

Test Series: April, 2014

**MOCK TEST PAPER – 2**  
**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) From the following information of Reliable Marine Insurance Ltd. for the year ending 31<sup>st</sup> March, 2012, find out the Net claims incurred:

	(₹) <i>Direct Business</i>	(₹) <i>Re-insurance Business</i>
Claims:		
Paid	69,00,000	5,54,000
Payable – 01.04.2011	89,000	15,000
Payable – 31.03.2012	95,000	12,000
Received		2,01,000
Receivable – 01.04.2011		40,000
Receivable – 31.03.2012		38,000

- (b) A company has filed a legal suit against the trade receivable from whom ₹ 15 lakh is recoverable as on 31.3.2012. The chances of recovery by way of legal suit are not good as per legal opinion given by the counsel in April, 2012. Can the company provide for full amount of ₹ 15 lakhs as provision for doubtful debts? Discuss in detail.
- (c) “Assets and liabilities and income and expenditure items in respect of dependent foreign branches are translated into Indian rupees at the prevailing rate of exchange at the end of the year. The resultant exchange differences in the case of profit, is carried to other Liabilities Account and the Loss, if any, is charged to revenue.” Comment.
- (d) X Limited began construction of a new plant on 1<sup>st</sup> April 2012 and obtained a special loan of 8 lakhs to finance the construction of the plant. The rate of interest on loan was 10 per cent per annum.

The expenditure that was made on the construction project of plant was as follows:

	₹
1-4-2012	10,00,000
1-8-2012	24,00,000
1-1-2013	4,00,000

The Company's other outstanding non - specific loan was ₹ 46,00,000 at an interest of 12 percent per annum.

The construction of the plant was completed on 31-3-2013. You are required to calculate the amount to be capitalized including amount of interest as per the provision of AS 16 'Borrowing Costs'.  
(4x 5= 20 Marks)

2. AX Ltd. and BX Ltd. amalgamated on and from 1st January, 2013. A new Company ABX Ltd. was formed to take over the businesses of the existing companies.

**Summarized Balance Sheet as on 31-12-2012**

<i>Equity and Liabilities</i>	<i>AX Ltd.</i> ₹ '000	<i>BX Ltd.</i> ₹ '000	<i>Assets</i>	<i>AX Ltd.</i> ₹ '000	<i>BX Ltd.</i> ₹ '000
Share Capital			Sundry Fixed		
Equity Shares of			Assets	85,00	75,00
₹ 10 each	60,00	70,00	Investment	10,50	5,50
General Reserve	15,00	20,00	Inventroy	12,50	27,50
P & L A/c	10,00	5,00	Trade	18,00	40,00
Investment Allowance			receivables		
Reserve	5,00	1,00	Cash & Bank	4,50	4,00
Export Profit Reserve	50	1,00			
12% Debentures	30,00	40,00			
Trade payables	<u>10,00</u>	<u>15,00</u>			
	<u>130,50</u>	<u>152,00</u>		<u>130,50</u>	<u>152,00</u>

ABX Ltd. issued requisite number of shares to discharge the claims of the equity shareholders of the transferor companies.

You are required to prepare (i) Note showing purchase consideration and discharge thereof, (ii) Journal entries in the books of ABX Ltd. for taking over both companies, (iii) Balance Sheet of ABX Ltd. as on 1<sup>st</sup> January, 2013 assuming the amalgamation is in the nature of purchase.  
(16 Marks)

3. Some of the items in the Trial Balance of Gain Bank Limited as on March 31, 2013 were as follows:

	₹ ('000)		₹ ('000)
Loans and Advances	35,75.00	Printing and Stationery	2.50
Current Accounts (including overdrafts of ₹ 7,50 thousands)	33,00.00	Interest on Saving Bank Deposits	37.50
Bills Discounted and Purchased	9,60.00	Auditor's Fees	2.50
Interest on Fixed Deposits	77.50	Directors' Fees	1.50
Interest on Loans	1,12.50	Interest on Overdrafts	47.50
Discount (subject to unexpired Discount ₹ 15 thousand)	100.50	Provision for Doubtful Debts: April 1, 2012	21.00
Interest on Cash Credits	52.50	Bad Debts	10.50
Commission earned	23.50	Provision for Income-tax: April 1, 2012	33.00
Loss on Investment	17.00	Income-tax paid for 2012-2013	27.00
Salaries and Allowances	41.00		

**Required:** Prepare the Profit and Loss Account of the Gain Bank maintaining the provision for Income-tax at ₹42,000 and Provision for Doubtful Debts at ₹26,000 for the year ended March 31, 2013. Transfer 25% of profit to Statutory reserve. (16 Marks)

4. 'Hari, Lal and Jay have been in partnership for a number of years, sharing profits/losses in the ratio of 2:2:1 as wholesale stationers trading under the name 'Hari Brothers'. They decide to convert their partnership into a limited company (With effect from 1<sup>st</sup> January, 2013) to be known as Hari Ltd.

Immediately prior to this conversion the balance sheet of partnership as at 31<sup>st</sup> December 2012 disclosed the following figures:

**Balance Sheet**  
**As on 31<sup>st</sup> December 2012**

Liabilities	₹	₹	Assets	₹
Capital accounts			Fixed assets	
Hari	70,000		(at written down value)	
Lal	30,000		Land & Buildings	50,000
Jay	<u>20,000</u>	1,20,000	Plant & Machinery	30,000
Current accounts			Motor vehicles	20,000
Hari	7,000		Current Assets:	
Lal	5,000		Inventories	60,000

Jay	<u>3,000</u>	15,000	Debtors	25,000
Current liabilities			Axis Bank account	5,000
Creditors	25,000			
Dena Bank account	<u>20,000</u>	45,000		
Long-term liabilities				
Loan-Hari	3,000			
Loan-Gopi Ltd.	<u>7,000</u>	<u>10,000</u>		
		<u>1,90,000</u>		<u>1,90,000</u>

The terms of conversion are that Hari Ltd. is to take over the assets and liabilities of Hari Brothers & Company as follows:

	Valuation for take-over ₹
Land and Building	96,000
Plant and Machinery	28,000
Motor vehicles	15,000
Inventories	60,000
Debtors	24,000
Creditors	25,000
Goodwill	10,000

The closing balance in Axis Bank account is to be transferred to Dena Bank account before all the other dissolution entries are effected in the partnership ledgers.

Lal took over one of the motor vehicles at an agreed amount of ₹ 2,000. All other liabilities were paid from the Dena Bank account.

The purchase consideration is discharged by an issue at par of ₹ 60,000 10% Debentures (fully paid) to the partners in their capital account proportions as shown in the above balance sheet plus equity shares in Hari Ltd. of ₹ 1 each (fully paid to make up the balance due to each partner).

You are required to

- (i) prepare
  - (a) Realisation Account (b) Partners' capital Account (c) Bank account of Axis Bank and Dena Bank in the books of Hari Brothers :
- (ii) Prepare Business purchase account and Hari Brothers & Company accounts in Hari Ltd.'s books. (16 Marks)

5. (a) Fanna Cloth Mills opened a branch at Mumbai on 1<sup>st</sup> April, 2011. The goods were invoiced to the branch at selling price which was 125% of the cost to the head office.

The following are the particulars of the transactions relating to branch during the year ended 31<sup>st</sup> March, 2012:

	₹	₹
Goods sent to branch at cost to head office		42,12,600
Sales:		
Cash	18,76,050	
Credit	26,61,450	45,37,500
Cash collected from debtors		23,55,000
Discount allowed to debtors		23,550
Returns from debtors		15,000
Spoiled cloth in bales written off at invoice price		7,500
Cheques sent to branch for:		
Rent	1,08,000	
Salaries	2,70,000	
Other Expenses	52,500	4,30,500

Prepare Branch Account under Debtors method for ascertaining profit for the year ended 31<sup>st</sup> March, 2012.

- (b) Prakash Limited leased a machine to Badal Limited on the following terms:

	(₹ In lakhs)
(i) Fair value of the machine	48.00
(ii) Lease term	5 years
(iii) Lease rental per annum	8.00
(iv) Guaranteed residual value	1.60
(v) Expected residual value	3.00
(vi) Internal rate of return	15%

Discounted rates for 1<sup>st</sup> year to 5<sup>th</sup> year are 0.8696, 0.7561, 0.6575, 0.5718, and 0.4972 respectively.

Ascertain Unearned Finance Income. (10 +6= 16 Marks)

6. (a) From the data, prepare Departmental Trading Profit and Loss Account and thereafter the combined Profit and Loss Account revealing the concern's true result for the year ended on 31<sup>st</sup> December 2012:

	Departments	
	A (₹)	B (₹)
Stock (January)	40,000	-
Purchase from outside	2,00,000	20,000
Wages	10,000	1,000
Transfer of goods from Dept. A	-	50,000
Stock (December 31 <sup>st</sup> ) at cost to the Department	30,000	10,000
Sale to outside	2,00,000	71,000

B's entire stock represents goods from Department A which transfers them at 25% above its cost. Administrative and selling expenses amount to ₹ 15,000 which are to be allocated between departments A and B in the ratio 4:1 respectively.

- (b) Noida Toll Bridge Corporation Ltd. (an infrastructure Company) issued 100 lakhs 10% Debentures of ₹ 100 each on 1<sup>st</sup> April, 2013 due for redemption on 31<sup>st</sup> March, 2014 at 10% Premium. How much minimum amount should be credited to Debenture Redemption Reserve as per the MCA clarification? Also state the amount required to be deposited / invested in the year of redemption. Record necessary entries for redemption of debentures. (8+8 = 16 Marks)

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

- (a) A company with a turnover of ₹ 300 crores and an annual advertising budget of ₹ 2 crores had taken up the marketing of a new product. It was estimated that the company would have a turnover of ₹ 20 crores from the new product. The company had debited to its Profit and Loss account the total expenditure of ₹ 2 crore incurred on extensive special initial advertisement campaign for the new product. Is the procedure adopted by the company correct? Comment in line with AS 26 'Intangible Assets'.
- (b) Beta Ltd. has its share capital divided into shares of ₹ 10 each. On 1<sup>st</sup> April, 2011, it granted 25,000 employees stock options at ₹ 50 when the market price was ₹ 140 per share. The options were to be exercised between 1<sup>st</sup> January, 2012 and 28<sup>th</sup> February, 2012. The employees exercised options for 24,000 shares only; the remaining options lapsed. The company closes its books of account on 31<sup>st</sup> March every year. You are required to show necessary journal entries reflecting these transactions.
- (c) Tiger Motor Car Limited signed an agreement with its employees union for revision of wages on 01.07.2012. The revision of wages is with retrospective effect from 01.04.2008. The arrear wages up to 31.3.2012 amounts to ₹ 40,00,000 and that for the period from 01.04.2012 to 01.07.2012 amount to ₹ 3,50,000. In view of the provisions of AS 5 "Net Profit or Loss for the period, Prior Period Items and

Changes in Accounting Policies”, decide whether a separate disclosure of arrear wages is required while preparing financial statements for the year ending 31.3.2013.

- (d) A Company had deferred research and development cost amounting ₹ 225 Lakhs. Sales expected in the subsequent years are as under:

Years	Sales (₹ in lakhs)
1	600
2	450
3	300
4	150

You are asked to suggest how should research and development cost be charged to Profit and Loss Account assuming entire cost of ₹ 225 Lakhs is development cost. If at the end of 3rd year, it is felt that no further benefit will accrue in the 4th year, how the unamortized expenditure would be dealt with in the accounts of the company ?

- (e) Yogya Ltd. received a specific grant of ₹ 300 lakhs for acquiring the plant of ₹ 1,500 lakhs during 2009-10 having useful life of 10 years. The grant received was credited to deferred income and shown in the balance sheet. During 2012-13, due to non-compliance of conditions laid down for the grant the company had to refund the grant to the Government. Balance in the deferred income on that date was ₹ 210 lakhs and written down value of plant was ₹ 1,050 lakhs.
- (i) What should be the treatment for 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 2012-13 in profit and loss account? Assume that depreciation is charged on assets as per straight line method.
- (ii) What should be the treatment of the refund if grant was deducted from the cost of the plant during 2009-10? (4 x 4 = 16 Marks)

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**SUGGESTED ANSWERS/HINTS**

1. (a)

**Schedule 2 : Claims Incurred (Net)**

<i>Particulars</i>	₹
Claims paid on direct business	69,00,000
<i>Add: Re-insurance accepted (W.N. 1)</i>	5,51,000
<i>Less: Re-insurance ceded (W.N. 2)</i>	<u>(1,99,000)</u>
Net claims paid	72,52,000
<i>Add: Claims outstanding at the end of the year</i>	95,000
<i>Less: Claims outstanding at the beginning of the year</i>	<u>(89,000)</u>
Total claims incurred	<u>72,58,000</u>

**Working Note:**

**Reinsurance accepted and ceded**

	₹
1. Claims paid under re-insurance	5,54,000
<i>Add: Outstanding as on 31.3.2012</i>	12,000
<i>Less: Outstanding as on 1.4.2011</i>	<u>(15,000)</u>
Reinsurance accepted	<u>5,51,000</u>
2. Claims received from re-insurance	2,01,000
<i>Add: Outstanding as on 31.3.2012</i>	38,000
<i>Less: Outstanding as on 1.4.2011</i>	<u>(40,000)</u>
Reinsurance ceded	<u>1,99,000</u>

- (b) As per para 13 of AS 4 "Contingencies and Events Occurring After the Balance Sheet Date", assets and liabilities should be adjusted for events occurring after the balance sheet date that provide additional evidence to assist the estimation of amounts relating to conditions existing at the balance sheet date.

In the given case, company should make the provision for doubtful debts, as legal suit has been filed on 31<sup>st</sup> March, 2012 and the chances of recovery from the suit



are not good. Though, the actual result of legal suit will be known in future yet situation of non-recovery from the trade receivables exists before finalisation of financial statements. Therefore, provision for doubtful debts should be made for the year ended on 31<sup>st</sup> March, 2012.

- (c) The financial statements of an integral foreign operation (dependent foreign branches) should be translated using the principles and procedures described in paragraphs 8 to 16 of AS 11 “The Effects of Changes in Foreign Exchange Rates” (Revised 2003). The individual items in the financial statements of a foreign operation are translated as if all its transactions had been entered into by the reporting enterprise itself.

Individual items in the financial statements of the foreign operation are translated at the actual rate on the date of transaction. For practical reasons, a rate that approximates the actual rate at the date of transaction is often used, for example, an average rate for a week or a month may be used for all transactions in each foreign currency during the period. The foreign currency monetary items (for example cash, receivables, payables) should be reported using the closing rate at each balance sheet date. Non-monetary items (for example, fixed assets, inventories, investments in equity shares) which are carried in terms of historical cost denominated in a foreign currency should be reported using the exchange rate at the date of transaction. Thus the cost and depreciation of the tangible fixed assets is translated using the exchange rate at the date of purchase of the asset if asset is carried at cost. If the fixed asset is carried at fair value, translation should be done using the rate existed on the date of the valuation. The cost of inventories is translated at the exchange rates that existed when the cost of inventory was incurred and realizable value is translated applying exchange rate when realizable value is determined which is generally closing rate.

Exchange difference arising on the translation of the financial statements of integral foreign operation should be charged to profit and loss account. Thus, the treatment by the management of translating all assets and liabilities; income and expenditure items in respect of foreign branches at the prevailing rate at the year end and also the treatment of resultant exchange difference is not in consonance with AS 11 (Revised 2003).

- (d) (i) **Computation of weighted average accumulated expenses**

		₹
₹ 10,00,000 x 12 / 12	=	10,00,000
₹ 24,00,000 x 8 / 12	=	16,00,000
₹ 4,00,000 x 3 / 12	=	<u>1,00,000</u>
		<u>27,00,000</u>

(ii) Non-specific Borrowings utilized for construction of Plant

Non-specific Borrowings = Average accumulated capital expenses – Specific borrowings

$$= ₹ 27,00,000 - ₹ 8,00,000 = ₹ 19,00,000$$

(iii) Interest on weighted average accumulated expenses

	₹
Specific borrowings (₹ 8,00,000 X 10%)	80,000
Non-specific borrowings (₹ 19,00,000 × 12%)	<u>2,28,000</u>
Amount of interest to be capitalized	<u>3,08,000</u>

(iv) Total expenses to be capitalized for Plant

	₹
Cost of plant ₹ (10,00,000 + 24,00,000 + 4,00,000)	38,00,000
Add: Amount of interest to be capitalised	<u>3,08,000</u>
Total cost of plant	<u>41,08,000</u>

2. (i) Calculation of Purchase Consideration

		AX Ltd. ₹ '000		BX Ltd. ₹ '000
<i>Assets taken over:</i>				
Sundry fixed assets		85,00		75,00
Investments		10,50		5,50
Inventory		12,50		27,50
Trade receivables		18,00		40,00
Cash & Bank		<u>4,50</u>		<u>4,00</u>
Gross Assets		130,50		152,00
<i>Less : Sundry Liabilities</i>				
12% Debentures	30,00		40,00	
Trade payables	<u>10,00</u>	<u>(40,00)</u>	<u>15,00</u>	<u>(55,00)</u>
Purchase Consideration		90,50		97,00

Discharge of Purchase consideration:

	AX Ltd.	BX Ltd.
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	₹ '000	₹ '000
9,05,000 Equity Shares of ₹ 10 each	90,50	
9,70,000 Equity Shares of ₹ 10 each		97,00

(ii) **Journal entries in books of ABX Ltd.**

	₹'000	₹'000
Business Purchase A/c Dr.	18,750	
To Liquidator of AX Ltd.		90,50
To Liquidator of BX Ltd.		97,00
Sundry fixed assets Dr.	85,00	
Investment A/c Dr.	10,50	
Inventory Dr.	12,50	
Trade receivables Dr.	18,00	
Cash and Bank Dr.	4,50	
To 12% Debentures		30,00
To Trade payables		10,00
To Business Purchase A/c		90,50
(Being the purchase consideration of AX Ltd. accounted for)		
Sundry fixed assets Dr.	75,00	
Investment A/c Dr.	5,50	
Inventory Dr.	27,50	
Trade receivables Dr.	40,00	
Cash and Bank Dr.	4,00	
To 12% Debentures		40,00
To Trade payables		15,00
To Business Purchase A/c		97,00
(Being the purchase consideration of BX Ltd. accounted for)		
Liquidator of AX Ltd. Dr.	90,50	
To Equity share capital A/c		90,50
(Being shares issued to Liquidator of AX Ltd.)		
Liquidator of BX Ltd. A/c Dr.	97,00	
To Equity share capital A/c		97,00
(Being shares issued to Liquidator of BX Ltd.)		

(iii) **Balance Sheet of ABX Ltd. as on 1.1.2013**

Particulars	Note No.	(₹ 000)
<b>I. Equity and Liabilities</b>		
(1) <b>Shareholder's Funds</b>		
(a) Share Capital	1	187,50
(b) Reserves and Surplus	2	7,50
(2) <b>Non-Current Liabilities</b>		
Long-term borrowings	3	70,00
(3) <b>Current Liabilities</b>		
(a) Trade payables (10,00 + 15,00)		25,00
Total		290,00
<b>II. Assets</b>		
(1) <b>Non-current assets</b>		
(a) Fixed assets		
Tangible assets (85,00 + 75,00)		160,00
(b) Non-current Investments (10,50+ 5,50)		16,00
(c) Other non-current asset	4	7,50
(2) <b>Current assets</b>		
(a) Inventories (12,50 + 27,50)		40,00
(b) Trade Receivables ( 18,00 + 40,00)		58,00
(c) Cash & Cash equivalents (4,50 + 4,00)		8,50
Total		290,00

**Notes to Accounts**

	(₹ 000)	(₹ 000)
<b>1. Share Capital</b>		
18,75,000 Equity Shares of ₹ 10 each		187,50
<b>2. Reserves and surplus</b>		
Investment Allowance Reserve	6,00	
Export Profit Reserve	<u>1,50</u>	7,50
<b>3. Long Term Borrowings</b>		
12% Debentures (Assumed that new debentures were issued in exchange of the old series)		70,00
<b>4. Other non current assets</b>		

	Amalgamation Adjustment Account		7,50
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**Notes :**

- (1) Shares are issued by ABX Ltd. on the basis of net assets acquired of AX Ltd. and BX Ltd. Hence, there is no goodwill.
- (2) The statutory reserves of AX Ltd. and BX Ltd. are shown in the balance sheet of ABX Ltd. with a corresponding debit in Amalgamation Adjustment Account.

**3. Profit and Loss Account for the year ended 31<sup>st</sup> March, 2013**

<i>Particulars</i>	<i>Schedule No.</i>	<i>Year ended 31st March, 2013 (₹ '000)</i>
<b>I. Income:</b>		
Interest earned	13	313.00
Other income	14	6.50
Total		319.50
<b>II. Expenditure:</b>		
Interest expended	15	115.00
Operating expenses	16	47.50
Provisions & Contingencies (Provisions for income tax + Provisions for doubtful debts + unexpired discount) [36+15.5+15]		66.50
Total		229.00
<b>III. Profit/Loss:</b>		
Net Profit for the year		90.50
Profit/Loss brought forward		-
		90.50
<b>IV. Appropriations:</b>		
Transfer to Statutory Reserve @ 25%		22.63
Balance carried over to Balance Sheet		67.87
Total		90.50

**Schedule 13 – Interest Earned**

<i>Particulars</i>	<i>Year ended 31st</i>
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	March, 2013 (₹ 000)
I. Interest/Discount (112.5 + 100.5 + 52.5 + 47.5)	313.00
II. Interest on investment	-
III. Interest on balances with RBI and other inter bank fund	-
	313.00

**Schedule 14 – Other Income**

Particulars	Year ended 31st March, 2013 (₹ 000)
I. Commission, Exchange and Brokerage	23.50
II. Loss on sale of investments	(17.00)
	6.50

**Schedule 15 – Interest Expended**

Particulars	Year ended 31st March, 2013 (₹ 000)
I. Interest on Deposits (77.5 + 37.5)	115
II. Interest on RBI/inter bank borrowings	-
	115

**Schedule 16 – Operating Expenses**

Particulars	Year ended 31st March, 2013 (₹ 000)
I. Payments to and provision for employees	41
II. Printing & Stationery	2.5
III. Directors' fees, allowances and expenses	1.5
IV. Auditors' fees	2.5
	47.50

4.

**In the books of Hari Brothers****Realisation Account**

	₹	₹		₹
To Land and buildings		50,000	By Creditors	25,000
To Plant and machinery		30,000	By Lal's capital A/c	2,000
To Motor vehicles		20,000	By Dena Bank A/c	25,000
To Inventories		60,000	By Hari Ltd.	1,83,000
To Debtors		25,000		
To Partners' capital accounts				
Hari (2/5)	20,000			
Lal (2/5)	20,000			
Jay (1/5)	<u>10,000</u>	<u>50,000</u>		
		<u>2,35,000</u>		<u>2,35,000</u>

(b)

**Partners' Capital Accounts**

Particulars	Hari ₹	Lal ₹	Jay ₹	Particulars	Hari ₹	Lal ₹	Jay ₹
To Realisation A/c (motor vehicle takeover)		2,000		By Balance b/d	70,000	30,000	20,000
To 10% Debentures*	35,000	15,000	10,000	By Current A/c	7,000	5,000	3,000
To Equity shares	62,000	38,000	23,000	By Realisation A/c Profit	<u>20,000</u>	<u>20,000</u>	<u>10,000</u>
	<u>97,000</u>	<u>55,000</u>	<u>33,000</u>		<u>97,000</u>	<u>55,000</u>	<u>33,000</u>

\* Debenture have been issued in proportion of capital account balances i.e. in ratio of 7:3:2.

(c)

**Bank Account**

Particulars	Axis Bank	Dena Bank	Particulars	Axis Bank	Dena Bank
To Balance b/d	₹ 5,000	₹ -	By Balance b/d	₹ -	₹ 20,000
To Axis Bank	-	5,000	By Loan (Gopi Ltd.)	-	7,000

To Realisation A/c	-	25,000	By Loan-Hari	-	3,000
			By Dena Bank	<u>5,000</u>	
	<u>5,000</u>	<u>30,000</u>		<u>5,000</u>	<u>30,000</u>

(ii)

**In Hari Ltd.'s Books****Business Purchase Account**

	₹		₹
To Creditors	25,000	By Land and buildings	96,000
To Bank (overdraft)	25,000	By Plant and Machinery	28,000
To Hari Brothers	1,83,000	By Motor Vehicles	15,000
		By Inventories	60,000
		By Debtors	24,000
		By Goodwill	<u>10,000</u>
	<u>2,33,000</u>		<u>2,33,000</u>

**Hari Brothers Account**

	₹		₹
To 10% Debentures	60,000	By Business purchase	1,83,000
To Equity share capital	1,23,000		
	<u>1,83,000</u>		<u>1,83,000</u>

5. (a)

**Branch Account**

	₹	₹		₹	₹
To Goods sent to Branch Account		52,65,750	By Bank-		
To Bank - Rent	1,08,000		Sales	18,76,050	
Salaries	2,70,000		Collection from debtors	<u>23,55,000</u>	42,31,050
Other expenses	<u>52,500</u>	4,30,500	By Goods sent to Branch Account (Loading)		10,53,150
To Branch Stock Reserve		1,47,150	By Abnormal Loss -Cost of spoiled cloth		



To	H.O. Profit and Loss Account		(7,500x100/125)		6,000
	-Transfer of profit		By Balance c/d		
			Branch Stock	7,35,750	
			Branch Debtors	<u>2,67,900</u>	
		<u>4,50,450</u>			<u>10,03,650</u>
		<u>62,93,850</u>			<u>62,93,850</u>

**Working Notes:**

**1. Memorandum Branch Stock Account**

	₹	₹		₹
To Goods sent to Brach:			By Cash - Sales	18,76,050
Cost	42,12,600		By Credit Sales	26,61,450
Add: Loading @ 25%	<u>10,53,150</u>		By Abnormal Loss	
		52,65,750	- Spoiled cloth	7,500
To Returns from Debtors		15,000	By Balance c/d	
			(Balancing figure)	<u>7,35,750</u>
		<u>52,80,750</u>		<u>52,80,750</u>

**2. Memorandum Branch Debtors Account**

	₹	₹		₹
To Credit Sales	26,61,450		By Cash collected	23,55,000
			By Discount allowed	23,550
			By Returns	15,000
			By Balance c/d	
			(Balancing figure)	<u>2,67,900</u>
	<u>26,61,450</u>			<u>26,61,450</u>

- (b) As per AS 19 on Leases, **unearned finance income** is the difference between (a) the **gross investment** in the lease and (b) the present value of minimum lease payments under a finance lease from the standpoint of the lessor; and any unguaranteed residual value accruing to the lessor, at the interest rate implicit in the lease.

Where:

- (a) **Gross investment** in the lease is the aggregate of (i) minimum lease payments from the stand point of the lessor and (ii) any unguaranteed residual value accruing to the lessor.

**Gross investment** = Minimum lease payments + Unguaranteed residual value  
 = [Total lease rent + Guaranteed residual value (GRV)] + Unguaranteed residual value (URV)

= [(₹ 8,00,000 × 5 years) + ₹ 1,60,000] + ₹ 1,40,000 = ₹ 43,00,000 (a)

- (b) Table showing present value of (i) Minimum lease payments (MLP) and (ii) Unguaranteed residual value (URV).

Year	MLP inclusive of URV ₹	Internal rate of return (Discount factor @ 15%)	Present Value ₹
1	8,00,000	0.8696	6,95,680
2	8,00,000	0.7561	6,04,880
3	8,00,000	0.6575	5,26,000
4	8,00,000	0.5718	4,57,440
5	8,00,000	0.4972	3,97,760
	<u>1,60,000 (GRV)</u>	0.4972	<u>79,552</u>
	41,60,000		27,61,312 (i)
	<u>1,40,000 (URV)</u>	0.4972	<u>69,608 (ii)</u>
	<u>43,00,000</u>	(i)+ (ii)	<u>28,30,920(b)</u>

**Unearned Finance Income** (a) - (b) = ₹ 43,00,000 – ₹ 28,30,920 = ₹ 14,69,080.

6. (a) **Departmental Trading & profit and Loss Account for the year ending on 31.12.2012**

Particulars	A	B	Particulars	A	B
	₹	₹		₹	₹
To Opening Stock	40,000	-	By Sales	2,00,000	71,000
To Purchases	2,00,000	20,000	By Transfer of goods (A to B)	50,000	-
To Wages	10,000	1,000	By Closing stock	30,000	10,000
To Transfer of Goods (A to B)	-	50,000			
To Gross Profit c/d	30,000	10,000			
	<u>2,80,000</u>	<u>81,000</u>		<u>2,80,000</u>	<u>81,000</u>
To Adm. & Selling Exp. (4:1)	12,000	3,000	By Gross Profit b/d	30,000	10,000
To Profit	18,000	7,000			
	<u>30,000</u>	<u>10,000</u>		<u>30,000</u>	<u>10,000</u>

### General Profit and Loss Account

<i>Particulars</i>	₹	<i>Particulars</i>	₹
To Stock Reserve (Loading on unsold Stock at Dept. B 10,000x 1/5]	2,000	By Profit A	18,000
To Net Profit	23,000	B	<u>7,000</u>
	25,000		25,000

- (b) According to Section 117C of Companies Act, where a company issues debentures after the commencement of this Act, it shall create a debenture redemption reserve for the redemption of such debentures, to which adequate amounts shall be credited, out of its profits every year until such debentures are redeemed.

Ministry of Corporate Affairs has made a clarification on adequacy of Debenture Redemption Reserve (DRR) vide Circular no. 04/2013 dated 11 February, 2013.

As per this clarification, adequacy of Debenture Redemption Reserve (DRR) for debentures issued by companies including manufacturing and infrastructure companies is 25% of the value of debentures issued through public issue. Therefore minimum amount of DRR will be ₹ 25 crores i.e. 25% of 100 crores in the case of Noida Toll Bridge Corporation Ltd.

Further, every company required to create/maintain DRR shall before the 30th day of April of each year, deposit or invest, as the case may be, a sum which shall not be less than fifteen percent of the amount of its debentures maturing during the year ending on the 31st day of March next following in any one or more of the following methods, namely:

- (a) in deposits with any scheduled bank, free from charge or lien;
- (b) in unencumbered securities of the Central Government or of any State Government;
- (c) in unencumbered securities mentioned in clauses (a) to (d) and (ee) of section 20 of the Indian Trusts Act, 1882;
- (d) in unencumbered bonds issued by any other company which is notified under clause (f) of section 20 of the Indian Trusts Act, 1882;

Accordingly, Noida Toll Bridge Corporation Ltd., have to deposit / invest ₹ 15 crores (100 × 15%) in any of the above mentioned categories.

**Journal Entries**  
**In books of Noida Toll Bridge Corporation Ltd.**

			₹ in crores	₹ in crores
1	10% Debentures A/c Debenture Redemption Premium* A/c To Debentureholders' A/c (Being the amount due to debenture holders on Redemption)	Dr. Dr.	100 10	110
2	Debentureholders' A/c To Investment A/c To Bank A/c (Being payment made to debenture holders out of own balance and from investments made specifically for this purpose)	Dr.	110	15 95
3	Debenture Redemption Reserve A/c To General Reserve (Being the transfer of DRR to General Reserve)	Dr.	25	25
4	Profit & Loss A/c To Debenture Redemption Premium A/c (Being the premium on redemption charged to Profit and loss Account)	Dr.	10	10

\* It has been assumed that the premium on redemption was not recorded at the time of issue of debentures.

7. (a) According to paras 55 and 56 of AS 26 'Intangible Assets', "expenditure on an intangible item should be recognised as an expense when it is incurred unless it forms part of the cost of an intangible asset".

In the given case, advertisement expenditure of ₹ 2 crores had been taken up for the marketing of a new product which may provide future economic benefits to an enterprise by having a turnover of ₹ 20 crores. However, no intangible asset or other asset is acquired or created that can be recognized in the given case. Therefore, the accounting treatment by the company of debiting the entire advertising expenditure of ₹ 2 crores to the Profit and Loss account of the year is correct.

(b) **Journal Entries**

			₹	₹
1.1.12	Bank A/c	Dr.	12,00,000	
to	Employees compensation expense A/c	Dr.	21,60,000	
28.2.12	To Equity Share Capital A/c			2,40,000
	To Securities Premium A/c			31,20,000
	(Allotment of 24,000 equity shares of ₹10 each at a premium of ₹130 per share to the employees)			
31.3.12	Profit and Loss A/c	Dr.	21,60,000	
	To Employees Compensation Expense A/c			21,60,000
	(For transfer of employees compensation expense to profit and loss account)			

- (c) It is given that revision of wages took place in July, 2012 with retrospective effect from 1.4.2008. The arrear wages payable for the period from 1.4.2008 to 31.3.2012 cannot be taken as an error or omission in the preparation of financial statements and hence this expenditure cannot be taken as a prior period item.

Additional wages liability of ₹ 40,00,000 (from 1.4.2008 to 31.3.2012) should be included in current year's wages. It may be mentioned in the Statement of Profit and Loss that additional wages is an expense arising from the ordinary activities of the company, although abnormal in amount, such an expense does not qualify as an extraordinary item. However, as per para 12 of AS 5, 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies' when items of income and expense within profit or loss from ordinary activities are of such size, nature or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately. Since the amount involved herein is huge, the separate disclosure for the same is required.

However, wages payable for the current year (from 1.4.2012 to 1.7.2012) amounting ₹ 3,50,000 is not a prior period item hence need not be disclosed separately. This may be shown as current year wages.

- (d) Based on sales, research and development cost (assumed that entire cost of ₹ 225 lakhs is development cost) is allocated as follows:

Year	Research and Development cost allocation
	(₹ in lakhs)
1	$225/1,500 \times 600 = 90$

2	$225/1,500 \times 450 = 67.5$
3	$225/1,500 \times 300 = 45$
4	$225/1,500 \times 150 = 22.5$

- (ii) If at the end of the 3rd year, the circumstances do not justify that further benefit will accrue in the 4th year, then the company has to charge the unamortised amount i.e. remaining ₹ 67.5 lakhs [ $225 - (90 + 67.5)$ ] as an expense immediately.
- (e) As per para 21 of AS 12, 'Accounting for Government Grants', amount refundable in respect of a grant related to revenue should be applied first against any unamortised deferred credit remaining in respect of the grant. To the extent the amount refundable exceeds any such deferred credit, the amount should be charged to the Statement of Profit and Loss.
- (i) In this case, the grant refunded is ₹ 300 lakhs and balance in deferred income is ₹ 210 lakhs, therefore, ₹ 90 lakhs shall be charged to the Statement of Profit and Loss for the year 2012-13. There will be no effect on the cost of the fixed asset and depreciation charged will be same as charged in the earlier years.
- (ii) As per para 21 of AS 12, the amount refundable in respect of grant which was related 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 ₹ 300 lakhs. The increased cost of ₹ 300 lakhs of the plant should be amortised over 7 years (remaining useful life). Depreciation charged during the year 2012-13 shall be  $(1200/10 + 300/7)$  162.86 lakhs.

Test Series: April, 2014

**MOCK TEST PAPER – 2**  
**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 or give your answer as per requirement of the question:-
  - (a) Standards collectively known as the Engagements Standards issued by AASB under the authority of the council of ICAI - Discuss (5 Marks)
  - (b) "The auditors should consider the effect of subsequent events on the financial statement and on auditors report according to SA 560" – Comment. (5 Marks)
  - (c) "The auditor is faced with sampling risk in both tests of control and substantive procedures."  
Comment on this statement with reference to SA 530 on "Audit Sampling". (5 Marks)
  - (d) "Responsibility for properly determining the quantity and value of inventory rests with the management." Comment on this statement. (5 Marks)
2.
  - (a) Discuss the types of audits required under law. (6 Marks)
  - (b) What do you mean by the term 'Sufficient Appropriate Audit Evidence'? State various factors that help the auditor to ascertain as to what is sufficient appropriate audit evidence. (4+6=10 Marks)
3. As an auditor, comment on the following situation/statements or give your answer as per requirement of the question:-
  - (i) KBC & Co. a firm of Chartered Accountants has three partners, K, B & C; K is also in whole time employment elsewhere. The firm is offered the audit of ABC Ltd. and its twenty branches. The firm already holds audit of 40 companies including audit of one foreign company.
  - (ii) At the Annual General Meeting of CU Ltd., Mr. L is appointed as the auditor which later is held to be void ab initio. The company holds another general meeting and appoints a new auditor.

- (iii) At an Annual General Meeting, Mr. R a retiring auditor claims that he has been reappointed automatically, as the intended resolution of which a notice had been given to appoint Mr. P, could not be proceeded with, due to Mr. P's death.
- (iv) MNC Ltd. in which 24 per cent of the subscribed capital is held by a public financial institution at the time of issuing the notice for the Annual General Meeting, appoints RK & Co. as auditors by an ordinary resolution at the Annual General Meeting when the Public Financial Institution increased its Stake in MNC Ltd. to 25 per cent of its subscribed capital. *(4x4=16 Marks)*
4. (a) Explain, what are the factors to be considered while "Vouching of travelling expenses" *(8 Marks)*
- (b) As an Auditor, Enunciate the General principles of verification of Assets. *(8 Marks)*
5. (a) 'A Joint Auditor is not bound by the views of the majority of the joint auditors regarding matters to be covered in the report.'
- Justify this statement in the light of responsibilities of Joint Auditors under SA 299. *(8 Marks)*
- (b) What special steps will you take into consideration in auditing the accounts of a hotel? *(8 Marks)*
6. (a) How an auditor can audit allotment of debentures? *(6 Marks)*
- (b) What are the duties of an auditor in case of reduction of capital? *(5 Marks)*
- (c) *Discuss the audit procedure for verification of payment of dividends.* *(5 Marks)*
- 7 Write short notes on any four of the following:
- (a) Basic elements of the Auditor's Report.
- (b) Filling of a Casual Vacancy in the office of Auditor.
- (c) Internal Audit System and CARO, 2003
- (d) Purpose of Providing Depreciation
- (e) Extent of Reliance on Analytical Procedures. *(4 x 4 = 16 Marks)*



**MOCK TEST PAPER – 2**  
**INTERMEDIATE (IPC): GROUP – II**  
**PAPER – 6: AUDITING AND ASSURANCE**  
**SUGGESTED ANSWERS/HINTS**

1. (a) **Engagement Standards:** The following standards issued by the Auditing and Assurance Standards Board under the authority of the Council are collectively known as the Engagement Standards.

- (i) Standards on Auditing (SAs), to be applied in the audit of historical financial information.
- (ii) Standards on Review Engagements (SREs), to be applied in the review of historical financial information.
- (iii) Standards on Assurance Engagements (SAEs), to be applied in assurance engagements, dealing with subject matters other than historical financial information.
- (iv) Standards on Related Services (SRSs), to be applied to engagements involving application of agreed-upon procedures to information, compilation engagements, and other related services engagements, as may be specified by the ICAI.

(b) **Effect of Subsequent Events:** SA 560 “Subsequent Events”, establishes standards on the auditor’s responsibility regarding subsequent events.

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

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

- (i) obtain an understanding of any procedures management has established to ensure that subsequent events are identified.
- (ii) inquire of management and, where appropriate, those charged with governance as to whether any subsequent events have occurred which might affect the financial statements.
- (iii) Read minutes, if any, of the meetings, of the entity’s owners, management and those charged with governance, that have been held after the date of the

financial statements and inquiring about matters discussed at any such meetings for which minutes are not yet available.

- (iv) Read the entity's latest subsequent interim financial statements, if any.
- (v) Read the entity's latest available budgets, cash flow forecasts and other related management reports for periods after the date of the financial statements.
- (vi) Inquire, or extend previous oral or written inquiries, of the entity's legal counsel concerning litigation and claims; or
- (vii) Consider whether written representations covering particular subsequent events may be necessary to support other audit evidence and thereby obtain sufficient appropriate audit evidence.

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

- (c) **Sampling Risk: (SA 530):** Audit sampling enables the auditor to obtain and evaluate audit evidence about some characteristic of the items selected in order to form or assist in forming a conclusion concerning the population from which the sample is drawn. Audit sampling can be applied using either non-statistical or statistical sampling approaches.

When designing a sample, the auditor determines tolerable misstatement in order to address the risk that the aggregate of individually immaterial misstatements may cause the financial statements to be materially misstated and provide a margin for possible undetected misstatements.

The risk that the auditor's conclusion based on a sample may be different from the conclusion if the entire population were subjected to the same audit procedure. Sampling risk can lead to two types of erroneous conclusions:

- (i) In the case of a test of controls, that controls are more effective than they actually are, or in the case of a substantive procedure i.e. test of details, that a material misstatement does not exist when in fact it does. The auditor is primarily concerned with this type of erroneous conclusion because it affects audit effectiveness and is more likely to lead to an inappropriate audit opinion.
- (ii) In the case of a test of controls, that controls are less effective than they actually are, or in the case of a substantive procedure i.e. test of details, that a material misstatement exists when in fact it does not. This type of erroneous conclusion affects audit efficiency as it would usually lead to additional work to establish that initial conclusions were incorrect.

- (d) **“Guidance note on Audit of Inventory”** specifies that the responsibility for properly determining the quantity and volume of inventories rests with the management of the entity. Therefore it is the responsibility of the management of the entity to ensure that inventories included in financial statements are physically in existence and represent all owned by the entity.

The management can satisfy this responsibility by carrying out appropriate procedures such as verification of all items of inventory at least once in every financial year. The auditor is expected to examine the compliance of “Accounting Standard 2: Valuation of Inventory” and adequacy of the method and procedures of physical verification followed by the entity. He is also required to determine whether the procedure for identifying defective, damaged, obsolete and slow moving items are well designed and operate properly that proper books of accounts should be made following the accounting standards

The responsibility of management is not reduced even where the auditor attends any physical count of inventories in order to obtain audit evidence. The entities usually maintain detailed stock records in the form of stores/stock ledgers showing in respect of each major item, the receipts issues and balances. The extent of examination of these records by an auditor with reference to the relevant basic documents depends on the facts and circumstances of each case.

CARO 2003 also requires specific comment by auditor as to the adequacy and reasonableness of the physical verification of inventory by the management. It also requires auditor to comment whether discrepancy, if any, observed in such a physical verification had been duly accounted for.

2. (a) **Audits required under Law:** Audit is not legally obligatory for all types of business organisations or institutions. On this basis audits may be of two broad categories i.e., audit required under law and voluntary audits.

The organisations which require audit under law are the following:

- (i) Companies governed by the Companies Act, 1956;
- (ii) Banking companies governed by the Banking Regulation Act, 1949;
- (iii) Electricity supply companies governed by the Electricity Supply Act, 1948;
- (iv) Co-operative societies registered under the Co-operative Societies Act, 1912;
- (v) Public and charitable trusts registered under various Religious and Endowment Acts;
- (vi) Corporations set up under an Act of Parliament or State Legislature such as the Life Insurance Corporation of India.
- (vii) Specified entities under various sections of the Income-tax Act, 1961.
- (viii) Audit required under Sales-tax and VAT by various State Government.

- (b) **Meaning of sufficient appropriate audit evidence:** The auditor shall design and perform audit procedures that are appropriate in the circumstances for the purpose of obtaining sufficient appropriate audit evidence.

SA 500 on 'Audit Evidence' further expounds this concept. According to it, the sufficiency and appropriateness of audit evidence are interrelated. Sufficiency is the measure of the quantity of audit evidence. The quantity of audit evidence needed is affected by the auditor's assessment of the risks of misstatement (the higher the assessed risks, the more audit evidence is likely to be required) and also by the quality of such audit evidence (the higher the quality, the less may be required). Obtaining more audit evidence, however, may not compensate for its poor quality.

Appropriateness is the measure of the quality of audit evidence; that is, its relevance and its reliability in providing support for the conclusions on which the auditor's opinion is based. The reliability of evidence is influenced by its source and by its nature, and is dependent on the individual circumstances under which it is obtained.

SA 330 requires the auditor to conclude whether sufficient appropriate audit evidence has been obtained. Whether sufficient appropriate audit evidence has been obtained to reduce audit risk to an acceptably low level, and thereby enable the auditor to draw reasonable conclusions on which to base the auditor's opinion, is a matter of professional judgment. Further, SA 200 contains discussion of such matters as the nature of audit procedures, the timeliness of financial reporting, and the balance between benefit and cost, which are relevant factors when the auditor exercises professional judgment regarding whether sufficient appropriate audit evidence has been obtained.

In general the various factors which may influence the auditor's judgment as to what is sufficient and appropriate audit evidence are as under:

- (i) Degree of risk of misstatements which may be affected by factors such as the nature of items, adequacy of internal control, nature and size of businesses carried out by the entity, situations which may exert an unusual influence on management and the financial position of the entity.
  - (ii) The materiality of the item.
  - (iii) The experience gained during previous audits.
  - (iv) The results of auditing procedures, including fraud and errors which may have been found.
  - (v) The type of information available.
  - (vi) The trend indicated by accounting ratios and analysis.
3. (i) **Ceiling on Number of Company Audits:** According to Section 224(1B) of the Companies Act, 1956 certain chartered accountants cannot hold more than the

specified number of company audits. The specified number is to be computed in the following manner:

In the case of firm of chartered accountants, the specified number should be construed as twenty companies (out of which not more than ten may have a paid-up share capital of rupees twenty five lakhs or more) per such partner who is not in whole-time employment elsewhere.

In the firm of KBC & Co., K is in whole-time employment elsewhere, therefore, he will be excluded in determining the number of company audits that the firm can hold. If B and C do not hold any audits in their personal capacity or as partners of other firms, the total number of company audits that can be accepted by KBC & Co., is forty, out of which not more than twenty companies may have a paid-up share capital of rupees twenty five lakhs or more.

Branch audits are not to be counted in computing this specified number. Therefore, it does not matter whether ABC Ltd. is having twenty branches. Audits of the accounts of foreign companies are also not to be included within the specified number as such companies are outside the scope of section 224.

Thus the acceptance of audit of ABC Ltd. and its twenty branches will accordingly be within specified limits.

*(Note: Students may note that section 224(1B) has been amended by the Companies (Amendment) Act, 2000 and a proviso has been added whereby this sub-section is not applicable to a private company after 13.12.2000.)*

- (ii) **Observance of provisions of the Companies Act, 1956:** Section 224 of the Companies Act, 1956, lays down the necessary details of appointment of an auditor. Accordingly, it is necessary that requirements of Section 224A with regard to passing of special resolution or ceiling on number of audits as laid down in Section 224(1B) amongst others have to be complied with.

In case a company fails to adhere to statutory provisions laid down in the Companies Act, 1956, then in such cases, the appointment of any person as the auditor at the Annual General Meeting would be void *ab initio*. Under the circumstances in view of the fact that the company failed to appoint an auditor, the provisions of Section 224(3) would be attracted and the appointment of the auditor can be made by the Central Government only.

Accordingly, the appointment of a new auditor at the subsequent general meeting will not be valid.

- (iii) **Reappointment of Retiring Auditor:** Section 224(2) of the Companies Act, 1956 dealing with reappointment of auditors specifies that subject to the provisions of sub-section (1B) and section 224A, at any Annual General Meeting a retiring auditor, by whatsoever authority appointed, shall be re-appointed unless, *inter alia*:

"Where notice has been given of an intended resolution to appoint some person or persons in the place of a retiring auditor, and by reason of the death, incapacity or dis-qualification of that person or of all those persons, as the case may be, the resolution cannot be proceeded with."

However, it should be noted that even for the re-appointment of a retiring auditor, the passing of a resolution is essential. Section 224 of the Companies Act, 1956, requires that a resolution has to be passed by the company every year. In the absence of a resolution, the retiring auditor is not re-appointed automatically.

Thus, the claim of Mr. R would not hold good.

- (iv) **Passing of a Special Resolution:** Section 224A of the Companies Act, 1956 does not specify the date on which 25% of the subscribed share capital should be held by the specified institutions to require the appointment of the auditors by a special resolution.

The Department of Company Affairs has opined that the material date is the date of the AGM at which the special resolution is required to be passed. In some cases, it is possible that the shareholding of the specified bodies is less than 25% of the subscribed share capital of a company at the time of issuing the notice for the AGM, but exceeds this limit on the date of the AGM. In such a case, it is advisable for the company to adjourn the meeting, issue another notice to the members for appointment of auditors by special resolution and pass the special resolution at the adjourned meeting.

Hence, MNC Ltd. should appoint RK & Co. as auditors in the above mentioned manner.

4. (a) **Vouching of Travelling Expenses:** The following factors are to be considered while "Vouching of Travelling Expenses":
- (i) Travelling expenses are normally payable to staff according to rules approved by directors or partners. Where no rules exist, the auditor should recommend that these be framed for controlling the expenditure. In the absence of T.A. Rules, the expenditure should be vouched on the basis of actual expenditure incurred. A voucher should be demanded for all items of expenses incurred, except those which are capable of independent verification.
  - (ii) As regards travelling expenses claimed by directors the auditor should satisfy himself that these were incurred by them in the interest of the business and that the directors were entitled to receive the amount from the business.
  - (iii) The voucher for travelling expenses should normally contain the under mentioned information:
    - (1) Name and designation of the person claiming the amount.
    - (2) Particulars of the journey.

- (3) Amount of railway or air fare.
  - (4) Amount of boarding or lodging expenses or daily allowance alongwith the dates and times of arrival and departure from each station.
  - (5) Other expenses claimed
  - (iv) If the journey was undertaken by air, the counterfoil of the air ticket should be attached to the voucher; this should be inspected. For travel by rail or road, the amount of the fare claimed should be checked from some independent source.
  - (v) Particulars of boarding and lodging expenses and in the case of halting allowance the rates thereof should be verified.
  - (vi) The evidence in regard to sundry expenses claimed is generally not attached to T.A. bills. So long as the amount appears to be reasonable it is usually not questioned. All vouchers for travelling expenses should be authorised by some responsible official. In the case of foreign travel or any extraordinary travel, the expenses, before being paid, should be sanctioned by the Board.
  - (vii) The travelling advance taken, if any, should be settled on receipt of final bills. At the year end, the amount not settled should be shown appropriately in the Balance Sheet.
  - (viii) Unless the articles specifically provide or their payment has been authorised by a resolution of shareholders, directors are not entitled to charge travelling expenses for attending Board Meetings.
- (b) **General principles of verification of Assets** : It is not sufficient for the auditors only to verify correctness of the amount of assets shown in the balance sheet, he must verify them by actual inspection or otherwise and establish the existence of assets.

Points requiring auditor's attention for verification are as under:

- (i) **Cost** - In regard to assets, verification procedure need not generally be extended to determination of the correctness of costs and authority to incur costs unless the items concerned were purchased during the accounting period under review. In such cases the auditor should check the correctness of costs through normal vouching method. He should ensure that adequate distinction has been made between 'revenue' and 'capital' nature of costs.
- (ii) **Ownership** – Where ownership of assets is evidenced by documents of title etc. as in the case of immovable property, a reference should be made to such documents. If the documents are held by third person the auditor should either obtain a certificate directly from that party or arrange to inspect them at the third party's place of business.

- (iii) **Valuation** - It must be ascertained that all assets are valued in accordance with appropriate accounting policy. For the valuation made, the basis must be consistently applied, unless circumstances necessitated a change. Even then a disclosure is required for the change and its monetary effect.
  - (iv) **Existence** – Physical inspection should be done wherever possible. Where physical inspection is not possible, the possibility of obtaining indirect evidence be considered e.g. machinery imported held in customs godown or materials sent to subcontractor for job work or fabrication. In such circumstances certificating of such parties should be obtained and if considered necessary even physical verification may be requested.
  - (v) **Presentation in accounts** - Material assets must be properly disclosed and correctly described in the accounts. It should be seen that the description given to them is clear and complete and is not misleading e.g. stating loans on the assets side of the balance sheet “as dependent upon realization” is just misleading as was held in the case of London and General Bank Ltd. care must be taken to see that disclosures required under the statute or statement issued by ICAI are complied with.
5. (a) **Responsibility of Joint Auditors:** SA 299 on, “Responsibility of Joint Auditors” deals with the professional responsibilities, which the auditors undertake in accepting such appointments as joint auditors. The responsibilities of joint auditors, as a rule are no different from the responsibilities of individual auditors as enumerated in the Companies Act, 1956. Main features of the said SA are discussed below:
- ◆ **Division of Work:** Where joint auditors are appointed, they should, by mutual discussion, divide the audit of identifiable units or specified areas. Certain areas of work, owing to their importance or owing to the nature of work involved would not be divided and would be covered by all the joint auditors. Such a division effected by the joint auditors should be adequately documented and preferably communicated to the auditee.
  - ◆ **Coordination:** Where in the course of his work, a joint auditor comes across matters which are relevant to the areas of other joint auditors and which require joint discussion, he should communicate the same to all the other joint auditors in writing before the finalisation of audit and preparation of audit report.

In respect of the work divided amongst the joint auditors, each joint auditor is responsible only for the work allocated to him, whether or not he has made a separate report on the work performed by him. On the other hand the joint auditors are jointly and severally responsible in respect of the audit conducted by them as under:



- (i) in respect of the audit work which is not divided among the joint auditors and is carried out by all of them;
- (ii) in respect of decisions taken by all the joint auditors concerning the nature, timing or extent of the audit procedures to be performed by any of the joint auditors.
- (iii) in respect of matters which are brought to the notice of the joint auditors by any one of them and on which there is an agreement among the joint auditors;
- (iv) for examining that the financial statements of the entity comply with the disclosure requirements of the relevant statute; and
- (v) for ensuring that the audit report complies with the requirements of the relevant statute.
- (vi) it is the separate and specific responsibility of each joint auditor to study and evaluate the prevailing system of internal control relating to the work allocated to him, the extent of enquiries to be made in the course of his audit.
- (vii) the responsibility of obtaining and evaluating information and explanation from the management is generally a joint responsibility of all the auditors.
- (viii) each joint auditor is entitled to assure that the other joint auditors have carried out their part of work in accordance with the generally accepted audit procedures and therefore it would not be necessary for joint auditor to review the work performed by other joint auditors.

Normally, the joint auditors are able to arrive at an agreed report. However where the joint auditors are in disagreement with regard to any matters to be covered by the report, each one of them should express his own opinion through a separate report. A joint auditor is not bound by the views of majority of joint auditors regarding matters to be covered in the report and should express his opinion in a separate report in case of a disagreement.

- (b) **Audit of Hotels:** The business of running a hotel is very much dissimilar to running an industrial unit for manufacturing of products. It is a service-oriented industry. The business is characterized by handling of large amounts of liquid cash, stock of foods providing a variety of services, and keeping watch on customers to ensure that they do not leave hotel without settling the dues. In view of these, the following matters require special attention by the auditor.

- (i) **Internal Control:** Pilferage is one of the greatest problems in any hotel and it is extremely important to have a proper internal control to minimize the leakage. The following points should be checked:
  - (a) Effectiveness of arrangement regarding receipts and disbursements of cash.
  - (b) Procedure for purchase and stocking of various commodities and provisions.

- (c) Procedure regarding billing of the customers in respect of room service, telephone, laundry, etc.
- (d) System regarding recording and physical custody of edibles, wines, cigarettes, crockery and cutlery, linen, furniture, carpets, etc.
- (e) Ensure that trading accounts are prepared preferably weekly, for each sales point. A scrutiny of the percentage of profit should be made, and any deviation from the norms is to be investigated.

**(ii) Room Sales and Cash Collections**

- (a) There are various sales points scattered in a hotel and sales are both for cash and credit. The control over cash is very important. The charge for room sales is made from the guest register, and tests are to be carried out to ensure that the correct numbers of guests are charged for the exact period of stay. Any difference between the rate charged to the guests and standard room rent is to be investigated to see that it is properly authorized.
- (b) The total sales reported with the total bills issued at each sales point have to be reconciled.
- (c) Special care must be taken in respect of bills issued to customers who are staying in the hotel, because they may not be required to pay the bills immediately in cash but at a future date or by credit cards. Billing is to be done room-wise. It must be ensured that all customers pay their bills on leaving the hotel or within specified dates.

**(iii) Stock:** the stocks in a hotel are all saleable item like food and beverages. Therefore, following may be noted in this regard:

- (a) All movement and transfer of stocks must be properly documented.
- (b) Areas where stocks are kept must be kept locked and the key retained by the departmental manager.
- (c) The key should be released only to trusted personnel and unauthorized persons should not be permitted in the stores area.
- (d) Many hotels use specialized professional valuers to count and value the stocks on a continuous basis throughout the year.
- (e) The auditor should ensure that all stocks are valued at the year end and that he should himself be present at the year end physical verification, to the extent practicable, having regard to materiality consideration and nature and location of inventories

**(iv) Fixed Assets:** The fixed assets should be properly depreciated, and the Fixed Assets Register should be updated.

- (v) **Casual Labour:** In case the hotel employs a casual labour, the auditor should consider, whether adequate records have been maintained in this respect and there is no manipulation taking place. The wages payment of the casual labour must also be checked thoroughly.
- (vi) The compliance with all statutory provisions, and compliance with the Foreign Exchange Regulations must also be verified by the auditor, especially because hotels offer facility of conversion of foreign exchange to rupees.
- (vii) Other special aspects are to be verified as under
  - (a) Consumption shown in various physical stock accounts must be traced to the customers' bills to ensure that all issues to the customers have been billed.
  - (b) All payments to the foreign collaborator, if any, are to be checked.
  - (c) Expenses and receipts are to be compared with figures of the previous year, having regard to the average occupancy of visitors and changes in rates.
  - (d) Special receipts on account of letting out of auditorium, banquet hall, spaces for shops, boutiques, and special shows should be verified with the arrangements made.
  - (e) In depth check should be carried out on the customers' ledgers to verify that all charges have been properly made and recovered.
  - (f) The occupancy rate should be worked out, and compared with other similar hotels, and with previous year. Material deviations should be investigated.
  - (g) Expenses for painting, decoration, renovation of building, etc. are to be properly checked.
  - (h) It is common that hotels get their bookings done through travel agents. The auditor should ensure that the money is recovered from the travel agents as per credit terms allowed. Commission paid to travel agents should be checked by reference to the agreement on that behalf.
  - (i) Apart from control over stock of edibles, control over issue and physical stock of linen crockery, cutlery, glassware, silver, toilet items, etc. should be verified.
  - (j) The auditor should verify the restaurant bills with reference to KOT (Kitchen order Ticket).
  - (k) The auditor should ensure that all taxes have been included in the client's bills.

(l) Computation and payment of salaries and wages vis-a-vis number of employees must be checked.

6. (a) **Allotment of Debentures:** Following are the steps to be taken by an auditor while doing the audit of allotment of debentures :

- (i) Verify that the Prospectus or the Statement in lieu of Prospectus had been duly filed with the Registrar before the date of allotment.
- (ii) Check the applications for debentures with the Application and Allotment Book to verify that the name, address of the applicants and the number of debentures applied for are correctly recorded.
- (iii) Verify the allotment of debentures by reference to the Directors' Minute Book.
- (iv) Vouch the amounts collected as are entered in the Cash Book with the counterfoils of receipts issued to the applicants; also trace the amounts into the Application and Allotment Book.
- (v) Check postings of allotments of debentures and the amounts received in respect thereof from the Application and Allotment Book, into the Debentures Register.
- (vi) Verify the entries on the counterfoils of debentures issued with the Debentures Register.
- (vii) Extract balances in the Debentures Register in respect of amounts paid by the debenture holders and agree their total with the balance in the Debentures Account in the General Ledger.
- (viii) Examine a copy of the Debenture Trust Deed and note the conditions including creation of Debenture Redemption Reserve contained therein as to issue and repayment.
- (ix) If the debentures are covered by a mortgage or charge, it should be verified that the charge has been correctly recorded in the Register of Mortgages and Charges and that it has also been registered with the Registrar of Companies. Further, that the charge is clearly disclosed in the Balance Sheet.
- (x) Compliance with SEBI Guidelines should also be seen.
- (xi) Where debentures have been issued as fully paid up to vendors as a part of the purchase consideration, the contract in this regard should be referred to.

(b) **Reduction of Capital:** The duties of the auditor in this regard are following :

- (i) Verify that the meeting of the shareholders was properly convened and the proposal of reduction of share capital was passed by Special Resolution and also that the proposal was circularised in advance among the members.

- (ii) Verify that the reduction of share capital is authorised by the Articles of Association and the procedure prescribed by the Article has been followed.
  - (iii) Examine the order of the Tribunal confirming the reduction of share capital and see that a copy of the order and the minutes have been registered and filed with the Registrar of Companies.
  - (iv) Inspect Registrar's Certificate as regards reduction of capital.
  - (v) Vouch the journal entries recorded to reduce the capital and to write down the assets by reference to the resolution of shareholders and other documentary evidence; also seeing that the requirements of Schedule VI, Part I, have been complied with.
  - (vi) Confirm that revaluation of assets have been properly disclosed in Balance Sheet.
  - (vii) Verify the adjustment made in the member's accounts in the Register of Members and confirm that either the paid up amount shown on the old share certificates have been altered or new certificates have been issued in lieu of the old, and the old ones have been cancelled.
  - (viii) Confirm that the words "and reduced", if required by the order of the Tribunal, have been added to the name of the company in the Balance Sheet.
  - (ix) Verify that the Memorandum of Association of the company has been suitably altered.
- (c) **Verification of Dividends:** The procedure for the verification of payment of dividends is stated below:
- (i) Examine the company's Memorandum and Articles of Association to ascertain the dividend rights of different classes of shares.
  - (ii) Confirm that the profits appropriated for payment of dividend are distributable having regard to the provisions contained in Section 205 of the Companies Act, 1956 and that the transfer to reserves is according to rules framed by the Central Government in this respect [vide Section 205(2A)]. It may be noted that now there exists a requirement to transfer profits to reserves upon 10 per cent of the profits of that year. However, if the rate of dividend does not exceed 10 per cent no such transfer is necessary. If the company proposes to pay the dividend out of past profits, see that either this is in accordance with the rules framed by the Central Government in this behalf or the consent of the Government has been obtained. [vide Section 205A(3)].
  - (iii) Inspect the shareholders' Minute Book to verify the amount of dividend declared and confirm that the amount recommended by the directors.
  - (iv) If a separate bank account was opened for payment of dividends, check the transfer of the total amount of dividends payable from the Dividends Accounts.

- (v) Check the particulars of members as are entered in the Dividend Register or Dividend List by reference to the Register of Members. Test check the calculation of the gross amount of dividend payable to each shareholder on the basis of the number of the shares held. Verify the casts and cross cast of the different columns.
- (vi) Check the amount of dividend paid with the dividend warrants surrendered. Reconcile the amount of dividend warrants outstanding with the balance in the Dividend Bank Account.
- (vii) Examine the dividend warrants in respect of previous years presented during the year for payment and verify that by their payment any provision contained in the Articles in the matter of period of time during which amount of unclaimed dividend can be paid had not been contravened.
- (viii) According to section 205A, as it is compulsory for a company to transfer the total amount of dividend which remains unpaid or unclaimed, within thirty days of the declaration of the dividend to a special bank account entitled "Unpaid Dividend Account of .Company Limited/Company (Pvt.) Limited". Such an account is to be opened only in a scheduled bank. The transfer must be made within 7 days from the date of expiry of thirty days.  
  
The expression "dividend which remains unpaid" means any dividend the warrant in respect thereof has not been encashed or which has otherwise not been paid or claimed.
- (ix) In case any money transferred to the unpaid dividend amount of a company remain unpaid or unclaimed for a period of seven years from the date of such transfer shall be transferred to Investor Education and Protection Fund established under section 205C of the Act.

7. (a) **Basic elements of the Auditor's Report:** As per SA 700(Revised), "Forming an Opinion and Reporting on Financial Statements", the auditor's report includes the following basic elements, ordinarily, in the following layout:

- (i) Title;
- (ii) Addressee;
- (iii) Introductory Paragraph
- (iv) Management's Responsibility for the Financial Statements.
- (v) Auditor's Responsibility
- (vi) Auditor's Opinion
- (vii) Other Reporting Responsibilities
- (viii) Signature of the Auditor
- (ix) Date of Auditor's Report.

(x) Place of signature

**(b) Filling of a Casual Vacancy:** A casual vacancy in the office of the auditor can be filled by the Board of Directors, provided such vacancy has not been caused by the resignation of the auditor. In case of a casual vacancy arising on account of resignation, only the company in general meeting can fill the vacancy by appointing another auditor. The expression 'casual vacancy' has not been defined in the Act. Taking its natural meaning, it stands for a vacancy created by the auditor ceasing to act after he was validly appointed and the appointment was accepted. This may arise due to a variety of reasons which include death, resignation, disqualification, dissolution of the firms of auditors, etc. The provision to require the filling of casual vacancy caused by resignation of the auditor by the general meeting is in consonance with the principle of auditor's independence. The process may bring out facts regarding the auditor's resignation to the notice of, and hence scrutiny by the shareholders. Any abuse of authority or financial impropriety by the management that might have contributed to the resignation will be known. If the auditor could be found to be conscientious and honest, the general meeting may even request him to reconsider his decision and take appropriate steps to cure the evils, if any, in the management. The auditor appointed to a casual vacancy shall hold office till the conclusion of the next annual general meeting.

**(c) Internal Audit System and CARO, 2003:** As per Para 4(vii) of CARO, 2003, statutory auditor is required to comment on whether the auditee company has an internal audit system commensurate with its size and nature of its business.

The clause has a mandatory application in respect of listed companies. For other companies, it is applicable if either of the following conditions is satisfied:

- (1) the paid-up capital and reserves of the company are more than rupees fifty lakhs as at the commencement of the financial year; or
- (2) average annual turnover exceeds rupees five crores for a period of three consecutive financial years immediately preceding the financial year concerned.

The following are some of the factors to be considered to ensure that the internal audit system is commensurate with the size of the company and the nature of its business:

- (i) Size of the internal audit department.
- (ii) The qualifications of the persons who undertake the internal audit work
- (iii) Reporting officer of the internal auditor.
- (iv) Areas covered by the internal auditor.
- (v) Technical assistance of the internal auditor.
- (vi) Reports submitted by the internal auditor or other evidence of his work: It is important that the auditor should satisfy himself that not merely does an

internal audit system exist but also that it is functioning effectively. He can do so by examining the reports submitted by the internal auditor.

- (vii) Follow-up: It is not sufficient that the internal audit system should point out errors in operation or deficiencies in the internal control system. It is equally necessary that there is an adequate follow-up system to ensure that the errors pointed out are corrected and remedial action taken on the deficiencies reported upon.

**(d) Purpose of Providing Depreciation:** According to AS 6 on Depreciation Accounting, depreciation may be defined as, "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. Depreciation is allocated so as to charge a fair proportion of the depreciable amount in each accounting period during the expected useful life of the asset. Depreciation includes amortisation of assets whose useful life is predetermined". This is a measure of the exhaustion of the useful life of an asset during the accounting period. Depreciation is charged in each accounting period by reference to the extent of the depreciable amount irrespective of an increase in the market value of fixed assets. The principal objective of depreciation on fixed assets is to allocate as an expense, the related depreciation amount on a year to year basis. Depreciation has a significant effect in determining and presenting the financial position and results of operations of an enterprise. The main purpose of providing depreciation is as under:

- (i) To keep intact the capital invested in fixed assets - This is accomplished by retaining the amount of depreciation charged in the profit and loss account in the business.
- (ii) To ascertain the true cost of production - As the value of fixed assets depletes gradually by consumption during the process of production, it is necessary that such consumption of value be charged in the accounts for determination of the true cost of production.
- (iii) To determine the profit or loss for the year - Depreciation being an expense represented by the loss in value of fixed assets arising on use, it is charged to the profit and loss account for determining the profit or loss during a year;
- (iv) To present a true and fair value of entity's assets in the balance sheet, since the original costs of fixed assets gradually decreases due to use and other factors, it is improper to continue to carry such assets at original costs. Therefore, the amount of depreciation charged in the profit and loss account representing the loss in value of the assets is deducted from the original cost on a cumulative basis so as to reflect in the balance sheet a true and fair value of the fixed assets.

**(e) Extent of Reliance on Analytical Procedures:** As per SA 520 "Analytical procedures" means the analysis of significant ratios and trends, including the



resulting investigation of fluctuations and relationships that are inconsistent with other relevant information or which deviate from predicted amounts. The application of analytical procedures is based on the expectation that relationships among data exist and continue in the absence of known conditions to the contrary. The presence of these relationships provides audit evidence as to the completeness, accuracy and validity of the data produced by the accounting system. However, reliance on the results of analytical procedures will depend on the auditor's assessment of the risk that the analytical procedures may identify relationships as expected when, in fact, a material misstatement exists. The extent of reliance that the auditor places on the results of analytical procedures depends on the following factors:

- (i) materiality of the items involved, for example, when inventory balances are material, the auditor does not rely only on analytical procedures in forming conclusions. However, the auditor may rely solely on analytical procedures for certain income and expense items when they are not individually material;
- (ii) other audit procedures directed toward the same audit objectives, for example, other procedures performed by the auditor in reviewing the collectibility of accounts receivable, such as the review of subsequent cash receipts, might confirm or dispel questions raised from the application of analytical procedures to an ageing schedule of customers' accounts;
- (iii) accuracy with which the expected results of analytical procedures can be predicted. For example, the auditor will ordinarily expect greater consistency in comparing gross profit margins from one period to another than in comparing discretionary expenses, such as research or advertising; and
- (iv) assessments of inherent and control risks, for example, if internal control over sales order processing is weak and, therefore, control risk is high, more reliance on tests of details of transactions and balances than on analytical procedures in drawing conclusions on receivables may be required.

The auditor will need to consider testing the controls, if any, over the preparation of information used in applying analytical procedures. When such controls are effective, the auditor will have greater confidence in the reliability of the information and, therefore, in the results of analytical procedures. The tests of accounting-related controls. For example, an entity in establishing recording of unit sales. In these circumstances, the auditor could test the controls over the recording of unit sales in conjunction with tests of the controls over the processing of sales invoices.

Test Series: April, 2014

**MOCK TEST PAPER – 2**  
**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) Device Drivers
  - (ii) Multitasking
  - (iii) Internet
  - (iv) Hyper Text Transfer Protocol (HTTP)
  - (v) Data Definition Language (DDL)
  - (vi) Switch
  - (vii) Business-to-Business (B2B)
  - (viii) ASCII code
  - (ix) Protocol
  - (x) Web Casting (1 x 10 = 10 Marks)
2.
  - (a) Differentiate between Serial and Parallel Transmission. (4 Marks)
  - (b) Discuss some of the benefits of using Intranet. (4 Marks)
3.
  - (a) Discuss the concept of Virtual Memory. (4 Marks)
  - (b) Discuss different types of Electronic Payments. (4 Marks)
4.
  - (a) Discuss DBMS structure in brief. (4 Marks)
  - (b) Discuss Serial and Sequential file organizations used in business data processing applications. (4 Marks)
5.
  - (a) Discuss two-tier architecture in detail. (4 Marks)
  - (b) What do you understand by Disaster Recovery Site? Discuss its types in brief. (4 Marks)

6. A company ABC Ltd. is engaged in selling consumer goods to different categories of customers. In order to increase its sales, different types of discounts are offered to customers. The policy of discount is as given below:
- (i) On cooking range, a discount of 12 percent is allowed to dealers and 9 percent to retailers irrespective of the value of the order.
  - (ii) A discount of 12 percent is allowed on washing machine irrespective of the category of customer and the value of the order.
  - (iii) On decorative products, dealers are allowed a discount of 20 percent provided that the value of the order is ₹ 10,000 and above. Retailers are allowed a discount of 10 percent irrespective of the value of the order.

Draw a flow chart to calculate the discount for the above policy.

*(8 Marks)*

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

- (a) Operating System
- (b) Structured Query Language
- (c) Multiplexer
- (d) Bluetooth
- (e) Dependent Data Mart

*(4 × 2 = 8 Marks)*

Test Series: April, 2014

**MOCK TEST PAPER – 2**  
**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) How is TOWS Matrix relevant in strategic planning process? *(3 Marks)*  
(b) Discuss how divesting a major product line in an organization can be termed as retrenchment strategy. *(3 Marks)*  
(c) Briefly discuss four major components of marketing mix. *(3 Marks)*  
(d) What are major differences between logistic management and supply chain management? *(3 Marks)*  
(e) Explain the meaning of premise control. *(3 Marks)*
2. (a) Briefly analyze contemporary developments in business environment. *(3 Marks)*  
(b) State with reasons which of the following statements is correct/incorrect:
  - (i) SWOT analysis restricts itself to mapping of internal environment of organisation. *(2 Marks)*
  - (ii) The term PESTLE analysis is used to describe a framework for analyzing the macro-environmental factors. *(2 Marks)*
3. (a) Write short notes on the following:
  - (i) Kieretsus *(2 Marks)*
  - (ii) Strategic groups. *(2 Marks)*
3. (b) Distinguish between the terms vision and mission. *(3 Marks)*
- 4 What do you understand by the term corporate strategy? Explain characteristics of a good corporate strategy. *(7 Marks)*
- 5 What is turnaround strategy? Under what conditions would you recommend its use? What should be constituents of a suitable work plan for implementation of turnaround strategy? *(7 Marks)*

6. A company is planning to introduce changes in its structure, technology and people. Explain how Kurt Lewin's change process can help this organisation. (7 Marks)
7. What do you understand by 'business process re-engineering'? Briefly outline its steps. (7 Marks)

**MOCK TEST PAPER – 2**  
**INTERMEDIATE (IPC): GROUP – II**  
**PAPER – 7: INFORMATION TECHNOLOGY AND STRATEGIC MANAGEMENT**  
**SECTION – A: INFORMATION TECHNOLOGY**

**SUGGESTED ANSWERS/HINTS**

1. (i) **Device Drivers:** Device drivers are small files that act as an interface between hardware in a computer system and the operating system (OS). Hardware requires device drivers so that the OS can “see” the devices and handle them effectively and efficiently.
- (ii) **Multitasking:** Multi-tasking refers to the operating system’s ability to execute two or more of a single user’s tasks concurrently.
- (iii) **Internet:** Internet may be defined as a collection of interconnected networks all using the Internet Protocol Suite (TCP/IP) and offers access to information and people.
- (iv) **HyperText Transfer Protocol (HTTP):** HTTP is defined as the set of rules for transferring files (text, graphic images, sound, video, and other multimedia files) on the World Wide Web. As soon as a Web user opens their Web browser, the user is indirectly making use of HTTP.
- (v) **Data Definition Language (DDL):** DDL defines the conceptual schema by providing a link between the logical (the way the user views the data) and physical (the way in which the data is stored physically) structures of the database.
- (vi) **Switch:** A switch is a kind of multi port connecting device which makes intelligent routing decisions on the basis of hardware (physical) addresses. It regenerates incoming signals and forwards it.
- (vii) **Business – to – Business (B2B):** Business-to-Business is defined as an exchange of services, information and/or products from one business to another.
- (viii) **ASCII Code:** ASCII stands for American Standard Code for Information Interchange. It is a seven-bit code used extensively in small computers, peripherals, instruments and communications devices. This includes both unprintable control codes (0-31) used to control various devices in computer and printable control codes (32-127) that represents lower case and upper case letters, digits, punctuation marks, and other symbols.
- (ix) **Protocol:** A protocol is a set of rules required to initiate and maintain communication between a sender and receiver device. For example – HTTP, FTP, SMTP etc.

- (x) **Web Casting:** Web casting is a media presentation distributed over the Internet using streamlining media technology to distribute a single content source to many simultaneous listeners/viewers. A webcast may either be distributed live or on demand. Essentially, webcasting is “broadcasting” over the Internet.

2. (a)

S.No.	SERIAL TRANSMISSION	PARALLEL TRANSMISSION
1	In this, the data bits are transmitted serially one after another.	In this, the data bits are transmitted simultaneously.
2	Data is transmitted over a single wire.	Data is transmitted over 8 different wires.
3	It is a cheaper mode of transferring data.	It is relatively expensive mode of transferring data.
4	It is useful for long distance data transmissions.	Not practical for long distance communications as it uses parallel path, so cross talk may occur.
5	It is relatively slower.	It is relatively faster.

(b) Some of the benefits of using Intranet are as follows:

- **Workforce Productivity:** Intranets can help users to locate and view information faster and use applications relevant to their roles and responsibilities. With the help of a web browser interface, users can access data held in any database the organization wants to make available, anytime and - subject to security provisions - from anywhere within the company workstations, increasing employees' ability to perform their jobs faster, more accurately, and with confidence that they have the right information. It also helps to improve the services provided to the users.
- **Time:** With intranets, organizations can make more information available to employees on a "pull" basis (i.e., employees can link to relevant information at a time which suits them) rather than being deluged indiscriminately by emails.
- **Communication:** Intranets can serve as powerful tools for communication within an organization, vertically and horizontally. Intranets are useful to communicate information that has a global reach throughout the organization. By providing this information on the intranet, staffs have the opportunity to keep up-to-date with the strategic focus of the organization.
- **Web publishing:** Intranets 'cumbersome' corporate knowledge is maintained and easily accessed throughout the company using hypermedia and Web technologies. Examples include: employee manuals, benefits documents,

company policies, business standards, newsfeeds, and even training can be accessed using common Internet standards (Acrobat files, Flash files, CGI applications).

- **Business Operations and Management:** Intranets are also being used as a platform for developing and deploying applications to support business operations and decisions across the internetworked enterprise.
- **Cost-effective:** Users can view information and data via web-browser rather than maintaining physical documents such as procedure manuals, internal phone list and requisition forms.
- **Promote Common Corporate Culture:** Every user is viewing the same information within the Intranet.
- **Enhance Collaboration:** With information easily accessible by all authorized users, teamwork is enabled.
- **Cross-platform Capability:** Standards-compliant web browsers are available for Windows, Mac, and UNIX.
- **Planning and Creating an Intranet:** Some of the planning include topics such as the purpose and goals of the intranet, persons or departments responsible for implementation and management, implementation schedules and phase-out of existing systems, defining and implementing security of the intranet, level of interactivity etc.

3. (a) **Virtual Memory:** A programmer has to take into account the size of the memory to fit all his instructions and the data to be operated in the primary storage. If the program is large, then the programmer has to use the concept of virtual memory. Virtual memory systems, sometimes called virtual storage systems, extend primary memory by treating disk storage as a logical extension of RAM. The technique works by dividing a program on disk into fixed-length pages or into logical, variable-length segments. Virtual memory is typically implemented as follows:

- Programs stored on disk are broken up into fixed-length pages. When a program needs to be processed, the first few pages of it are brought into primary memory. Then, the computer system starts processing the program.
- If the computer needs a page it does not have, it brings that page in from secondary storage and overwrites it onto the memory locations occupied by a page it no longer needs. Processing continues in this manner until the program finishes. This is known as overlaying.
- By allowing programs to be broken up into smaller parts, and by allowing only certain parts to be in main memory at any one time, virtual memory enables computers to get by with less main memory than usual.



- (b) Different types of electronic payments are as follows:
- (i) **Credit Cards:** In a credit card transaction, the consumer presents preliminary proof of his ability to pay by presenting his credit card number to the merchant. The merchant can verify this with the bank and create a purchase slip for the consumer to endorse. The merchant then uses this purchase slip to collect funds from the bank, and, on the next billing cycle, the consumer receives a statement from the bank with a record of the transaction.
  - (ii) **Electronic Cheques: Financial Services Technology Corporation (FSTC) and CyberCash** are the two systems that let consumers use electronic cheques to pay Web merchants directly. An electronic cheque has all the same features as a paper cheque. It functions as a message to the sender's bank to transfer funds, and, like a paper cheque, the message is given initially to the receiver who, in turn, endorses the cheque and presents it to the bank to obtain funds. As sender, we can protect ourselves against fraud by encoding our account number with the bank's public key, thereby not revealing our account number to the merchant. As with the SET protocol, digital certificates can be used to authenticate the payer, the payer's bank, and bank account.
  - (iii) **Smart Cards:** Smart cards have an embedded microchip instead of magnetic strip. The chip contains all the information a magnetic strip contains but offers the possibility of manipulating the data and executing applications on the card. Contact Cards, Contactless Cards and Combi Cards are three different types of smart card.
  - (iv) **Electronic Purses:** Electronic purse is very similar to a pre paid card. For Example, Bank issues a stored value cards to its customers, the customer can then transfer value from their accounts to the cards at an ATM, a personal computer, or a specially equipped telephone. The electronic purse card can be used as ATM card as well as a credit card.

4. (a) **Structure of DBMS:**

- (i) **DDL Compiler –**
  - a. It converts data definition statements into a set of tables,
  - b. Tables contain meta data (data about the data) concerning the database,
  - c. It gives rise to a format that can be used by other components of database.
- (ii) **Data Manager –**
  - a. It is the central software component,
  - b. It is referred to as the database control system,
  - c. It converts operations in users' queries to physical file system.

(iii) **File Manager –**

- a. It is responsible for file structure,
- b. It is responsible for managing the space,
- c. It is responsible for locating block containing required record,
- d. It is responsible for requesting block from disk manager,
- e. It is responsible for transmitting required record to data manager.

(iv) **Disk Manager –**

- a. It is a part of the Operating System,
- b. It carries out all physical input / output operations,
- c. It transfers block / page requested by file manager.

(v) **Query Manager –**

- a. It interprets user's online query,
- b. It converts to an efficient series of operations,
- c. In a form it is capable of being sent to data manager,
- d. It uses data dictionary to find structure of relevant portion of database,
- e. It uses information to modify query,
- f. It prepares an optimal plan to access database for efficient data retrieval.

(vi) **Data Dictionary –**

- a. It maintains information pertaining to structure and usage of data and meta data,
- b. It is consulted by the database users to learn what each piece of data and various synonyms of data field means.

(b) **Serial File Organization:** With serial file organization, records are arranged one after another, in no particular order- other than, the chronological order in which records are added to the file. Serial organization is commonly found with transaction data, where records are created in a file in the order in which transactions take place. This type of file organization provides advantages like fast access to next record in sequence, cheap storage media and easy to do file back up facility. The updation can be done very slowly in this file organization.

Records in a serially organized file are sometimes processed in the order in which they occur. For example, when such a file consists of daily purchase and payment transaction data, it is often used to update records in a master account file. Since transactions are in random order by key field, in order to perform this update, records must be accessed randomly from the master file.

**Sequential File Organization:** In a sequential file, records are stored one after another in an ascending or descending order determined by the key field of the records. In payroll example, the records of the employee file may be organized sequentially by employee code sequence. Sequentially organized files that are processed by computer systems are normally stored on storage media such as magnetic tape, punched paper tape, punched cards, or magnetic disks. To access these records, the computer must read the file in sequence from the beginning. The first record is read and processed first, then the second record in the file sequence, and so on. To locate a particular record, the computer program must read in each record in sequence and compare its key field to the one that is needed. The retrieval search ends only when the desired key matches with the key field of the currently read record.

5. (a) **Two Tier Systems:** A two-tier system consists of a client and a server. The database is stored on the server, and the interface used to access the database is installed on the client. The user system interface is usually located in the user's desktop environment and the database management services are usually in a server that is more powerful machine that services many clients. Processing management is split between the user system interface environment and the database management server environment, the database management server provides stored procedures and triggers.

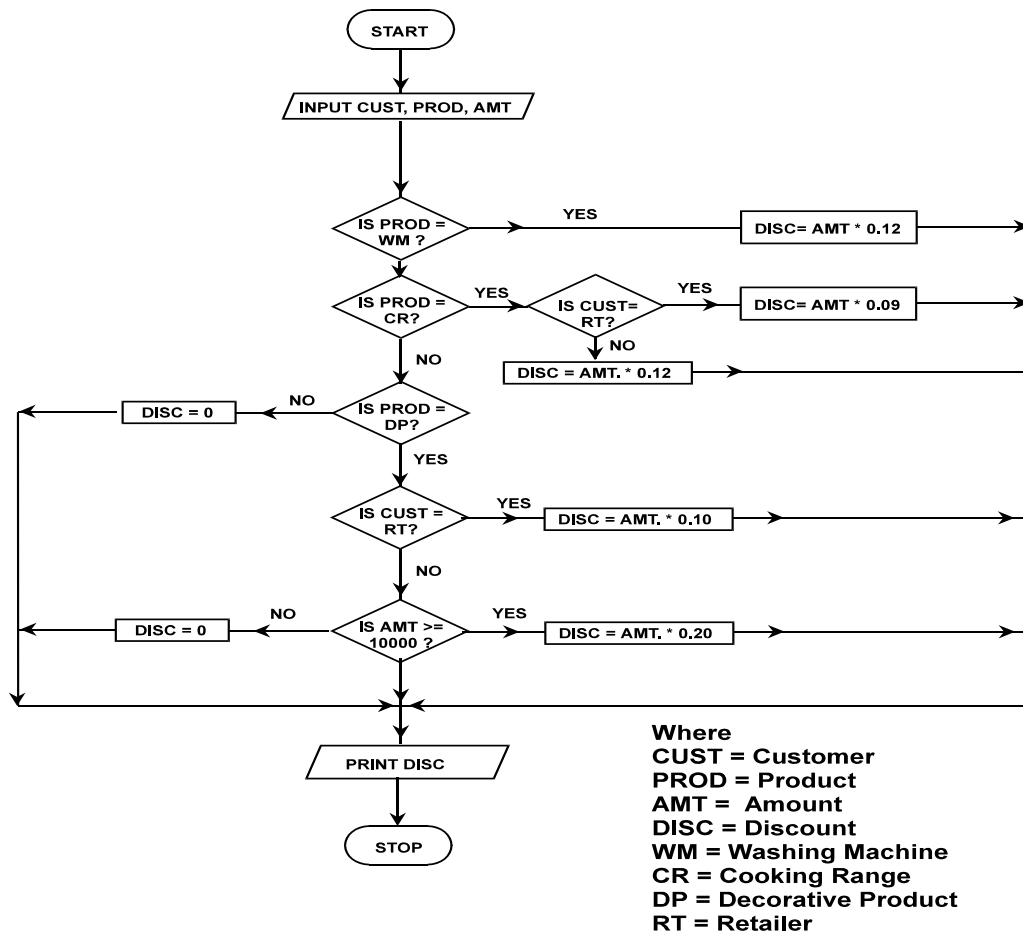
The following are the main objectives of two tier systems:

- (i) It is intended to improve usability by supporting a forms-based, user-friendly interface.
  - (ii) It improves scalability by accommodating up to approx 100 users and improves flexibility by allowing data to be shared, usually within a heterogeneous environment).
  - (iii) It requires minimal operator intervention, and is frequently used in non-complex, non-time critical information processing systems.
- (b) **Disaster Recovery Site:** Data centers need to be equipped with the appropriate disaster recovery systems that minimize downtime for its customers. This means that every data center needs to invest in solutions, such as power backup and remote management. Downtime can be eliminated by having proper Disaster Recovery (DR) plans for mission-critical types of organizations, so as to be prepared when disaster strikes. Some of the larger IT organizations, which cannot tolerate too much downtime, tend to set up their DR site as a hot site, where both the primary and DR sites are kept in real-time synchronization, all the time. The different types of plans are:
- **Cold site:** An alternative facility that is devoid of any resources or equipment,

except air conditioning and raised flooring. Equipment and resources must be installed in such a facility to duplicate the critical business functions of an organization. Cold sites have many variations depending on their communication facilities.

- **Warm site:** An alternate processing site that is only partially equipped, as compared to a hot site, which is fully equipped. It is defined as a backup location that is equipped with computers and hardware similar to those at the original business site, but does not include backed up copies of data and information. It can be shared (sharing servers equipment) or dedicated (own servers).
- **Hot site:** An alternative facility that has the equipment and resources to recover business functions that are affected by a disaster. Hot sites may vary in the type of facilities offered (such as data processing, communications, or any other critical business functions needing duplication). The location and size of the hot site must be proportional to the equipment and resources needed.

6.



7. (a) **Operating System:** The operating system may be defined as an integrated system of programs which supervises the operation of the CPU, controls the input/output functions of the computer system, translates the programming languages into the machine languages and provides various support services. Scheduling Jobs, managing hardware and software resources, maintaining System Security, enabling multiple user resource sharing, handling interrupts and maintain usage records are some of the major tasks of Operating system.
- (b) **Structured Query Language (SQL):** It is a query language which is a set of commands to create, update and access data from a database allowing users to raise adhoc queries/questions interactively without the help of programmers. It is a computer programming language used to manipulate information in relational database management systems (RDBMS).
- (c) **Multiplexer:** It is a device that enables several devices to share one communication line. The multiplexer scans each device to collect and transmit data on a single line

to the CPU, and also communicates transmission from the CPU to the appropriate terminal linked to the multiplexer. The devices are polled and periodically asked whether there is any data to transmit.

- (d) **Bluetooth:** It is telecommunication industry specifications that describe how mobile phones, computer and Personal Digital Assistant (PDAs) can easily be interconnected using a short range wireless connection. It is a short distance wireless connection which use transceiver chip that transmits and receives signals in the frequency band of 2.5 GHz. Using this technology, user of cell phones, pagers and PDAs can buy a 3-in-one phone that can double as a portable phone at home or in the office, get quickly synchronized with information in a desktop or a notebook computer, initiate the sending or receiving of a file, initiate a print- out, and, in general, have all mobile and fixed computer devices be totally coordinated. Connection can be point to point or multipoint.
- (e) **Dependent Data Mart:** A dependent data mart is a physical database stored (in either same or different hardware platform) that receives all its information from the data warehouse. It is a subset of Data Warehouse. The purpose of a data mart is to provide a sub-set of the warehousing data for a specific purpose or to a specific sub-group of the organization. Data Mart may or may not be dependent or related to other data mart in a single organization. They are usually built to achieve improved performance and availability, better control, and lower telecommunication costs resulting from local access of data relevant to a specific department.

**MOCK TEST PAPER – 2**  
**INTERMEDIATE (IPC): GROUP – II**  
**PAPER – 7: INFORMATION TECHNOLOGY AND STRATEGIC MANAGEMENT**  
**SECTION – B: STRATEGIC MANAGEMENT**  
**SUGGESTED ANSWERS/HINTS**

1. (a) The TOWS matrix illustrates how the external opportunities and threats facing a particular corporation can be matched with company's internal strengths and weaknesses to result in possible strategic alternatives to be competitive. It is a good way to use brainstorming and to create alternative strategies that might not otherwise be considered. It forces strategic managers to design various growth, stability or retrenchment strategies. It can be used to generate corporate as well as business strategies.

Moreover, TOWS Matrix is very useful for generating a series of alternatives that the decision makers of a company or business unit might not otherwise have considered. Nevertheless, the TOWS Matrix is only one of the many ways to generate alternative strategies.

In a way TOWS is considered to be an improvement over the SWOT. However, it is not undermining the SWOT analysis.

- (b) An organization can redefine its business by divesting a major product line or market. The divesting can be termed as retrenchment strategy. The enterprise may withdraw from marginal markets, withdraw some brands or sizes of products. It may also withdraw of some slow moving products. In an extreme manner it may seek retirement either from the production or the marketing activity.
- (c) Marketing mix is a systematic way of classifying the key decision areas of marketing management. It is the set of controllable marketing variables that the firm blends to produce the response it wants in the target market. The original framework of marketing mix comprises of 4Ps- product, price, place and promotion. These are subsequently expanded to highlight certain other key decision areas like people, processes, and physical evidence. The elements of original framework are:
- Product: It stands for the “goods-and-service” combination the company offers to the target market.
  - Price: It stands for the amount of money customers have to pay to obtain the product.

- Place: It stands for company activities that make the product available to target consumers and include marketing channel, distribution policies and geographical availability.
  - Promotion: It stands for activities that communicate the merits of the product and persuade target consumers to buy it.
- (d) Supply chain management is an extension of logistic management. However, there are differences between the two. Logistical activities typically include management of inbound and outbound goods, transportation, warehousing, handling of material, fulfillment of orders, inventory management and supply/demand planning. Although these activities also form part of supply chain management, the latter is much broader. Logistic management can be termed as one of its part that is related to planning, implementing, and controlling the movement and storage of goods, services and related information between the point of origin and the point of consumption.

Supply chain management is an integrating function of all the major business activities and business processes within and across organisations. Supply Chain Management is a systems view of the linkages in the chain consisting of different channel partners – suppliers, intermediaries, third-party service providers and customers. Different elements in the chain work together in a collaborative and coordinated manner. Often it is used as a tool of business transformation and involves delivering the right product at the right time to the right place and at the right price.

- (e) Premise control: A strategy is formed on the basis of certain assumptions or premises about the complex and turbulent organizational environment. Premise control is a tool for systematic and continuous monitoring of the environment to verify the validity and accuracy of the premises on which the strategy has been built. It primarily involves monitoring two types of factors:
- (i) Environmental factors such as economic (inflation, liquidity, interest rates), technology, social and regulatory.
  - (ii) Industry factors such as competitors, suppliers, substitutes.

It is neither feasible nor desirable to control all types of premises in the same manner. Different premises may require different amount of control. Thus, managers are required to select those premises that are likely to change and would severely impact the functioning of the organization and its strategy.

2. (a) A lot of changes are occurring within India and across the globe affecting the business. Students should list out different elements of macro environment and discuss the contemporary developments in each of the area. They may develop their answers to cover different elements of environment.



For example in the economic environment, students may briefly list out the impact of the global recession on the Indian Business. They may list different factors such as difficulty in financing through primary market, inflation, low demand in certain sectors such as real estate, etc.

As far as social environment is concerned a new culture is evolving in the country on account of increased global interaction and impact of mass media. There is also increase in awareness. The developments in the legal environment including introduction of new direct tax code, limited liability partnership, GST, etc. have their own bearing on the business. They may also touch upon emerging political paradigm on account of general elections.

- (b) (i) **Incorrect:** SWOT analysis presents the information about both external and internal environment in a structured form to compare external opportunities and threats with internal strengths and weaknesses. This helps in matching external and internal environments so that strategic decision makers in an organisation can come out with suitable strategies by identifying patterns of relationship and develop suitable strategies.
  - (ii) **Correct:** The term PESTLE Analysis is used to describe a framework for analysis of macro environmental factors. It involves identification of political, economic, socio-cultural, technological, legal and environmental influences on an organization and providing a way of scanning the environmental influences that have affected or are likely to affect an organization or its policy. The advantage of this tool is that it encourages management into proactive and structured thinking in its decision making.
3. (a) (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) Strategic groups are conceptually defined clusters of competitors that share similar strategies and therefore compete more directly with one another than with other firms in the same industry. Strong economic compulsions often constrain these firms from switching one competitive posture to another. Any industry contains only one strategic group when all firms essentially have identical strategies and have comparable market positions. At the other extreme, there are as many strategic groups as there are competitors when each rival pursues a distinctively different competitive approach and occupies a substantially different competitive position in the market place.
- (b) A **Mission statement** tells you the fundamental purpose of the organization. It concentrates on the present. It defines the customer and the critical processes. It informs you of the desired level of performance. On the other hand, a **Vision statement** outlines what the organization wants to be. It concentrates on the future.

It is a source of inspiration. It provides clear decision-making criteria.

A mission statement can resemble a vision statement in a few companies, but that can be a grave mistake. It can confuse people. Following are the differences between vision and mission:

The vision describes a future identity while the Mission serves as an ongoing and time-independent guide.

The vision statement can galvanize the people to achieve defined objectives, even if they are stretch objectives, provided the vision is specific, measurable, achievable, relevant and time bound. A mission statement provides a path to realize the vision in line with its values. These statements have a direct bearing on the bottom line and success of the organization.

A mission statement defines the purpose or broader goal for being in existence or in the business and can remain the same for decades if crafted well while a vision statement is more specific in terms of both the future state and the time frame. Vision describes what will be achieved if the organization is successful.

4. The term strategy is associated with unified design and action for achieving major goals, gaining command over the situation with a long-range perspective and securing a critically advantageous position. Strategies are formulated at the corporate, divisional and functional level. Corporate strategies are formulated by the top managers. They include the determination of the business lines, expansion and growth, vertical and horizontal integration, diversification, takeovers and mergers, new investment and divestment areas, R & D projects, and so on. These corporate wide strategies need to be operationalized by divisional and functional strategies regarding product lines, production volumes, quality ranges, prices, product promotion, market penetration, purchasing sources, personnel development and like.

In general, a corporate strategy has the following characteristics:

- It is long-range in nature, though valid for short-range situations.
- It is action oriented and is more specific than objectives.
- It is multi-pronged and integrated.
- It is flexible and dynamic.
- It is formulated at the top management level, though middle and lower level managers are associated in their formulation and in designing sub-strategies.
- It is generally meant to cope with a competitive and complex setting.
- It flows out of the goals and objectives of the enterprise and is meant to translate them into realities.
- It is concerned with perceiving opportunities and threats and seizing initiatives.

- It gives importance to combination, sequence, timing, direction and depth of various moves and action initiatives.
  - It provides unified criteria for managers in function of decision making.
5. Organizations facing significant crisis that has negatively affected operations require turnaround strategy. Turnaround strategy is used when both threats and weaknesses adversely affect the health of an organization so much that its basic survival is a question. When organization is facing both internal and external pressures making things difficult then it has to find something which is entirely new, innovative and different. Once turnaround is successful the organization may turn to focus on growth.

**Conditions for turnaround strategies:** When firms are losing their grips over market, profits due to several internal and external factors, and if they have to survive under the competitive environment they have to identify danger signals as early as possible and undertake rectification steps immediately. These conditions may be, *inter alia*, cash flow problems, lower profit margins, high employee turnover and decline in market share, capacity underutilization, low morale of employees, recessionary conditions, mismanagement, raw material supply problems and so on.

#### **Action plan for turnaround strategy**

**Stage One – Assessment of current problems:** The first step is to assess the current problems and get to the root causes and the extent of damage the problem has caused. Once the problems are identified, the resources should be focused toward those areas essential to efficiently work on correcting and repairing any immediate issues.

**Stage Two – Analyze the situation and develop a strategic plan:** Before you make any major changes; determine the chances of the business's survival. Then, identify appropriate strategies and develop a preliminary action plan. For this one should look for the viable core businesses, adequate bridge financing and available organizational resources. Develop a strategic plan with specific goals and detailed functional actions.

**Stage Three – Implementing an emergency action plan:** If the organization is in a critical stage, an appropriate action plan must be developed to enable the organization to survive. The plan typically includes human resource, financial, marketing and operations actions to restructure debts, improve working capital, reduce costs and so on. A positive operating cash flow must be established as quickly as possible and enough funds to implement the turnaround strategies must be raised.

**Stage Four – Restructuring the business:** The financial state of the organization's core business is particularly important. If the core business is irreparably damaged, then the outlook for the entire organization may be bleak. Prepare cash forecasts, analyze assets and debts, review profits and analyze other key financial functions. During the turnaround, the "product mix" may be changed, requiring the organization to do some repositioning. Core products neglected over time may require immediate attention to remain competitive. Some facilities might be closed; the organization may even withdraw from

certain markets to make organization leaner and focussed. The compensation systems that encourage dedication and creativity must be put in place.

**Stage Five – Returning to normal:** In the final stage of turnaround strategy process, the organization should begin to show signs of profitability, return on investments and enhancing economic value-added. Emphasis is placed on a number of strategic efforts such as carefully adding new products and improving customer service, creating alliances with other organizations, increasing the market share, etc.

6. The organisation can implement the desired changes in its structure, technology and people through three phases of the change process as given by Kurt Lewin. These stages are: **unfreezing, changing and refreezing.**

(i) **Unfreezing the situation:** Unfreezing is the process of breaking down the old attitudes and behaviours, customs and traditions.

(ii) **Changing to new situation:** Once the unfreezing process has been completed, members' behaviour patterns need to be redefined. This can be done through compliance (through rewards and punishment), identification (impressing people to identify with new patterns) and internalisation (changing the thought processes)

(iii) **Refreezing:** Refreezing occurs when the new behaviour becomes a normal way of life replacing the former behaviour completely for successful and permanent change to take place.

Change process is not a onetime application but a continuous process due to dynamism and ever changing environment. The process of unfreezing, changing and refreezing is a cyclical one and remains continuously in action. By the change management process, organizations can better manage the required strategic change. In the given scenario, the company may:

- Create awareness on compelling reasons for change.
- Steer the organization on the desired path with wide acceptance.
- Implement and install the necessary changes in the desired manner for the overall benefit of the organisation.
- Aim to stabilize the operation at a higher level of performance.

7. Business Process Reengineering (BPR) is an approach to unusual improvement in operating effectiveness through the redesigning of critical business processes and supporting business systems. BPR refers to the analysis and redesign of workflows and processes both within the organization and between the organization and the external entities like suppliers, distributors, and service providers.

The orientation of redesigning efforts is basically radical. In other words, it is a total deconstruction and rethinking of business process in its entirety, unconstrained by its existing structure and pattern. Its objective is to obtain quantum jump in process

performance in terms of time, cost, output, quality, and responsiveness to customers. BPR is a revolutionary redesigning of key business processes.

BPR involves the following steps:

1. **Determining objectives and framework:** Objectives are the desired end results of the redesign process which the management and organization attempts to achieve. This will provide the required focus, direction, and motivation for the redesign process. It helps in building a comprehensive foundation for the reengineering process.
2. **Identify customers and determine their needs:** The designers have to understand customers – their profile, their steps in acquiring, using and disposing a product. The purpose is to redesign business process that clearly provides added value to the customer.
3. **Study the existing process:** The existing processes will provide an important base for the redesigners. The purpose is to gain an understanding of the 'what', and 'why' of the targeted process. However, some companies go through the reengineering process with clean perspective without laying emphasis on the past processes.
4. **Formulate a redesign process plan:** The information gained through the earlier steps is translated into an ideal redesign process. Formulation of redesign plan is the real crux of the reengineering efforts. Customer focused redesign concepts are identified and formulated. In this step alternative processes are considered and the best is selected.
5. **Implement the redesign:** It is easier to formulate new process than to implement them. Implementation of the redesigned process and application of other knowledge gained from the previous steps is key to achieve dramatic improvements. It is the joint responsibility of the designers and management to operationalise the new process.