'. Corporate culture refers to a company's values, beliefs, business principles, traditions, ways of operating and internal work environment. Every corporation has a culture that exerts powerful influences on the behaviour of managers. Culture affects not only the way managers behave within an organization but also the decisions they make about the organization's relationships with its environment and its strategy.

"Culture is a strength that can also be a weakness". This statement can be explained by splitting it in to two parts.

Culture as a strength: As a strength, culture can facilitate communication, decision-making & control and create cooperation & commitment. An organization's culture could be strong and cohesive when it conducts its business according to a clear and explicit set of principles and values, which the management devotes considerable time to communicating to employees and which values are shared widely across the organization.

Culture as a weakness: As a weakness, culture may obstruct the smooth implementation of strategy by creating resistance to change. An organization's culture could be characterized as weak when many subcultures exist, few values and behavioral norms are shared and traditions are rare. In such organizations, employees do not have a sense of commitment, loyalty and sense of identity.