

Test Series: September, 2014

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

Question No. 1 is compulsory.

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

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

Working notes should form part of the answer.

Time Allowed – 3 Hours

Maximum Marks – 100

1. (a) A major fire has damaged the assets in a factory of a Limited Company on 5th April – five days after the year end and closure of accounts. The loss is estimated at Rs. 10 crores out of which Rs. 7 crores will be recoverable from the insurers. Explain briefly how the loss should be treated in the final accounts for the previous year.
- (b) Sohan Ltd. provides you the following information:
- | | |
|----------------------|---------------------------------------|
| Issued capital | 1,00,000 equity shares of Rs. 10 each |
| Reserves and surplus | Capital reserve Rs. 5,00,000 |
| | Securities premium Rs. 9,00,000 |
| | Revenue reserve Rs. 15,00,000 |
- The company resolved to buy 10% of its equity share capital @ Rs. 60 per share. Give the necessary journal entries in the books of Sohan Ltd.
- (c) A loan account remains out of order as on the date of Balance Sheet of a Bank. The account has been classified as doubtful assets (upto 1 year).
- Details of the accounts are:
- | | |
|------------------------|-------------------------------|
| Outstanding | Rs. 6,73,000 |
| ECGC coverage | 25% (Limited to Rs. 1,00,000) |
| Value of security held | Rs. 1,50,000 |
- Compute the necessary provision to be made by a Bank as per applicable rates.
- (d) A company went into liquidation whose creditors are Rs. 36,000. This amount of Rs. 36,000 includes Rs. 6,000 on account of wages of 15 men at Rs. 100 per month for 4 months, immediately before the date of winding up, Rs. 9,000 being the salaries of 5 employees at Rs. 300 per month for the previous 6 months, Rent for godown for the last six months amounting to Rs. 3,000; Income-tax deducted out of salaries of employees Rs. 1,000. In addition it is estimated that the company would

have to pay Rs. 3,000 as compensation to an employees for injuries suffered by him, which was contingent liability not accepted by the company and not included in above said creditors figure.

Find the amount of Preferential Creditors. (4 x 5 = 20 Marks)

2. Ajay Enterprises, a Partnership firm in which A, B and C are three partners sharing profits and losses in the ratio of 4 : 3 : 3. The balance sheet of the firm as on 31st December, 2013 is as below:

Liabilities	Rs.	Assets	Rs.
A' s Capital	15,000	Factory Building	24,160
B' s Capital	7,500	Plant & Machinery	16,275
C' s Capital	15,000	Debtors	5,400
B' s Capital	4,500	Stock	12,390
Sundry Creditor	<u>16,500</u>	Cash at Bank	<u>275</u>
	<u>58,500</u>		<u>58,500</u>

On balance sheet date all the three partners have decided to dissolve their partnership. Since the realization of assets was protracted, they decided to distribute amounts as and when feasible and for this purpose they appoint C who was to get as his remunerations 1% of the value of the assets realized other than cash at Bank and 10% of the amount distributed to the partners.

Assets were realized piecemeal as under:

First instalment	Rs. 18,650
Second installment	Rs. 17,320
Third installment	Rs. 10,000
Last installment	Rs. 7,000
Dissolution expenses were provided for estimated amount of	Rs. 3,000
The creditors were settled finally for	Rs. 15,900

Prepare a statement showing distribution of cash amongst the partners by 'Highest Relative Capital Method'. (16 Marks)

3. (a) M/s. AM Enterprise had two departments, Cloth and Readymade Clothes. The readymade clothes were made by the firm itself out of the cloth supplied by the Cloth Department at its usual selling price. From the following figures, prepare Departmental Trading and Profit & Loss Account for the year ended 31st March, 2012:

	Cloth Department Rs.	Readymade Clothes Department Rs.
Opening stock on 1 st April, 2011	31,50,000	5,32,000
Purchases	2,10,00,000	1,68,000
Sales	2,31,00,000	47,25,000
Transfer to Readymade Clothes Department	31,50,000	-
Manufacturing expenses	-	6,30,000
Selling expenses	2,10,000	73,500
Rent & warehousing	8,40,000	5,60,000
Stock on 31 st March, 2012	21,00,000	6,72,000

In addition to the above, the following information is made available for necessary consideration:

The stock in the Readymade Clothes Department may be considered as consisting of 75% cloth and 25% other expenses. The Cloth Department earned a gross profit at the rate of 15% in 2010-11. General expenses of the business as a whole amount to Rs. 10,85,000.

- (b) Prepare the Fire Insurance Revenue A/c as per IRDA regulations for the year ended 31st March, 2013 from the following details:

	Rs.
Claims paid	4,90,000
Legal expenses regarding claims	10,000
Premiums received	13,00,000
Re-insurance premium paid	1,00,000
Commission	3,00,000
Expenses of management	2,00,000
Provision against unexpired risk on 1 st April, 2012	5,50,000
Claims unpaid on 1 st April, 2012	50,000
Claims unpaid on 31 st March, 2013	80,000

(8 + 8 = 16 Marks)

4. Following is the Balance Sheet of M Ltd. as at 31st March, 2013:

Liabilities	Rs.	Assets	Rs.
15,000, 10% Preference shares of Rs. 100 each	15,00,000	Goodwill	3,50,000
35,000 Equity shares of Rs. 100 each	35,00,000	Land & Buildings	15,00,000

Securities Premium account	1,00,000	Plant & Machinery	10,00,000
7% Debentures of Rs. 100 each	5,00,000	Inventory	6,00,000
Trade payables	12,50,000	Trade receivables	15,00,000
Loan from Director	1,50,000	Cash at bank	1,00,000
		Profit & Loss A/c	<u>19,50,000</u>
	<u>70,00,000</u>		<u>70,00,000</u>

No dividend on Preference shares has been paid for the last 5 years.

The following scheme of reorganization was duly approved by the Tribunal:

- (i) Each Equity share to be reduced to Rs. 25.
- (ii) Each existing Preference share to be reduced to Rs. 75 and then exchanged for 1 new 13% Preference share of Rs. 50 each and 1 Equity share of Rs. 25 each.
- (iii) Preference shareholders have forgone their right for dividend for four years. One year's dividend at the old rate is however, payable to them in fully paid equity Shares of Rs. 25.
- (iv) The Debentureholders be given the option to either accept 90% of their claims in cash or to convert their claims in full into new 13% Preference shares of Rs. 50 each issued at par. One half (in value) of the debentureholders accepted Preference shares for their claims. The rest were paid cash.
- (v) Contingent liability of Rs. 1,50,000 is payable, which has been created by wrong action of one Director. He has agreed to compensate this loss out of the loan given by the Director to the company.
- (vi) Goodwill does not have any value in the present. Decrease the value of Plant and Machinery, Inventory and Trade receivables by Rs. 4,00,000, Rs. 1,00,000 and Rs. 1,50,000 respectively. Increase the value of Land and Buildings to Rs. 18,00,000.
- (vii) 40,000 new Equity shares of Rs. 25 each are to be issued at par, payable in full on application. The issue was underwritten for a commission of 4%.
Shares were fully taken up.
- (viii) The total expenses incurred by the company in connection with the scheme excluding underwriting commission amounted to Rs. 15,000.

Pass necessary Journal Entries to record the above transactions. (16 Marks)

5. (a) X Co. Ltd. has its share capital divided into equity shares of Rs. 10 each. On 1.1.2012 it granted 20,000 employees' stock option at Rs. 50 per share, when the market price was Rs. 120 per share. The options were to be exercised between 15th March, 2013 and 31st March, 2013. The employees exercised their options for 16,000 shares only and the remaining options lapsed. The company closes its books on 31st March every year. Show Journal entries (with narration) as would

appear in the books of the company up to 31st March, 2013.

- (b) A joint stock company resolved to issue 10 lakh equity shares of Rs. 10 each at a premium of Rs. 1 per share. One lakh of these shares were taken up by the directors of the company, their relatives, associates and friends, the entire amount being received forthwith. The remaining shares were offered to the public, the entire amount being asked for with applications.

The issue was underwritten by X, Y and Z for a commission @ 2% of the issue price, 65% of the issue was underwritten by X, while Y's and Z's shares were 25% and 10% respectively. Their firm underwriting was as follows :

X 30,000 shares, Y 20,000 shares and Z 10,000 shares. The underwriters were to submit unmarked applications for shares underwritten firm with full application money along with members of the general public.

Marked applications were as follows:

X 1,19,500 shares, Y 57,500 shares and Z 10,500 shares.

Unmarked applications totaled 7,00,000 shares.

Accounts with the underwriters were promptly settled.

You are required to prepare a statements calculating underwriters' liability for shares other than shares underwritten firm. (8 + 8 = 16 Marks)

6. The following figures are extracted from the books of KLM Bank Ltd. as on 31-03-2013:

	Rs.
Interest and discount received	38,00,160
Interest paid on deposits	22,95,360
Issued and subscribed capital	10,00,000
Salaries and allowances	2,50,000
Directors Fees and allowances	35,000
Rent and taxes paid	1,00,000
Postage and telegrams	65,340
Statutory reserve fund	8,00,000
Commission, exchange and brokerage	1,90,000
Rent received	72,000
Profit on sale of investment	2,25,800
Depreciation on assets	40,000
Statutory expenses	68,000
Auditor's fee	12,000

The following further information is given:

- (1) A customer to whom a sum of Rs. 10 lakhs was advanced has become insolvent and it is expected only 55% can be recovered from his estate.
- (2) There was also other debts for which a provisions of Rs. 2,00,000 was found necessary.
- (3) Rebate on bill discounted on 31-03-2012 was Rs. 15,000 and on 31-03-2013 was Rs. 20,000.
- (4) Income tax of Rs. 2,00,000 is to be provided.

The directors desire to declare 5% dividend.

Prepare the Profit and Loss account of KLM Bank Ltd. for the year ended 31-03-2013 and also show, how the Profit and Loss account will appear in the Balance Sheet if the Profit and Loss account opening balance was NIL as on 31-03-2012. (16 Marks)

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

- (a) A Company had issued 20,000, 13% Convertible debentures of Rs. 100 each on 1st April, 2011. The debentures are due for redemption on 1st July, 2013. The terms of issue of debentures provided that they were redeemable at a premium of 5% and also conferred option to the debenture holders to convert 20% of their holding into equity shares (Nominal value Rs. 10) at a price of Rs. 15 per share. Debenture holders holding 2,500 debentures did not exercise the option. Calculate the number of equity shares to be allotted to the Debenture holders exercising the option to the maximum.
- (b) Compute Basic Earnings per share from the following information:

Date	Particulars	No. of shares
1 st April, 2013	Balance at the beginning of the year	1,500
1 st August, 2013	Issue of shares for cash	600
31 st March, 2014	Buy back of shares	500

Net profit for the year ended 31st March, 2014 was Rs. 2,75,000.

- (c) Explain "monetary item" as per Accounting Standard 11. How are foreign currency monetary items to be recognized at each Balance Sheet date? Classify the following as monetary or non-monetary item:
 - (i) Share Capital
 - (ii) Trade Receivables
 - (iii) Investments
 - (iv) Fixed Assets.

- (d) Santosh Ltd. has received a grant of Rs. 8 crores from the Government for setting up a factory in a backward area. Out of this grant, the company distributed Rs. 2 crores as dividend. Also, Santosh Ltd. received land free of cost from the State Government but it has not recorded it at all in the books as no money has been spent. In the light of AS 12 examine, whether the treatment of both the grants is correct.
- (e) A company is in a dispute involving allegation of infringement of patents by a competitor company who is seeking damages of a huge sum of Rs. 900 lakhs. The directors are of the opinion that the claim can be successfully resisted by the company. How would you deal the same in the annual accounts of the company?

(4 x 4 =16 Marks)

MOCK TEST PAPER - 2
INTERMEDIATE (IPC): GROUP – II
PAPER – 5: ADVANCED ACCOUNTING
SUGGESTED ANSWERS/HINTS

1. (a) As per AS 11 (revised 2003), 'The Effects of Changes in Foreign Exchange Rates', monetary items denominated in a foreign currency should be reported using the closing rate at each balance sheet date. The effect of exchange difference should be taken into profit and loss account. Trade payables is a monetary item, hence should be valued at the closing rate i.e, Rs. 48 at 31st March, 2012 irrespective of the payment for the same subsequently at lower rate in the next financial year. The difference of Rs. 5 (Rs. 48-Rs. 43) per US dollar should be shown as an exchange loss in the profit and loss account for the year ended 31st March, 2012 and is not to be adjusted against the cost of raw- materials. In the subsequent year, the company would record an exchange gain of Re.1 per US dollar, i.e., the difference between Rs. 48 and Rs. 47 per US dollar. Hence, the accounting treatment adopted by the company is incorrect.

(b) **Journal Entries**

		(Rs.)	
		<i>Dr.</i>	<i>Cr.</i>
Equity shares buy back A/c	Dr.	6,00,000	
To Bank A/c			6,00,000
(Being Buy back of 10,000 shares @ Rs. 60)			
Equity share capital A/c	Dr.	1,00,000	
Securities premium A/c	Dr.	5,00,000	
To Equity shares buy back A/c			6,00,000
(Being cancellation of equity shares bought back)			
Revenue reserves A/c	Dr.	1,00,000	
To Capital redemption reserve A/c			1,00,000
(Being amount equal to nominal value of shares bought back transferred to capital redemption reserve)			

(c) Calculation of Preferential Creditors

	Rs.
Tax deducted at source on salaries	1,000
Wages (15 men for 4 months at Rs. 100 each)	6,000
Salaries (5 men for 4 months at Rs. 300 each)	6,000
Workmen's compensation	<u>3,000</u>
Total	<u>16,000</u>

Note:

- (i) Wages or Salaries payable to any employee due for the period not exceeding 4 months within the twelve months next before commencement of winding up subject to maximum 20,000 per claimant are preferential creditors.
- (ii) Rent for godown is not included in preferential creditors.
- (d) According to para 11 of AS 19 "Leases", the lessee should recognise the lease as an asset and a liability at an amount equal to the fair value of the leased asset at the inception of the finance lease. However, if the fair value of the leased asset exceeds the present value of the minimum lease payments from the standpoint of the lessee, the amount recorded as an asset and a liability should be the present value of the minimum lease payments from the standpoint of the lessee. In calculating the present value of the minimum lease payments the discount rate is the interest rate implicit in the lease. Present value of minimum lease payments will be calculated as follows:

Year	Minimum Lease Payment Rs.	Internal rate of return (Discount rate @ 5%)	Present value Rs.
1	6,25,000	0.8696	5,43,500
2	6,25,000	0.7561	4,72,563
3	6,25,000	0.6575	4,10,937
4	<u>7,50,000*</u>	0.5718	<u>4,28,850</u>
Total	<u>26,25,000</u>		<u>18,55,850</u>

Present value of minimum lease payments Rs. 18,55,850 is less than fair value at the inception of lease i.e. Rs. 20,00,000, therefore, the lease liability should be recognized at Rs. 18,55,850 as per AS 19.

* Minimum Lease Payment of 4th year includes guaranteed residual value amounting Rs. 1,25,000.

2. (a) **Balance Sheet of the PQR Pvt. Ltd. as on 1-4-2014**

	Note No.	Rs.
Equity and Liabilities		
Shareholders funds		
Share capital	1	1,90,000
Current liabilities		
Trade Payables		<u>48,000</u>
Total		<u>2,38,000</u>
Assets		
Non-current assets		
Fixed assets		
Tangible assets	2	1,22,000
Intangible assets	3	36,000
Current assets		
Inventories		50,000
Trade Receivables		<u>30,000</u>
Total		<u>2,38,000</u>

Notes to Accounts

	Rs.
1. Share Capital	
Equity share capital 18,000 fully paid shares of Rs. 10 each	1,80,000
Preference share capital (9% Preference Shares)	<u>10,000</u>
(All the shares have been issued for consideration other than cash)	<u>1,90,000</u>
2. Tangible assets	
Plant and Machinery	1,02,000
Fixtures	<u>20,000</u>
	<u>1,22,000</u>
3. Intangible assets	
Goodwill	36,000

(b) **In the books of Partnership Firm**

Partners' Capital Accounts

	P	Q	R		P	Q	R
	Rs.	Rs.	Rs.		Rs.	Rs.	Rs.
To Plant and machinery	3,000	2,000	1,000	By Balance b/d	50,000	30,000	20,000

account								
To Equity shares in PQR Pvt. Ltd.	90,000	60,000	30,000	By Reserve fund	30,000	20,000	10,000	
To 9% Preference shares in PQR Pvt. Ltd.	5,000		5,000	By Realization* A/c (Profit on sale of business)	18,000	12,000	6,000	
	98,000	62,000	36,000		98,000	62,000	36,000	

(c) **Statement showing the final settlement between the Partners taking Q's capital as basis**

	P	Q	R	Total
	Rs.	Rs.	Rs.	Rs.
Value of Equity Shares to be allotted, taking Q's capital as basis P's Capital = $60,000 \times \frac{3}{2}$ R's Capital = $60,000 \times \frac{1}{2}$	90,000	60,000	30,000	1,80,000
Total Value of Equity Shares allotted to P, Q and R				1,80,000
9% Preference Shares to be allotted to P Rs. (95,000-90,000)	5,000			
9% Preference Shares to be allotted to R Rs. (35,000-30,000)			5,000	
Total Value of Preference Shares allotted to P and R				<u>10,000</u>
Total Purchase Consideration				<u>1,90,000</u>

Taking Q's capital as Basis, both P and R have Rs. 5,000 each as excess in their capital account balances. Since interest on capital is meant to compensate those whose capital is in excess of proportionate limits and since in the case of partners it is an appropriation of profit, it will be proper to give 9% preference shares to P and R for Rs. 5,000 each and the remaining amount of Rs. 1,80,000 in the form of Equity Shares to be divided among P, Q and R in the ratio 3:2:1. They will then share the company's profit in the ratio 3:2:1 after allowing preference dividend.

Working Notes:

1. Calculation of goodwill

	2009-10 Rs.	2010-11 Rs.	2011-12 Rs.	2012-13 Rs.	2013-14 Rs.
Profits	10,000	(5,000)	18,000	27,000	30,000

Adjustment for abnormal loss in 2010-11	—	10,000	—	—	—
	10,000	5,000	18,000	27,000	30,000
Total Profit from 2009-10 to 2013-14					90,000
Average Profit (90,000 / 5)					18,000
Goodwill equal to 2 years' purchase					36,000

2 Purchase consideration Computation of Value placed on business:

Assets :	Rs.
Goodwill	36,000
Plant & Machinery	1,02,000
Fixtures	20,000
Stock	50,000
Sundry Debtors	<u>30,000</u>
	<u>2,38,000</u>
Less: Liabilities:	
Creditors	<u>48,000</u>
Purchase Consideration	<u>1,90,000</u>

3. Balance Sheet of Star Ltd. as at 1st April, 2014

Particulars	Note No.	(Rs. in lakhs)
EQUITY AND LIABILITIES		
1 Shareholders' funds		
a) Share capital	1	750
b) Reserves and Surplus	2	875
2 Non-current liabilities		
Long-term borrowings	3	30
3 Current liabilities		
Trade Payables	4	<u>305</u>
Total		<u>1,960</u>
ASSETS		
1 Non-current assets		
a) Fixed assets		
i) Tangible assets	5	775

ii) Intangible assets	6	13
b) Non-current investments	7	100
Other non-current assets	8	50
2 Current assets		
a) Inventories (175+125)		300
b) Trade receivables	9	325
c) Cash and cash equivalents	10	<u>397</u>
Total		<u>1,960</u>

Notes to Accounts

	(Rs. in Lakhs)	
1. Share Capital		
<i>Authorised share capital:</i>		
50,00,000 Equity shares of Rs. 10 each		<u>500</u>
<i>Issued and subscribed:</i>		
50,00,000 Equity shares of Rs. 10 each		500
2,50,000 Preference shares of Rs. 100 each		250
(Of the above shares 35,00,000 equity shares and all preference shares are allotted as fully paid up for consideration other than cash)		
		<u>750</u>
2. Reserves and Surplus		
Securities premium		
Preference shares (2.5 Lakhs x Rs. 50)	125	
Equity shares (35 Lakhs x Rs. 20)	<u>700</u>	825
Investment allowance reserve (25+25)		<u>50</u>
		<u>875</u>
3. Long-term borrowings		
Secured		
15% Debentures (W.N. 2)		30
4. Trade Payables		
Acceptances (75+35)		110
Sundry creditors (135+60)		<u>195</u>
		<u>305</u>

5. Tangible assets	
Land and building (275+200)	475
Plant and machinery (175+125)	<u>300</u>
	<u>775</u>
6. Intangible assets	
Goodwill (10+2+1)	13
7. Non-current investments	
Other non-current investments(75+25)	100
8. Other non-current assets	
Amalgamation adjustment account	50
9. Trade receivables	
Sundry debtors (125+150)	275
Bills receivables (25+25)	<u>50</u>
	<u>325</u>
10. Cash and cash equivalents	
Cash and bank (250+150-3)	397

Working Notes:

1. Computation of Purchase Consideration	<i>Rs. in lakhs</i>	
	<i>Sun Ltd.</i>	<i>Moon Ltd.</i>
(a) Preference shareholders:		
1,50,00,000/100 = 1,50,000 shares		
Share capital = 1,50,000 shares × Rs. 100 each	150	
Securities premium = 1,50,000 shares × Rs. 50 each	<u>75</u>	225
1,00,00,000/100 = 1,00,000 shares		
Share capital = 1,00,000 shares × Rs. 100 each	100	
Securities premium= 1,00,000 shares × Rs. 50 each	<u>50</u>	150
(b) Equity shareholders:		
4,00,00,000/100 × 5 = 20,00,000 shares		
Share capital = 20,00,000 shares × Rs. 10 each	200	
Securities premium=20,00,000 shares× Rs. 20 each	<u>400</u>	600
3,75,00,000/100 × 4 = 15,00,000 shares		

	Share capital = 15,00,000 shares × Rs. 10 each	150	
	Securities premium = 15,00,000 shares × Rs. 20 each	<u>300</u>	450
	Amount of purchase consideration	825	600
2.	Calculation of number of debentures issued	<i>Rs. in lakhs</i>	
		<i>Sun Ltd.</i>	<i>Moon Ltd.</i>
	10% Debentures of Rs. 100 each	30	15
	15% Debentures to be issued to maintain same amount of interest:		
	Interest = Rs. 30,00,000 × 10% = Rs. 3,00,000		
	Value of 15% Debentures = $\frac{₹ 3,00,000}{15} \times 100$	20	
	Interest = Rs. 15,00,000 × 10%		
	Value of 15% Debentures = $\frac{₹ 1,50,000}{15} \times 100$		10
3.	Net assets taken over	<i>Rs. in lakhs</i>	
		<i>Sun Ltd.</i>	<i>Moon Ltd.</i>
	Assets taken over		
	Land and building	275	200
	Plant and machinery	175	125
	Investments	75	25
	Stock	175	125
	Sundry debtors	125	150
	Bills receivable	25	25
	Cash and bank	150	100
	(A)	1,000	750
	Less: Liabilities taken over		
	Debentures	20	10
	Sundry Creditors	135	60
	Bills payable	<u>75</u>	<u>35</u>
	(B)	230	105
	Net assets taken over (A – B)	770	645

Purchase consideration	825	600
(Goodwill)/ Capital Reserve	(55)	45
Net goodwill		(10)

4. As the Liquidation expenses of Sun Ltd. and Moon Ltd., Rs. 2 lakhs and Rs. 1 lakh respectively are borne by Star Ltd. the same will be debited to Goodwill account in the books of Star Ltd.

4. (a) Calculation of Tier I and Tier II Capital

		<i>Rs. in crores</i>	<i>Rs. in crores</i>
(i)	Capital funds – Tier I		
	Equity share capital		750
	Statutory reserve		150
	Securities Premium		150
	Capital reserve (arising out of sale of assets) (90-40)		<u>50</u>
			1,100
	Less: Intangible Assets		<u>(15)</u>
			1,085
	Capital funds – Tier II		
	Capital reserve (arising out of revaluation of assets)	40	
	Less: Discount to the extent of 55%	<u>(22)</u>	<u>18</u>
			<u>1,103</u>
		<i>Rs. in crores</i>	<i>% of risk weight</i>
(ii)	Risk Adjusted Assets		
	Funded Risk Assets		
	Cash balance with RBI	60	0
	Claims on banks	170	20
	Other investments	2,300	100
	Loans and advances:		
	(i) Guaranteed by the government	400	0
	(ii) Granted to staff of bank, fully covered by Super Annuation Benefits and mortgage of Flat/House	50	20

(iii) Other loans and advances	6,170	100	6,170
Other assets			
Premises, furniture and fixtures and other assets	3,925	100	<u>3,925</u>
			<u>12,439</u>

	<i>Rs. in crores</i>	<i>Credit conversion factor</i>	
Off-Balance Sheet items: Acceptances, endorsements and Letters of credit, Guarantees and other obligations	1,550	100	<u>1,550</u>
			<u>13,989</u>

$$\text{Capital Adequacy Ratio} = \frac{\text{Capital fund}}{\text{Risk adjusted assets + off balance sheet items}} \times 100 =$$

$$\frac{\text{₹ 1,103 crores} \times 100}{\text{₹ 13,989 crores}} = 7.89\%$$

(b) **Journal Entries**

			Rs.	Rs.
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 Rs.10 each at a premium of Rs.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)			

5. (a)

**Departmental Trading and Profit and Loss Account
for six months ending 31.3.2012**

Particulars	X	Y	Z	Particulars	X	Y	Z
	Rs.	Rs.	Rs.		Rs.	Rs.	Rs.
To Purchases	70,350	45,300	32,200	By Sales	75,000	50,000	12,500
To Gross Profit c/d	<u>34,700</u>	<u>14,850</u>	<u>2,600</u>	By Closing Stock	<u>30,050</u>	<u>10,150</u>	<u>22,300</u>
	<u>1,05,050</u>	<u>60,150</u>	<u>34,800</u>		<u>1,05,050</u>	<u>60,150</u>	<u>34,800</u>
To Salaries & Wages	6,000	12,000	6,000	By Gross Profit b/d	34,700	14,850	2,600
To Rent	4,700	4,700	1,500	By Net Loss (Departmental)	-	1,850	4,900
To Net Profit (Departmental)	<u>24,000</u>						
	<u>34,700</u>	<u>16,700</u>	<u>7,500</u>		<u>34,700</u>	<u>16,700</u>	<u>7,500</u>

**General Profit and Loss Account
for six months ending 31.3.2012**

Particulars	Rs.	Particulars	Rs.
To Profit & Loss A/c (Dept. Y)	1,850	By Profit & Loss A/c (Dept. X)	24,000
To Profit & Loss A/c (Dept. Z)	4,900		
To Profit (to be transferred to Balance Sheet)	<u>17,250</u>		
	<u>24,000</u>		<u>24,000</u>

Working Notes:

- (i) Salaries and wages are to be allocated first between show room and workshop in the ratio of 3:1 i.e. Rs.18,000 and Rs. 6,000. Work shop salaries are to be charged to Dept. Z.
- (ii) Since, Dry cleaners and Dumpsters are sold at show room, salaries are to be allocated to Dept. 'X' and Dept. 'Y' respectively in the ratio of 1 : 2.
- (iii) Rent to workshop at Rs. 250 p.m. for six months, Rs. 1,500 is to be charged to Dept. 'Z' first and the balance Rs. 9,400 is to be divided equally between Dept. 'X' and 'Y'.

(b) **In the books of Head Office**
Journal Entries

	<i>Particulars</i>	<i>Dr.</i> <i>Amount</i> <i>Rs.</i>	<i>Cr.</i> <i>Amount</i> <i>Rs.</i>
(i)	Loss of goods due to theft during transit Dr. To Purchases account (Being goods lost on account of theft during transit)	12,000	12,000
(ii)	Salaries account Dr. To Branch account (Being salary paid by the branch for H.O. employee)	15,000	15,000
(iii)	No entry in the books of head office for goods sent to branch not received by branch till 31st March 2012		
(iv)	Cash in transit account Dr. To Branch account (Being remittance by branch not received by 31st March, 2012)	10,000	10,000
(v)	Branch account Dr. To Purchases account (Being rectification of entry for payment for goods purchased by branch wrongly debited to purchase account)	25,000	25,000

Note:

- In entry (i), it is assumed that refusal of branch manager (to accept liability of stolen goods) is accepted by the Head Office. Alternatively, Branch account will be credited on the basis of assumption that refusal of branch manager is not accepted by the Head Office.
- In entry (iii) the goods in transit entry will be passed in the Books of the Branch.

6. (a)

FORM B-RA

Name of the Insurer: Bigfish Marine Insurance Ltd.

Revenue Account for the year ended 31st March, 2014

Particulars	Schedule	Rs.
Premium earned (Net)	1	16,72,800
Profit on sale of investment		46,000

Interest, dividend and rent (Gross)		<u>1,65,250</u>
Total (A)		<u>18,84,050</u>
Claims incurred (Net)	2	12,00,000
Commission	3	1,94,000
Operating expenses related to insurance business	4	<u>3,75,000</u>
Total (B)		<u>17,69,000</u>
Profit for Marine Insurance Business (A-B)		1,15,050

Schedule -1

Premium Earned (Net)	Rs.
Premium received	18,75,000
Add: Outstanding premium as on 31.03.2014	<u>1,25,000</u>
	20,00,000
Less: Premium on reinsurance ceded	<u>(2,28,000)</u>
	17,72,000
Less: Adjustment for change in reserve for unexpired risk (Refer W.N. 1)	<u>(99,200)</u>
Net premium earned	<u>16,72,800</u>

Schedule -2

Claim Incurred (Net)	Rs.
Claim paid	10,54,000
Add: Surveyor's fee & legal expenses paid for settlement of claim (Rs. 45,000 + Rs. 65,000)	1,10,000
Add: Outstanding claims as on 31.03.2014	<u>2,25,000</u>
	13,89,000
Less: Outstanding claims as on 01.04.2013	<u>(1,89,000)</u>
Claim incurred (Net)	<u>12,00,000</u>

Schedule -3

Commission	Rs.
Commission paid	<u>1,94,000</u>

Schedule -4

Operating expenses related to insurance business	Rs.
Expenses of Management	4,85,000
Less: Surveyor's fee & legal expenses	<u>(1,10,000)</u>
	<u>3,75,000</u>

Working Notes:**1. Calculation for change in Reserve for Unexpired Risk**

		Rs.
Unexpired risk reserve at the beginning (including additional reserve)		18,50,000
Less: Reserve for unexpired risk as on 31.03.2014 (100% of Rs. 17,72,000)	17,72,000	
Additional reserve as on 31.03.2014 (10% of Rs. 17,72,000)	<u>1,77,200</u>	<u>(19,49,200)</u>
Change in provision for unexpired risk		<u>99,200</u>

2. Income tax on interest and dividend Rs. 49,575 is part of Profit & Loss Account, therefore, not given effect to in the Revenue Account.

(b) Statement showing net liability of underwriters (No. of shares)

	A	B	C	Total
Gross liability	20,000	12,000	8,000	40,000
Less: Unmarked applications in the Gross Liability ratio of 5:3:2	<u>(1,000)</u>	<u>(600)</u>	<u>(400)</u>	<u>(2,000)</u>
	19,000	11,400	7,600	38,000
Less: Marked applications	<u>(16,000)</u>	<u>(5,700)</u>	<u>(8,300)</u>	<u>(30,000)</u>
	3,000	5,700	(700)	8,000
Credit of C's surplus to A and B in the ratio of 5:3	<u>(438)</u>	<u>(262)</u>	<u>700</u>	<u>-</u>
Net liability	<u>2,562</u>	<u>5,438</u>	<u>-</u>	<u>8,000</u>

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 Rs. 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 Rs. 25 crores. Here, no intangible asset or other asset is acquired or created that can be recognised. Therefore, the accounting treatment by the company of debiting the entire advertising expenditure of Rs. 2 crores to the Profit and Loss account of the year is correct.

- (b) As per para 29 of AS 29 'Provisions, Contingent Liabilities and Contingent Assets', a past event will lead to present obligation when the enterprise has no realistic alternative to settle the obligation created by the past event.

However, when environmental damage is caused there may be no obligation to remedy the consequences. The causing of the damage will become an obligating event when a new law requires the existing damage to be rectified. Where details of a proposed new law have yet to be finalised, an obligation arises only when the legislation is virtually certain to be enacted.

In the given case it is virtually certain that law will be enacted requiring clean-up of a land already contaminated. Therefore, an oil company has to provide for such clean up cost in the year in which the law is virtually certain to be enacted.

(c) Earnings for the year = No. of Shares x Basic EPS

$$= 30,00,000 \text{ shares} \times \text{Rs. } 5 \text{ per share} = \text{Rs. } 1,50,00,000$$

Adjusted net profit for the current year = Earnings for the year + Interest on debentures (net of tax) = 1,50,00,000 + (6,00,000 – 1,80,000) = Rs. 1,54,20,000

No. of equity shares resulting from conversion of debentures

$$= 50,000 \times 10 \text{ shares} = 5,00,000 \text{ shares}$$

Total number of equity shares for diluted EPS = 30,00,000 + 5,00,000

$$= 35,00,000 \text{ shares.}$$

Diluted earnings per share = Rs. 1,54,20,000 / 35,00,000 shares

$$= \text{Rs. } 4.4 \text{ per share.}$$

(d) 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 31st 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 debtors exists before finalisation of financial statements. Therefore, provision for doubtful debts should be made for the year ended on 31st March, 2012.

(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 unamortized 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 Rs. 300 lakhs and balance in deferred income is Rs. 210 lakhs. Therefore, Rs. 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 Rs. 300 lakhs. The increased cost of Rs. 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: September, 2014

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

Question No.1 is compulsory.

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

Time Allowed – 3 Hours

Maximum Marks – 100

1. *Discuss with reference to SAs:*
 - (a) The auditor shall communicate all significant findings with those charged with Governance. *(5 Marks)*
 - (b) Factors effecting form, contents and extent of audit. *(5 Marks)*
 - (c) Factors that are to be considered while designing a confirmation request. *(5 Marks)*
 - (d) “Auditor shall establish an overall strategy that sets the scope, timing and directions of the audit, and that guides the development of the audit plan.” *(5 Marks)*
2. State with reason (in short) whether the following statements are true or false. (Answer any eight):
 - (i) The overall objective of audit does not change in Computer Information System (CIS) environment.
 - (ii) Interim dividend is not a part of dividend.
 - (iii) Comptroller and Auditor General of India can be removed by the Prime Minister of India on the recommendation of his Council of Ministers.
 - (iv) “Examination in depth” implies that the auditor vouches almost all transactions in a manner that the chances of not checking any transaction are left at minimum.
 - (v) The first auditors appointed by the board of directors can be removed by the board at its subsequent meeting.
 - (vi) SA 620 is applicable when an auditor seeks legal opinion from an advocate.
 - (vii) If there is difference of opinion among the joint auditors with regard to any matter, majority joint auditors opinion will prevail while reporting.
 - (viii) Procedural error arises as a result of transactions having been recorded in a fundamentally incorrect manner.
 - (ix) An auditor may be removed from office before the expiry of his term, by the company in general meeting.

- (x) Taking management representation is a convenient, economical and equally acceptable auditing method even where the direct access by auditor to audit evidence is possible. *(8 x 2 = 16 Marks)*
3. (a) What is "Audit Evidence"? *(2 Marks)*
- (b) What are the various methods of obtaining audit evidence? Mention the same in brief. *(6 Marks)*
- (c) Comment on the following:
- (i) NM & Co., chartered accountants were appointed as the auditors of a public limited company in their Annual General Meeting. Various co-operative and term lending institutions held 51% of the paid-up share capital of the company.
- (ii) Mr. L, a chartered accountant in full-time practice, was acting as the statutory auditor of a public limited company, till it was wound up. Mr. L was appointed as the liquidator for purposes of winding up proceedings. *(2 x 4 = 8 Marks)*
4. (a) Give various factors which result in increase in Gross profit. *(8 Marks)*
- (b) Define depreciation and discuss various purposes of providing depreciation. *(8 Marks)*
5. (a) Mention the eight important points which an auditor will consider while conducting the audit of educational institutions. *(8 Marks)*
- (b) What special steps will you take into consideration in auditing the accounts of a hotel? *(8 Marks)*
6. (a) Ram Ltd. Co. gave a donation of Rs. 1,50,000 each to a Charitable Society running a school and a trust set up for the service of Blind during financial year ending on 31st March, 2014. The average net profits of the company for the last three years were Rs. 45 lakhs. Comment. *(6 Marks)*
- (b) Explain the meaning of term "Subsequent Events" as used in the SA560. Should all types of subsequent events be considered by the auditor in his attest functions? *(6 Marks)*
- (c) How will you verify/ vouch the retirement gratuity to employees? *(4 Marks)*
- 7 Write short notes on any four of the following:
- (a) Audit of Expenditure in Government Audit
- (b) Disclaimer of Opinion.
- (c) Disadvantages of the use of an audit programme.
- (d) Audit Techniques.
- (e) Simple random sampling. *(4 x 4 = 16 Marks)*

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

1. (a) **As per SA-260 “Communication with Those Charged with Governance”**, the auditor shall communicate the following significant findings from the audit, with those charged with governance:
- (i) The auditor’s views about significant qualitative aspects of the entity’s accounting practices, including accounting policies, accounting estimates and financial statement disclosures. When applicable, the auditor shall explain to those charged with governance why the auditor considers a significant accounting practice, that is acceptable under the applicable financial reporting framework, not to be most appropriate to the particular circumstances of the entity;
 - (ii) Significant difficulties, if any, encountered during the audit;
 - (iii) Unless all of those charged with governance are involved in managing the entity:
 - (1) Significant matters, if any, arising from the audit that were discussed, or subject to correspondence with management; and
 - (2) Written representations the auditor is requesting; and
 - (iv) Other matters, if any, arising from the audit that, in the auditor’s professional judgment, are significant to the oversight of the financial reporting process.
- (b) **As per SA-230 on “Audit Documentation”**, the form, content and extent of audit documentation depend on the following factors:
- (i) The size and complexity of the entity.
 - (ii) The nature of the audit procedures to be performed.
 - (iii) The identified risks of material misstatement.
 - (iv) The significance of the audit evidence obtained.
 - (v) The nature and extent of exceptions identified.
 - (vi) The need to document a conclusion or the basis for a conclusion not readily determinable from the documentation of the work performed or audit evidence obtained.
 - (vii) The audit methodology and tools used.

(c) **As per SA -505 “External Confirmations”**, the design of a confirmation request may directly affect the confirmation response rate, and the reliability and the nature of the audit evidence obtained from responses. **The following factors should be considered while designing a confirmation request:-**

- (i) The assertions being addressed.
- (ii) Specific identified risks of material misstatement, including fraud risks.
- (iii) The layout and presentation of the confirmation request.
- (iv) Prior experience on the audit or similar engagements.
- (v) The method of communication
- (vi) Management’s authorisation to the confirming parties to respond to the auditor. Confirming parties may only be willing to respond to a confirmation request containing management’s authorisation.
- (vii) The ability of the confirming party to provide the requested information.

(d) **Establishment of overall strategy for development of audit plan:** According to SA 300, “Planning an Audit of Financial Statements” the auditor shall establish an overall audit strategy that sets the scope, timing and directions of the audit, and that guides the development of the audit plan.

In establishing the overall audit strategy, the auditor shall:

- (i) Identify the characteristics of the engagement that define its scope;
- (ii) Ascertain the reporting objectives of the engagement to plan the timing of the audit and the nature of the communications required;
- (iii) Consider the factors that, in the auditor’s professional judgment, are significant in directing the engagement team’s efforts;
- (iv) Consider the results of preliminary engagement activities and, where applicable, whether knowledge gained on other engagements performed by the engagement partner for the entity is relevant; and
- (v) Ascertain the nature, timing and extent of resources necessary to perform the engagement.

2. (i) **True** : Overall objective of audit does not change in Computer Information System (CIS) environment. But the use of computer changes the processing and storage, retrieval and communication of financial information.
- (ii) **False** : The definition of dividend has been amended by the Companies (Amendment) Act, 2000 where the interim dividend has been treated as part of dividend. With an amendment in Section 205, the interim dividend has been brought at par with dividends declared in the normal course.

- (iii) **False** : The Comptroller and Auditor General of India cannot be removed by the Prime Minister of India on the recommendation of his Council of Ministers. He can be removed on the ground of proven misbehavior or incapacity, when each House of Parliament decides to do so by majority of not less than 2/3 of the members of the house present and voting.
 - (iv) **False** : Examination in depth implies examination of a few selected transactions from the beginning to the end through the entire flow of the transaction. This examination consists of studying the recording of transactions at the various stages through which they have passed. At each stage, relevant records and authorities are examined; it is also judged whether the person who has exercised the authority in relation to the transactions is fit to do so in terms of the prescribed procedure.
 - (v) **False** : The first auditor appointed by the board of directors may be removed at general meeting of the shareholders and not meeting of the board of directors.
 - (vi) **True** : SA 620 on using the work of an expert applies when the auditor seeks opinion/reports of an expert on any audit matter. Therefore, SA 620 is applicable when an auditor seeks legal opinion from an advocate.
 - (vii) **False** : As per SA 299 “Responsibility of Joint Auditors”, where the joint auditors are in disagreement with regard to any matter to be covered by the audit report, each one of them should express his own opinion through a separate report.
 - (viii) **False** : Procedural error arises when there is error in implementation of the procedure. If transaction has been recorded in a fundamentally incorrect manner it will result in error of principle.
 - (ix) **False** : As per Section 224(7), the auditor may be removed from the office before the expiry of his term by the company in general meeting obtaining the prior approval of the Central Government. But such approval is not required for the removal of the first auditor appointed by the Board of Directors.
 - (x) **False** : Where it is possible for auditor to check the transaction by himself through direct access, it is not fair for him to merely rely the management representation as prime audit evidence.
3. (a) **Audit Evidence:** As per SA 500 “Audit evidence” Information used by the auditor in arriving at the conclusions on which the auditor’s opinion is based. Audit evidence includes both information contained in the accounting records underlying the financial statements and other information.
- (b) **Methods of Obtaining Audit Evidence:** The auditor obtains evidence by one or more of the following methods:
- Inspection:** Inspection involves examining records or documents, whether internal or external, in paper form, electronic form, or other media, or a physical examination of an asset. Inspection of records and documents provides audit evidence of varying

degrees of reliability, depending on their nature and source and, in the case of internal records and documents, on the effectiveness of the controls over their production. An example of inspection used as a test of controls is inspection of records for evidence of authorisation.

Some documents represent direct audit evidence of the existence of an asset, for example, a document constituting a financial instrument such as a inventory or bond. Inspection of such documents may not necessarily provide audit evidence about ownership or value. In addition, inspecting an executed contract may provide audit evidence relevant to the entity's application of accounting policies, such as revenue recognition.

Inspection of tangible assets may provide reliable audit evidence with respect to their existence, but not necessarily about the entity's rights and obligations or the valuation of the assets. Inspection of individual inventory items may accompany the observation of inventory counting.

Observation: Observation consists of looking at a process or procedure being performed by others, for example, the auditor's observation of inventory counting by the entity's personnel, or of the performance of control activities. Observation provides audit evidence about the performance of a process or procedure, but is limited to the point in time at which the observation takes place, and by the fact that the act of being observed may affect how the process or procedure is performed.

External Confirmation: An external confirmation represents audit evidence obtained by the auditor as a direct written response to the auditor from a third party (the confirming party), in paper form, or by electronic or other medium. External confirmation procedures frequently are relevant when addressing assertions associated with certain account balances and their elements. However, external confirmations need not be restricted to account balances only. For example, the auditor may request confirmation of the terms of agreements or transactions an entity has with third parties; the confirmation request may be designed to ask if any modifications have been made to the agreement and, if so, what the relevant details are. External confirmation procedures also are used to obtain audit evidence about the absence of certain conditions, for example, the absence of a "side agreement" that may influence revenue recognition.

Recalculation: Recalculation consists of checking the mathematical accuracy of documents or records. Recalculation may be performed manually or electronically.

Reperformance: Repformance involves the auditor's independent execution of procedures or controls that were originally performed as part of the entity's internal control.

Analytical Procedures: Analytical procedures consist of evaluations of financial information made by a study of plausible relationships among both financial and

non-financial data. Analytical procedures also encompass the investigation of identified fluctuations and relationships that are inconsistent with other relevant information or deviate significantly from predicted amounts.

Inquiry: Inquiry consists of seeking information of knowledgeable persons, both financial and non-financial, within the entity or outside the entity. Inquiry is used extensively throughout the audit in addition to other audit procedures. Inquiries may range from formal written inquiries to informal oral inquiries. Evaluating responses to inquiries is an integral part of the inquiry process.

Responses to inquiries may provide the auditor with information not previously possessed or with corroborative audit evidence. Alternatively, responses might provide information that differs significantly from other information that the auditor has obtained, for example, information regarding the possibility of management override of controls. In some cases, responses to inquiries provide a basis for the auditor to modify or perform additional audit procedures.

Although corroboration of evidence obtained through inquiry is often of particular importance, in the case of inquiries about management intent, the information available to support management's intent may be limited. In these cases, understanding management's past history of carrying out its stated intentions, management's stated reasons for choosing a particular course of action, and management's ability to pursue a specific course of action may provide relevant information to corroborate the evidence obtained through inquiry.

In respect of some matters, the auditor may consider it necessary to obtain written representations from management and, where appropriate, those charged with governance to confirm responses to oral inquiries.

- (c) (i) **Appointment of Auditors** : The implication of shareholding of 51% of paid-up capital by various co-operative and term lending institutions is two fold as discussed below:

In terms of Section 224A of the Companies Act, 1956, a company in which not less than 25% of the subscribed share capital is held, whether singly or in any combination, by:

- (1) a public financial institution or a Government company or the Central Government or any state government; or
- (2) any financial or other institution established by any Provincial or State Act in which a State Government holds not less than 51% of subscribed share capital; or
- (3) a nationalised bank or an insurance company carrying on general insurance business,

the appointment or re-appointment of an auditor in the Annual General Meeting

shall be made only by passing a special resolution.

In this case, NM & Co. were appointed as auditors of the public limited company where 51% of the paid-up share capital was held by co-operatives and term lending institutions. Presuming that such institutions are covered by the aforesaid criteria, passing a special resolution was necessary. Hence, the appointment of NM & Co., chartered accountants, was null and void provided such institutions are covered by Section 224A.

Section 619 B read with Section 619 of the Companies Act, 1956 requires that a company in which the central government or any state government or any government company or any government corporation hold either singly or jointly not less than 51% of the paid-up share capital, the auditors of such companies are to be appointed by the central government on the advice of the Comptroller and Auditor General of India.

However, the co-operative and term lending institutions are not covered within the definition of corporation/institution owned by the Central/State Government. Accordingly, the provisions of Section 619 will not apply in this case, although the co-operatives and term lending institutions hold majority share capital.

- (ii) **Appointment of auditor as a liquidator:** The Chartered Accountants Regulations allows a chartered accountant in practice, subject to the control of the Council, to act as a liquidator. But a chartered accountant at the same time cannot act both as liquidator and auditor of the company.

The Institute of Chartered Accountants of India, in order to establish a healthy convention, recommended that in cases where a chartered accountant acts as a liquidator, the statement of accounts to be filed u/s 551(1) of the Companies Act, 1956 should be audited by a qualified chartered accountant other than the chartered accountant who is the liquidator of the company.

The appointment of Mr. L, chartered accountant, to carry out both the functions as a liquidator and as an auditor will not be proper having regard to the concept of auditor's independence. Thus Mr. L, chartered accountant, cannot act both as the liquidator and the auditor.

4. (a) Factors which increase the gross profit:

- (i) Undervaluation of opening stock; it may be either the effect of non-inclusion of certain items of stocks or that of valuation of the stock at a rate lower than that warranted by the basis of valuation adopted or miscalculation of the value of one or more items of stock. In such a case, the increase in the rate of gross profit would be preceded by a fall in the rate of gross profit in the previous year.
- (ii) Overvaluation of closing stock, either by the inclusion therein of fictitious items

of stock or over-statement of values of some of them.

- (iii) Alteration of the basis of valuation of closing stock, e.g., where the opening stock was valued at cost or market rate whichever was lower, valuing the closing stock at the market price which is higher than cost.
- (iv) Increase in the value of some of the items included in the opening stock above cost, on account of which the unsold stock of these items at the close of the year is valued at cost.
- (v) Under-statement of opening stock or over-statement of closing stock, due to adjustment of the amount of sales, when goods sold but not delivered are included in the closing stock or when goods were delivered and taken out of stock last year, but sales invoices is raised in the current year.
- (vi) Entry of fictitious purchases to boost up the profits, if such a practice has been resorted to, it would have the effect of reducing the rate of gross profit in the ensuing year.
- (vii) Inclusion in the closing stock of goods returned awaiting despatch to supplier, the cost of which has been debited to them or goods returned by customers, the cost whereof has not been credited to parties.
- (viii) Inclusion in the closing stock of goods received for the sale on approval or on a consignment basis.
- (ix) Treatment of goods sent out for sale on consignment basis as regular sales.
- (x) No provision or under-provision in the expenses accounts included in the Trading Account. For example, purchase may be understated; provision for outstanding wages or carriage inward may not have been made.
- (xi) Wrong allocations of expenses, e.g., carriage inwards either in whole or in part may be wrongly taken to the Profit and Loss Account.

(b) Depreciation:

Definition : According to AS-6 “Depreciation Accounting” issued by the Institute of Chartered Accountants of India “Depreciation is a measure of the wearing out, consumption or other loss of value of a depreciable asset arising from use, effluxion of time, obsolescence through technology and market charges. 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 usefulness is predetermined”.

The term “depreciable amount” of a depreciable asset as per the standard is its historical cost, or other amount substituted for historical cost in the financial statements less the estimated residual value.

The accounting standard recommends that the depreciable amount of a depreciable asset should be allocated on a systematic basis to each accounting period during the useful life of the asset.

Purpose of Providing Depreciation:

- (i) **To keep capital intact:** It will be evident that one of the effects of providing for depreciation on an asset is to retain an amount (equal to the proportion of the cost of the asset employed in the business that has run off, estimated on the basis of the period of its working life and its scrap value) in the business out of the profits in each year.
- (ii) **To ascertain cost accurately:** Unless a proper charge on account of depreciation is included in the Profit and Loss Account, the true cost of manufacture of different products will not be ascertained. This is because depreciation is as much a charge against revenue as any other expenditure and must be included in accounts irrespective of the fact whether the final result of a working is profit or loss.
- (iii) **To charge initial costs against earnings :** The cost of a machine less its scrap value can, in effect, be regarded as the price for use of the machine paid in advance for the period it will be rendering service. According to this view unless an appropriate part of this price is charged to the profits of the business each year, the profit earned on its working will not be correctly ascertained.
- (iv) **To prepare true and fair statements:** Unless depreciation is provided, the assets will be shown at an amount higher than their true value and the profit shown will be more than the real profit. In other words, the Balance Sheet and the Profit and Loss Account will not be true and fair.

5. (a) Audit of Educational Institutions : The important points which an auditor should consider while conducting the audit of education institutions are as follows:

- (i) Examine the Trust Deed or Regulations, in the case of school or college and note all the provisions affecting accounts. In the case of a university, refer to the Act of Legislature and the Regulation framed thereunder.
- (ii) Read through the minutes of the meetings of the Managing Committee or Governing Body, noting resolutions affecting accounts to see that these have been duly complied with, specially the decisions as regards the operation of bank accounts and sanctioning of expenditure.
- (iii) Check names entered in the Students Fee Register for each month or term, with the respective Class Registers, showing names of students on rolls and test amount of fees charged; and verify that there operates a system of internal check which ensures that demands against the students are properly raised.
- (iv) Check fees received by comparing counterfoils of receipts granted with entries

in the Cash Book and tracing the collections in the Fee Register to confirm that the revenue from this source has been duly accounted for.

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

sanction for the Committee as contained in the minute book.

- (xix) Vouch, in the usual manner, all establishment expenses and enquire into any unduly heavy expenditure under any head. If there was any annual budget prepared, see that any excess under any head over the amount budget was duly sanctioned by the Managing Committee. If not, bring it to the Committee's notice in your report.
 - (xx) See that increase in the salaries of the staff have been sanctioned and minuted by the Committee.
 - (xxi) Ascertain that the system ordering inspection on receipt and issue of provisions, foodstuffs, clothing and other equipment is efficient and all bills are duly authorised and passed before payment.
 - (xxii) Verify the inventories of furniture, stationery, clothing, provision and all equipment etc. These should be checked by reference to Stock Register or corresponding inventories of the previous year and values applied to various items should be test checked.
 - (xxiii) Confirm that the refund of taxes deducted from the income from investment (interest on securities etc.) has been claimed and recovered since the institutions are generally exempted from the payment of income-tax.
 - (xxiv) Finally, verify the annual statements of account and, while doing so see that separate statements of account have been prepared as regards Poor Boys Fund, Games Fund, Hostel and Provident Fund of staff, etc.
- (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) **Donation to Charitable Institutions:** Section 181 of the Companies Act, 2013 provides that the Board of Directors of a company may contribute to bona fide charitable and other funds with prior permission of the company in general meeting for such contribution in case any amount the aggregate of which, in any financial year, exceed five per cent of its average net profits for the three immediately preceding financial years.

Facts of the case: In the instant case, the company has given donation of Rs. 1,50,000/- each to the two charitable organisations which amounts to Rs. 3,00,000. Assuming that the charitable organisations are not related to the business of the company, the average profits of the last 3 years is Rs. 45 lakhs and the 5% of this works out to Rs. 2,25,000. Hence the maximum of donation could be Rs. 2,25,000 only. For excess of Rs. 75,000 the company is required to take prior permission in general meeting which is not been taken.

Conclusion: By paying donations of Rs. 1,50,000 which is more than Rs. 75,000, the Board has contravened the provisions of Section 181 of the Companies Act, 2013.

- (b) **Meaning of Subsequent Events :** SA 560 on “Subsequent Events”, defines the term ‘subsequent events’ as events occurring between the date of the financial statements and the date of the auditor’s report, and facts that become known to the auditor after the date of the auditor’s report, “subsequent events” also refer to significant events which occurred up to the date of report of the auditor of that component. Thus, subsequent events are those events which occur after the date of the balance sheet till the audit report is signed by the auditor.

Consideration of Subsequent Events by the Auditor : SA 560 requires that the auditor should consider the effect of subsequent events on the financial statements and the auditor’s report. However, the exact manner of treatment would depend upon whether the event falls in the category of ‘adjusting event’ or ‘non-adjusting event’. As per Accounting Standard (AS) 4, events occurring after the date of the balance sheet are of two types, viz., adjusting events which provide further evidence of conditions that existed at the date of the balance sheet; and, non-adjusting events are those which are indicative of conditions that arose subsequent to the date of the balance sheet.

Therefore, an auditor is required to consider all subsequent events while discharging his duties and determine whether those shall have to be adjusted or simply required to be disclosed. However, the auditor should perform work as near as practicable to the date of the auditor’s report.

- (c) **Vouching / Verification of Retirement Gratuity to Employees**

- (i) Examine the basis on which the gratuity payable to employees is worked out. The liability for gratuity may either be worked out on actuarial rules or

agreement or on the presumption that all employees retire on the balance sheet date.

- (ii) Verify computation of liability of gratuity on the aggregate basis.
- (iii) Check the amount of gratuity paid to employees who retired during the year with reference to number of years of service rendered by them.
- (iv) See that the annual premium has been charged to Profit and Loss account in case the concern has taken a policy from LIC.
- (v) Ensure that the basis of computing gratuity is valid.
- (vi) Ensure that the accounting treatment is in accordance with Accounting Standards.

7. (a) **Audit of Expenditure in Government Audit:** The various standards set for audit of expenditure are:

- (i) **Audit against Rules & Orders:** The auditor has to see that the expenditure incurred conforms to the relevant provisions of the statutory enactment and is in accordance with the financial rules and regulations framed by the competent authority.
- (ii) **Audit of Sanctions:** The auditor has to ensure that each item of expenditure is covered by a sanction, either general or special, accorded by the competent authority, authorising such expenditure.
- (iii) **Audit against Provision of Funds:** It contemplates that there is a provision of funds out of which expenditure can be incurred and the amount of such expenditure does not exceed the appropriations made.
- (iv) **Propriety Audit:** It is required to be seen that the expenditure is incurred with due regard to broad and general principles of financial propriety. The auditor aims to bring out cases of improper, avoidable, or infructuous expenditure even though the expenditure has been incurred in conformity with the existing rules and regulations.
- (v) **Performance Audit:** This involves that the various programmes, schemes and projects where large financial expenditure has been incurred are being run economically and are yielding results expected of them.

(b) **Disclaimer of Opinion:** Where an auditor fails to obtain sufficient information to warrant an expression of opinion, and, thus, is unable to form an opinion, he issues a disclaimer of opinion.

Accordingly, the auditor may state that he is unable to express an opinion because he has not been able to obtain sufficient and appropriate audit evidence to form an opinion.

The necessity of a disclaimer of opinion may arise due to many reasons such as the

scope of examination is restricted or in certain circumstances the auditor may not have access to all the books of account for certain reasons, e.g., books are seized by excise authorities or destroyed in fire, etc. It is but natural that the auditor must make all efforts to verify and substantiate the events. In case he is unable to obtain audit evidence even from alternative sources, then the auditor can only state that he is unable to form an opinion.

(c) Disadvantages of the use of an Audit Programme : There are some disadvantages in the use of audit programmes but most of these can be removed by taking some steps which otherwise also contribute to the making of a good audit. The disadvantages are :

- (i) The work may become mechanical and particular parts of the programme may be carried out without any understanding of the object of such parts in the whole audit scheme.
- (ii) The programme often tends to become rigid and inflexible following set grooves; the business may change in its operation of conduct, but the old programme may still be carried on. Changes in staff or internal control may render precaution necessary at points different from those originally decided upon.
- (iii) Inefficient assistants may take shelter behind the programme i.e. defend deficiencies in their work on the ground that no instruction in the matter is contained therein.
- (iv) A hard and fast audit programme may kill the initiative of efficient and enterprising assistants.

All these disadvantages may be eliminated by imaginative supervision of the work carried on by the assistants; the auditor must have a receptive attitude as regards the assistants; the assistants should be encouraged to observe matters objectively and bring significant matters to the notice of supervisor/principal.

(d) Audit Techniques : For collection and accumulation of audit evidence, certain methods and means are available and these are known as audit techniques. Some of the techniques commonly adopted by the auditors are the following:

- (i) Posting checking
- (ii) Casting checking
- (iii) Physical examination and count
- (iv) Confirmation
- (v) Inquiry
- (vi) Year-end scrutiny
- (vii) Re-computation

(viii) Tracing in subsequent period

(ix) Bank Reconciliation

The audit techniques stand for the methods employed for carrying out the procedure. For example, procedure requires an examination of the documentary evidence. This job is performed by the procedure known as vouching which would involve techniques of inspection and checking computation of documentary evidence.

- (e) **Simple random sampling:** Under this method each unit of the whole population e.g. purchase or sales invoice has an equal chance of being selected. The mechanics of selection of items may be by choosing numbers from table of random numbers by computers or picking up numbers randomly from a drum. It is considered that random number tables are simple and easy to use and also provide assurance that the bias does not affect the selection. This method is considered appropriate provided the population to be sampled consists of reasonably similar units and fall within a reasonable range. For example the population can be considered homogeneous, if say, debtors balances fall within the range of Rs. 5,000 to Rs. 25,000 and not in the range between Rs. 25 to Rs. 2, 50,000.

Test Series: September, 2014

MOCK TEST PAPER – 1

INTERMEDIATE (IPC): GROUP – II

PAPER – 7: INFORMATION TECHNOLOGY AND STRATEGIC MANAGEMENT

SECTION – A: INFORMATION TECHNOLOGY

Question No. 1 is compulsory.

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

Time Allowed – 1½ Hours

Maximum Marks – 50

1. Answer all the following questions in brief.
 - (i) Total Quality Management (TQM)
 - (ii) Entity in DFD
 - (iii) Instruction Set Architecture
 - (iv) Application Software
 - (v) Public Data Network
 - (vi) Simplex Connection
 - (vii) Specialized Systems
 - (viii) Dashboards
 - (ix) MS Office applications
 - (x) Cryptography (1 x 10 = 10 Marks)
2.
 - (a) Differentiate between Serial and Parallel Transmission. (4 Marks)
 - (b) Discuss some of the risks involved in any e-Commerce transaction. (4 Marks)
3.
 - (a) How a Credit Card is processed? (4 Marks)
 - (b) What is Decision Support System? Discuss its components in brief. (4 Marks)
4.
 - (a) What do you understand by the term “Controls in Business Process Automation (BPA)”? What are the control objectives? (4 Marks)
 - (b) What is Grid Computing? Why do we need it? (4 Marks)
5.
 - (a) Discuss the different types of relationships in E-R Diagram. (4 Marks)
 - (b) Discuss Accounting Business Process Cycle. (4 Marks)
6.
 - (a) Discuss the various Service Models of Cloud Computing. (4 Marks)
 - (b) What do you understand by the term “Operating System”? Discuss the various activities executed by Operating System. (4 Marks)

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

- (a) Touchpad
- (b) Information as a Business Asset
- (c) Threats to a Computer Network Security
- (d) ACID Test for a Transaction Processing System (TPS)
- (e) Batch Controls

(4 × 2 = 8 Marks)

Test Series: September, 2014

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

Question No.1 is compulsory.

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

Time Allowed – 1½ Hours

Maximum Marks – 50

1. (a) What do you mean by ethnic mix? (3 Marks)
(b) What do you understand by 'shared vision' and 'vision shared'. (3 Marks)
(c) Briefly discuss growth phase of product life cycle. (3 Marks)
(d) What is skimming? (3 Marks)
(e) What are different target areas of six-sigma. (3 Marks)
2. (a) Contraction and consolidation are basic to turnaround strategy. Discuss. (3 Marks)
(b) State with reasons which of the following statements is correct/incorrect:
(i) SBUs facilitate management of multiple businesses. (2 Marks)
(ii) Information technology has reduced dynamism in the business environment. (2 Marks)
3. (a) Write short notes on the following:
(i) Star in BCG matrix (2 Marks)
(ii) Not-for profit organisations. (2 Marks)
(b) "Culture is a strength that can also be a weakness". Discuss (3 Marks)
4. (a) Explain the relevance of experience curve in strategic management. (3 Marks)
(b) What are the different sources of raising funds and their impact on the financial strategy which a Financial Manager may consider? (4 Marks)
5. What is micro environment of business? What are its elements? Discuss (7 Marks)
6. How is TOWS Matrix an improvement over the SWOT Analysis? Describe the construction of TOWS Matrix. (7 Marks)
7. (a) What do you understand by 'strategic control'? Briefly outline its types. (4 Marks)
(b) Briefly explain the concepts of operational control and management control. (3 Marks)

Test Series: October, 2014

MOCK TEST PAPER – 2

INTERMEDIATE (IPC): GROUP – II

PAPER – 7: INFORMATION TECHNOLOGY AND STRATEGIC MANAGEMENT

SECTION – A: INFORMATION TECHNOLOGY

SUGGESTED ANSWERS/HINTS

1. (i) **Six Sigma:** Six Sigma is a set of strategies, techniques, and tools for process improvement. It seeks to improve the quality of process outputs by identifying and removing the causes of defects and minimizing variability in manufacturing and business processes.
- (ii) **Decision Tree:** A Decision Tree is a collection of a basis (condition) and a conclusion (action). In its tree-like representation, the premises and conclusions are shown as nodes, and the branches of the tree connect the premises and the conclusions.
- (iii) **Micro Architecture:** It is a lower level detailed description of the system that is sufficient for completely describing the operation of all parts of the computing system, and how they are inter-connected and inter-operate in order to implement the ISA.
- (iv) **Virtual Memory:** Virtual Memory is in fact not a separate device but an imaginary memory area supported by some operating systems (for example, Windows) in conjunction with the hardware. Virtual memory combines computer's RAM with temporary space on the hard disk.
- (v) **Multiplexer:** A multiplexer is a communications processor that allows a single communications channel to carry simultaneous data transmissions from many terminals. Typically, a multiplexer merges the transmissions of several terminals at one end of a communications channel, while a similar unit separates the individual transmissions at the receiving end.
- (vi) **HTTPS (Hyper Text Transfer Protocol Secure):** Hypertext Transfer Protocol Secure (HTTPS) is a communications protocol for secure communication over a computer network, with especially wide deployment on the Internet. The security of HTTPS uses long term public and secret keys to exchange a short term session key to encrypt the data flow between client and server.
- (vii) **Transaction Processing System:** A **Transaction Processing System (TPS)** may be defined as a type of information system that collects, stores, modifies and retrieves the day-to-day data transactions of an enterprise. Archetypal examples of such systems would be used in an Airline Reservation Systems, Railway reservation

by IRCT, Banking Systems, or the Accounting System of roughly any outsized company.

- (viii) **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/Hybrid Cards** are three types of smart cards.
- (ix) **Access Controls:** Access controls are implemented with an access control mechanism and links the authentic users to the authorized resources they are permitted to access. Cryptography, Passwords, Personal Identification Numbers (PIN) and Identification Cards are some of the examples of access controls.
- (x) **Customer Relationship Management Software:** These are specialized applications catering to the need of organizations largely in **FMCG (Fast-Moving Consumer Goods)** categories. These entities need to interact with their customers and respond to them. The response may be in the form of service support or may lead to product innovation. These are sought by entities, which deal directly with consumers.

2. (a)

S.No.	ASYNCHRONOUS TRANSMISSION	SYNCHRONOUS TRANSMISSION
1	Each data word is accompanied by start and stop bits.	Allows characters to be sent down the line without start-stop bits.
2	Extra Start and Stop bits slow down the transmission process relatively.	Transmission is faster as in absence of start and stop bits, many data words can be transmitted per second.
3	It is relatively cheaper.	The synchronous device is more expensive to build as it must be smart enough to differentiate between the actual data and the special synchronous characters.
4	More reliable as the start and stop bits ensure that the sender and the receiver remain in step with one another.	Chances of data loss are relatively higher.
5	It is less efficient.	It is more efficient.

- (b) **Network Security Vulnerability:** Network Security Vulnerability is an inherent weakness in the design, configuration, or implementation of a network or system that renders it susceptible to a threat.

The following facts are responsible for occurrence of vulnerabilities in the software:

- ◆ **Software Bugs** - Software bugs are so common that users have developed techniques to work around the consequences, for example - buffer overflow, failure to handle exceptional conditions, access validation error, input validation errors are some of the common software flaws.
 - ◆ **Timing Windows** - This problem may occur when a temporary file is exploited by an intruder to gain access to the file, overwrite important data, and use the file as a gateway for advancing further into the system.
 - ◆ **Insecure default configurations** - Insecure default configurations occur when vendors use known default passwords to make it as easy as possible for consumers to set up new systems.
 - ◆ **Trusting Untrustworthy information** - This is usually a problem that affects routers, or those computers that connect one network to another. When routers are not programmed to verify that they are receiving information from a unique host, bogus routers can gain access to systems and do damage.
 - ◆ **End users** - Generally, users of computer systems are not professionals and are not always security conscious. Users do human errors, for example - save confidential files to places where they are not properly protected.
3. (a) Business Intelligence tools are a type of software that is designed to retrieve, analyze and report data. Some of the key Business Intelligence tools are given as follows:
- ◆ **Simple Reporting and Querying:** Business Intelligence must be connected with the enterprise data and all the necessary data is available in one place, in one common format. There are reporting tools used to arrange information into a readable format and distribute it to the people who need it.
 - ◆ **Business Analysis:** This refers to presenting visualizing data in a multidimensional manner. Query and report data is presented in row after row of two-dimensional data. **ETL (Extract, Transform, Load)** tools bring in data from outside sources, transform it to meet business specified operational needs, and then load the results into the company database.
 - ◆ **Dashboards:** This involves using the information gathered from the data warehouse and making it available to users as snapshots of many different things. Dashboards are flexible tools that can be bent into as many different shapes as per user requirements. It includes a collection of graphs, reports,

and Key Performance Indicators (KPIs) that can help monitor such business activities as progress on a specific initiative.

- ◆ **Scorecards:** This involves providing a visual representation of the enterprise strategy by taking critical metrics and mapping them to strategic goals throughout the enterprise. A scorecard has a graphical list of specific, attainable strategic milestones, combined with metrics that serve as benchmarks.
 - ◆ **Data Mining or Statistical Analysis:** This involves using statistical, artificial intelligence, and related techniques to mine through large volumes of data and providing knowledge without users even having to ask specific questions. For Example - OLAP (Online Analytical Processing) is a multi-dimensional analytical tool typically used in data mining that gathers and process vast amounts of information into useful packets.
- (b) **Supply Chain Management (SCM):** Supply Chain Management may be defined as the process of planning, implementing and controlling the operations of the supply chain with the purpose of satisfying the customer's requirement as efficiently as possible.

Components of SCM

- (i) **Procurement/Purchasing** – This begins with the purchasing of parts, components, or services. Procurement must ensure that the right items are delivered in the exact quantities at the correct location on the specified time schedule at minimal cost. This means that procurement must concern itself with the determination of who should supply the parts, the components, or the services.
- (ii) **Operations** - The second major element of supply chain management system is operations. Having received raw materials, parts, components, assemblies, or services from suppliers, the firm must transform them and produce the products or the services that meet the needs of its consumers. It must conduct this transformation in an efficient and effective manner for the benefit of the supply chain management system.
- (iii) **Distribution** - The third element of the supply chain management system is distribution. Distribution involves several activities—transportation (logistics), warehousing, and Customer Relationship Management (CRM). The first and most obvious is logistics—the transportation of goods across the entire supply chain.
- (iv) **Integration** - The last element of supply chain management is the need for integration. It is critical that all participants in the service chain recognize the entirety of the service chain. The impact of the failure to adopt a system-

wide perspective - that is, examining the totality of the chain can significantly increase costs and destroy value.

4. (a) Classification is an effort to categorize numerous types of business applications on a logical basis. There can be numerous ways under which classification can take place.

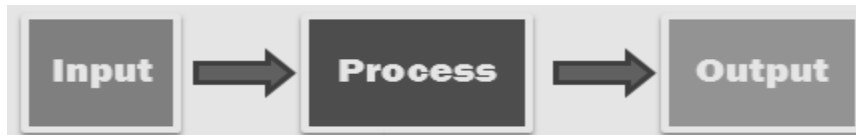
- ◆ **Nature of processing:** This is the way an application updates data, say in batch processing, there is a time delay in occurrence and recording of transaction. On the other hand in online processing, the transactions are recorded at the moment they occur. An application that allows query handling/ responses to updates in system is classified as real time processing system.
- ◆ **Source of application:** The name of category is self-explanatory, as it tells the source from where application has been bought. TALLY, is a purchased application. An entity may get an application developed for itself, this is in-house developed application. A new method for getting applications is being used today, i.e. leased applications, where user pays fixed rent for using the application for agreed terms. Many specialized vendors provide users with option to get their job done by paying monthly rent; this is referred to as outsourcing.
- ◆ **Nature of business:** This classification is based on the users for whom the application has been developed. Here, the emphasis is on size and complexity of business process. Say, for example, a business application being used by a large number of small business establishment in India may not be effective for a large business organizations.
- ◆ **Functions covered:** A business application may be classified based on business function it covers. For example - accounting applications, Office Management software, Compliance application, Customer Relationship Management, Decision making software, ERP software, Product lifecycle management, etc.

(b) **Manual Information Processing Cycle:** These are the systems where the level of manual intervention is very high. For example - valuation of exam papers, teaching, operations in operation theatres, ticket checking by railway staff in trains, buying of grocery, billing done by small medical shops, people maintaining books manually, etc. Components of manual information processing cycle include:

- ◆ **Input:** Put details in register.
- ◆ **Process:** Summarize the information.
- ◆ **Output:** Present information to management in the form of reports.

As the level of human intervention is very high, the quality of information generated from these systems is prone to flaws such as delayed information, inaccurate

information, incomplete information and low levels of detail.

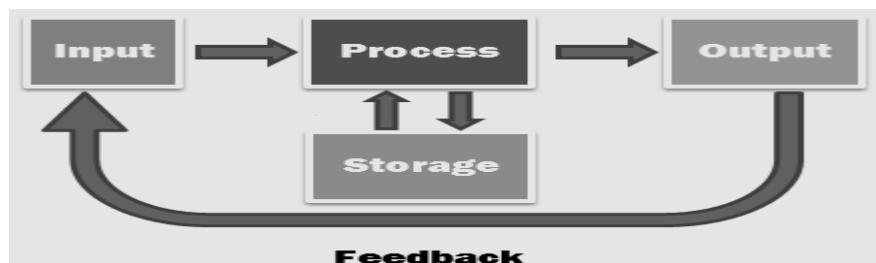


Manual Processing Cycle

Computerized Information Processing Cycle: These are systems where computers are used at every stage of transaction processing. The components of a computerized information processing cycle include:

- ◆ **Input:** Entering data into the computer;
- ◆ **Processing:** Performing operations on the data;
- ◆ **Storage:** Saving data, programs, or output for future use; and
- ◆ **Output:** Presenting the results.

As the processing is computerized the quality of information generated from these systems is timely, accurate, fast and reliable.



Computerized Processing Cycle

5. (a) **Value Chain Automation:** Value chain refers to separate activities which are necessary to strengthen an organization's strategies and are linked together both inside and outside the organization. It is defined as a chain of activities that a firm operating in a specific industry performs in order to deliver a valuable product or service for the market.

The idea of the Value Chain is based on the process view of organizations, the idea of seeing a manufacturing (or service) organization as a system, made up of subsystems each with inputs, transformation processes and outputs. Value chain of a manufacturing organization comprises of Primary and Supportive activities. The primary ones are inclusive of inbound logistics, operations, outbound logistics, marketing and sales, and services. The supportive activities relate to procurement, human resource management, technology development and infrastructure.

Six business functions of the value chain are Research and development; Design of

products, services, or processes; Production; Marketing and sales; Distribution and Customer service. Value Chain Analysis is a useful tool for working out how we can create the greatest possible value for our customers. IT helps us identify the ways in which we create value for our customers and then helps us think through how we can maximize this value: whether through superb products, great services, or jobs well done.

- (b) Various success factors of Business Process Re-engineering (BPR) are as follows:
- (i) **Organization wide commitment:** Changes to business processes would have a direct impact on processes, organizational structures, work culture, information flows, infrastructure & technologies and job competencies. This requires strong leadership, support and sponsorship from the top management. Top management not only has to recognize the need for change but also has to convince every affected group about the potential benefits of the change to the organization as a whole and secure their commitment.
 - (ii) **BPR team composition:** A BPR team is formed which would be responsible to take the BPR project forward and make key decisions and recommendations. The BPR team would include active representatives from top management, business process owners, technical experts and users. It is important that the teams must be kept of manageable size (say 10 members) to ensure well-coordinated, effective and efficient completion of the entire BPR process.
 - (iii) **Business needs analysis:** It is important to identify exactly what current processes need reengineering. This would help determine the strategy and goals for BPR. A series of sessions are held with the process owners and stakeholders and all the ideas would be evaluated to outline and conceptualize the desired business process. The outcome of this analysis would be BPR project plan – identifying specific problem areas, setting goals and relating them to key business objectives. This alignment of the BPR strategy with the enterprise strategy is one of the most important aspects.
 - (iv) **Adequate IT infrastructure:** Adequate investment in IT infrastructure in line is of vital importance to successful BPR implementation. An IT infrastructure is a set of hardware, software, networks, facilities, etc. (including all of the information technology), in order to develop, test, deliver, monitor, control or support IT services. Effective alignment of IT infrastructure to BPR strategy would determine the success of BPR efforts.
 - (v) **Effective change management:** BPR involves changes in people behavior and culture, processes and technologies. Hence, resistance would be a natural consequence which needs to be dealt with effectively. An effective change management process would consider the current culture to foster a change in the prevailing beliefs, attitudes and behaviors effectively. The success of BPR

depends on how effectively management conveys the need for change to the people.

(vi) **Ongoing continuous improvement:** BPR is an ongoing process; hence innovation and continuous improvement are key to the successful implementation of BPR.

6. (a) The Cloud Computing environment can consist of multiple types of clouds based on their deployment and usage. These are explained as follows:

- **Public Cloud:** The public cloud is made available to the general public or a large industry group. They are administrated by third parties or vendors over the Internet, and services are offered on pay-per-use basis. The key benefits are :

- (a) It is widely used in the development, deployment and management of enterprise applications, at affordable costs;

- (b) It allows organizations to deliver highly scalable and reliable applications rapidly and at more affordable costs.

- **Private Clouds:** This cloud computing environment resides within the boundaries of an organization and is used exclusively for the organization's benefits. These are also called internal clouds. They are built primarily by IT departments within enterprises who seek to optimize utilization of infrastructure resources within the enterprise by provisioning the infrastructure with applications using the concepts of grid and virtualization. The benefit of a Private Cloud is that it enables an enterprise to manage the infrastructure and have more control, but this comes at the cost of IT department creating a secure and scalable cloud.

- **Community Clouds:** This is the sharing of computing infrastructure in between organizations of the same community. For example, all Government organizations within India may share computing infrastructure on the cloud to manage data. The risk is that data may be stored with the data of competitors.

- **Hybrid Clouds:** It is a composition of two or more clouds (Private, Community or Public) and is maintained by both internal and external providers. They have to maintain their unique identity, but are bound together by standardized data and application portability. With a hybrid cloud, organizations might run non-core applications in a public cloud, while maintaining core applications and sensitive data in-house in a private cloud.

(b) **Information system Life Cycle:** This is commonly referred as **Software/System Development Life Cycle (SDLC)**, which is a methodology used to describe the process of building information systems. It is the logical starting point in the entire life cycle of a computerized system. Activities start when any enterprise decides to go for computerization or migrate from existing computerized system to a new one.

Phase 1: System Investigation - This phase examines that 'What is the problem and is it worth solving'? Feasibility study is done under the following dimensions:

- ◆ **Technical feasibility:** Does the technology exist to implement the proposed system or is it a practical proposition?
- ◆ **Economic feasibility:** Is proposed system cost-effective: if benefits do not outweigh costs, it's not worth going ahead?
- ◆ **Legal feasibility:** Is there any conflict between the proposed system and legal requirements?
- ◆ **Operational feasibility:** Are the current work practices and procedures adequate to support the new system?
- ◆ **Schedule feasibility:** How long will the system take to develop, or can it be done in a desired time-frame?

Phase 2: System Analysis - This phase examines that 'What must the Information System do to solve the problem'? The Systems Analyst examines data and information flows in the enterprise using data flow diagrams; establishes what the proposed system will actually do (not how it will do it); analyzes costs and benefits; outlines system implementation options (e.g. in-house or using consultants); considers possible hardware configurations; and makes recommendations.

Phase 3: System Designing - This phase examines that 'How will the Information System do what it must do to obtain the solution to the problem'? This phase specifies the technical aspects of a proposed system in terms of Hardware platform, Software, Outputs, Inputs, User interface, Modular design, Test plan, Conversion plan and Documentation.

Phase 4: System Implementation - This phase examines that 'How will the Solution be put into effect'? This phase involves Coding and testing of the system; Acquisition of hardware and software; and either installation of the new system or conversion of the old system to the new one.

In Installation, new hardware, which may involve extensive re-cabling and changes in office layouts are installed; Training the users on the new system; and Conversion of master files to the new system or creation of new master files.

Phase 5: System Maintenance and Review - This phase evaluates results of solution and modifies the system to meet the changing needs. Post implementation review would be done to address Programming amendments, Adjustment of clerical procedures, Modification of Reports, and Request for new programs.

This is often the longest of the stages since it is an on-going process having some sort of long term continuum.

7. (a) **Process Management: Process management** is based on a view of an organization as a system of interlinked processes which involves concerted efforts to map, improve and adhere to organizational processes. To manage a process,
- ◆ The first task is to **define** it. This involves defining the steps (tasks) in the process and mapping the tasks to the roles involved in the process.
 - ◆ Once the process is mapped and implemented, **performance measures** can be established. Establishing measurements creates a basis to improve the process.
 - ◆ The last piece of the process management definition describes the **organizational setup** that enables the standardization of and adherence to the process throughout the organization. Assigning enterprise process owners and aligning employees' performance reviews and compensation to the value creation of the processes could accomplish this.
- (b) **Application Software: Application software** includes all those computer software that cause a computer to perform useful tasks beyond the running of the computer itself. It is a collection of programs which address a real life problem of its end users which may be business or scientific or any other problem. The different types of application software are Application Suite, Enterprise Software, Enterprise Infrastructure Software, Information Worker Software, Content Access Software, Educational Software, Media Development Software etc.
- Some of the most popular and widely accepted benefits of Application Software are to address user needs, less threat from virus and Regular updates. However, there are certain disadvantages of such software as well. Development is costly and may be Infected from Malware.
- (c) **Virtual Private Network (VPN): Virtual Private Network (VPN)** is a secure network that uses the Internet as its main backbone network, but relies on the firewalls and other security features of the Internet and Intranet connections and those of participating organizations. Many organizations use Virtual Private Networks (VPNs) to establish secure intranets and extranets. A VPN is a private network that uses a public network (usually the Internet) to connect remote sites or users together. The VPN uses "virtual" connections routed through the Internet from the business's private network to the remote site or employee. By using a VPN, businesses ensure security - anyone intercepting the encrypted data can't read it.
- (d) **Business Intelligence: Business Intelligence (BI)** is the delivery of accurate, useful information to the appropriate decision makers within the necessary time frame to support effective decision making for business processes. It is comprised of information that contains patterns, relationships, and trends about customers, suppliers, business partners and employees. Business intelligence systems process, store and provide useful information to the user who need it, when they

need it. It can handle large amounts of information to help identify and develop new opportunities. BI, in simple words, refers to the process of collecting and refining information from many sources, analyzing and presenting the information in useful ways so that users can make better business decisions. It is essentially timely, accurate, high-value, and actionable business insights, and the work processes and technologies used to obtain them.

(e) Objectives of Business Process Automation (BPA)

The success of any Business Process Automation shall only be achieved when BPA ensures:

- ◆ **Confidentiality:** To ensure that data is only available to persons who have right to see the same;
- ◆ **Integrity:** To ensure that no un-authorized amendments can be made in the data;
- ◆ **Availability:** To ensure that data is available when asked for; and
- ◆ **Timeliness:** To ensure that data is made available in at the right time.

MOCK TEST PAPER – 2

INTERMEDIATE (IPC): GROUP – II

PAPER –7: INFORMATION TECHNOLOGY AND STRATEGIC MANAGEMENT

SECTION – B: STRATEGIC MANAGEMENT

SUGGESTED ANSWERS/HINTS

1. (a) While it can be argued whether competition is good or bad for an individual business, in broader sense it helps business and its environment. Some of the benefits of competition for businesses are:
1. Brings innovation.
 2. Pushes business to use resources wisely.
 3. Find better methods and processes for doing same things.
 4. Improve quality.
 5. Offer competitive prices and improve sales.
 6. Businesses with little or no competition will stagnate.

Competition not only help the business but also employees, customers/consumers and society. It is strong force behind the present growth and development. Accordingly we may say that the competition is good for business. This is notwithstanding that some of the businesses may lose out in the competitive race.

- (b) Core competencies are those capabilities that are critical to a business achieving competitive advantage. A core competence is a unique strength of an organization which may not be shared by others. This may be in the form of human resources, marketing, capability, or technological capability. If the business is organized on the basis of core competency, it is likely to generate competitive advantage. In order to qualify as a core competence, the competency should differentiate the business from any other similar businesses.

Many organizations have restructured their businesses by divesting those businesses which do not match their core competence. Organization of business around core competence implies leveraging the limited resources of a firm. It needs creative, courageous and dynamic leadership having faith in organization's human resources.

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

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

- (d) Turnaround is needed when an enterprise's performance deteriorates to a point that it needs a radical change of direction in strategy, and possibly in structure and culture as well. It is a highly targeted effort to return an organization to profitability and increase positive cash flows to a sufficient level. It is used when both threats and weaknesses adversely affect the health of an organization so much that its basic survival is difficult.

The overall goal of turnaround strategy is to return an underperforming or distressed company to normalcy in terms of acceptable levels of profitability, solvency, liquidity and cash flow. To achieve its objectives, turnaround strategy must reverse causes of distress, resolve the financial crisis, achieve a rapid improvement in financial performance, regain stakeholder support, and overcome internal constraints and unfavourable industry characteristics.

- (e) 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.

- 2. (a) Product Life Cycle is a useful concept for guiding strategic choice. Product Life Cycle is an S-shaped curve which exhibits the relationship of sales with respect of time for a product that passes through the four successive stages of introduction, growth, maturity and decline.

Introduction Stage: The first stage of PLC is the introduction stage in which competition is almost negligible, prices are relatively high and markets are limited.

Growth Stage: The second phase of PLC is growth stage. In the growth stage, the demand expands rapidly, prices fall, competition increases and market expands. The customer has knowledge about the product and shows interest in purchasing it.

Maturity Stage: The third phase of PLC is maturity stage. In this stage, the competition gets tough and market gets stabilised. Profit comes down because of stiff competition. At this stage organisations may work for maintaining stability.

Decline Stage: In the declining stage of PLC, the sales and profits fall down sharply due to some new product replaces the existing product. So a combination of strategies can be implemented to stay in the market either by diversification or retrenchment.

- (b) (i) **Incorrect:** Restructuring is neither slow nor the changes are consistent with the existing structure. An organisation that needs to improve its efficiency and profitability may use restructuring as a strategic tool. It involves careful study of existing structures and identifying focus areas that need to be dismantled and rebuilt within an organization. Strategic restructuring in organisations is often adopted after acquisitions, takeovers or bankruptcy. Invariably it also forms part of turnaround management. Restructuring can involve a significant change of an organization's liabilities or assets.
- (ii) **Incorrect:** In the context of strategic management, retrenchment implies giving up certain products and reducing the level of business as a compulsive measure to cope up with certain adverse developments on which the firm has little control. Downsizing is planned elimination of positions or jobs. Retrenchment does not imply downsizing, however, the latter is often used to implement a retrenchment strategy.
3. (a) (i) 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.
- (ii) Competitive advantage is the result of a strategy capable of helping a firm to maintain and sustain a favourable market position. This position is translated into higher profits compared to those obtained by competitors operating in the same industry.
- (b) Decision making is a managerial process and function which is greatly influenced by the broad characteristics of business environment. Business environment exhibits many characteristics. These characteristics are:
- **Environment is complex:** The environment consists of a number of factors, events, conditions and influences arising from different sources. All these do not exist in isolation but interact with each other to create entirely new sets of

influences. It is difficult to comprehend at once the factors constituting a given environment. All in all, environment is a complex that is somewhat easier to understand in parts but difficult to grasp in totality.

- **Environment is dynamic:** The environment is constantly changing in nature. Due to the several varied influences operating; there is dynamism in the environment causing it to continuously change its shape and character.
- **Environment is multi-faceted:** What shape and character an environment assumes depends on the perception of the observer. A particular change in the environment, or a new development, may be viewed differently by different observers. This is frequently seen when the same development is welcomed as an opportunity by one company while another company perceives it as a threat.
- **Environment has a far reaching impact:** The environment has a far reaching impact on organizations. The growth and profitability of an organization depends critically on the environment in which it exists. Any environment change has an impact on the organization in several different ways.

4 (a) Yes, strategy is partly proactive and partly reactive. In proactive strategy, organizations will analyze possible environmental scenarios and create strategic framework after proper planning and set procedures and work on these strategies in a predetermined manner. However, in reality no company can forecast both internal and external environment exactly. Everything cannot be planned in advance. It is not possible to anticipate moves of rival firms, consumer behaviour, evolving technologies and so on. There can be significant deviations between what was visualized and what actually happens. Strategies need to be attuned or modified in light of possible environmental changes. There can be significant or major strategic changes when the environment demands. Reactive strategy is triggered by the changes in the environment and provides ways and means to cope with the negative factors or take advantage of emerging opportunities.

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

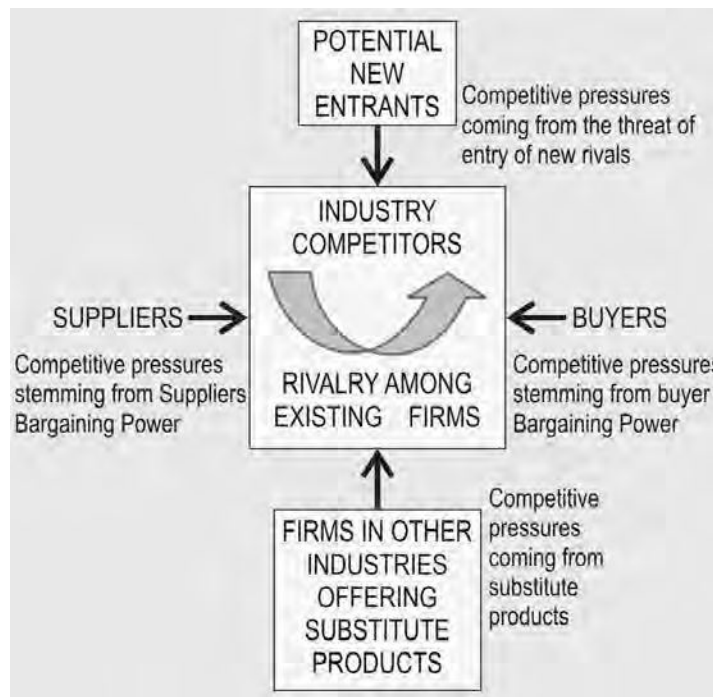
Top down strategic planning describes a centralized approach to strategy formulation in which the corporate centre or head office determines mission, strategic intent, objectives and strategies for the organization as a whole and for all parts. Unit managers are seen as implementers of pre-specified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

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

5. Five forces model of Michael Porter is a powerful and widely used tool for systematically diagnosing the significant competitive pressures in the market and assessing their strength and importance. The model holds that the state of competition in an industry is a composite of competitive pressures operating in five areas of the over all market. These five forces are:
 1. **Threat of new entrants:** New entrants are always a powerful source of competition. The new capacity and product range they bring in throw up new competitive pressure. And the bigger the new entrant, the more severe the competitive effect. New entrants also place a limit on prices and affect the profitability of existing players.
 2. **Bargaining power of customers:** This is another force that influences the competitive condition of the industry. This force will become heavier depending on the possibilities of the buyers forming groups or cartels. Mostly, this is a phenomenon seen in industrial products. Quite often, users of industrial products come together formally or informally and exert pressure on the producer. The bargaining power of the buyers influences not only the prices that the producer can charge but also influences in many cases, costs and investments of the producer because powerful buyers usually bargain for better services which involve costs and investment on the part of the producer.
 3. **Bargaining power of suppliers:** Quite often suppliers, too, exercise considerable bargaining power over companies. The more specialised the offering from the supplier, greater is his clout. And, if the suppliers are also limited in number they stand a still better chance to exhibit their bargaining power. The bargaining power of suppliers determines the cost of raw materials and other inputs of the industry and, therefore, industry attractiveness and profitability.
 4. **Rivalry among current players:** The rivalry among existing players is quite obvious. This is what is normally understood as competition. For any player, the competitors influence strategic decisions at different strategic levels. The impact is evident more at functional level in the prices being changed, advertising, and pressures on costs, product and so on.
 5. **Threats from substitutes:** Substitute products are a latent source of competition in an industry. In many cases they become a major constituent of competition. Substitute products offering a price advantage and/or performance improvement to the consumer can drastically alter the competitive character of an industry. And they

can bring it about all of a sudden. For example, coir suffered at the hands of synthetic fibre. Whenever substantial investment in R&D is taking place, threats from substitute products can be expected. Substitutes, too, usually limit the prices and profits in an industry.

The five forces together determine industry attractiveness/profitability. This is so because these forces influence the causes that underlie industry attractiveness/profitability. For example, elements such as cost and investment needed for being a player in the industry decide industry profitability, and all such elements are governed by these forces. The collective strength of these five competitive forces determines the scope to earn attractive profits. The strength of the forces may vary from industry to industry.



6. The prominent areas where the human resource manager can play strategic role are as follows:
 - (i) **Providing purposeful direction:** The human resource management must be able to lead people and the organization towards the desired direction involving people. The management have to ensure harmony between organisational objectives and individual objectives. Objectives are specific aims which must be in the line with the goal of the organization and the all actions of each person must be consistent with them.

- (ii) **Creating competitive atmosphere:** In the present business environment, maintaining competitive position or gains is an important objective of any business. Having a highly committed and competent workforce is very important for getting a competitively advantageous position.
 - (iii) **Facilitation of change:** The human resource manager will be more concerned about furthering the organization not just maintaining it. He has to devote more time to promote acceptance of change rather than maintaining the status quo.
 - (iv) **Diversion of workforce:** In a modern organization, management of diverse workforce is a great challenge. Workforce diversity can be observed in terms of male and female, young and old, educated and uneducated, unskilled and professional employee and so on. Maintaining a congenial healthy work environment is a challenge for HR Manager. Motivation, maintaining morale and commitment are some of the key task that a HR manager has to perform.
 - (v) **Empowerment of human resources:** Empowerment involves giving more power to those who, at present, have little control what they do and little ability to influence the decisions being made around them.
 - (vi) **Building core competency:** The human resource manager has an important role to play in developing core competency by the firm. A core competence is a unique strength of an organization which may not be shared by others. Organization of business around core competence implies leveraging the limited resources of a firm. It needs creative, courageous and dynamic leadership having faith in organization's human resources.
 - (vii) **Development of works ethics and culture:** A vibrant work culture will have to be developed in the organizations to create an atmosphere of trust among people and to encourage creative ideas by the people. Far reaching changes with the help of technical knowledge will be required for this purpose.
7. (a) Strategic leadership is the ability of influencing others to voluntarily make decisions that enhance prospects for the organisation's long-term success while maintaining short-term financial stability. It includes determining the firm's strategic direction, aligning the firm's strategy with its culture, modelling and communicating high ethical standards, and initiating changes in the firm's strategy, when necessary. Strategic leadership sets the firm's direction by developing and communicating a vision of future and inspire organization members to move in that direction. Unlike strategic leadership, managerial leadership is generally concerned with the short-term, day-to-day activities.

Two basic approaches to leadership can be transformational leadership style and transactional leadership style.

Transformational leadership style use charisma and enthusiasm to inspire people to exert them for the good of the organization. Transformational leadership style may

be appropriate in turbulent environments, in industries at the very start or end of their life-cycles, in poorly performing organizations when there is a need to inspire a company to embrace major changes. Transformational leaders offer excitement, vision, intellectual stimulation and personal satisfaction. They inspire involvement in a mission, giving followers a 'dream' or 'vision' of a higher calling so as to elicit more dramatic changes in organizational performance. Such a leadership motivates followers to do more than originally affected to do by stretching their abilities and increasing their self-confidence, and also promote innovation throughout the organization.

Whereas, transactional leadership style focus more on designing systems and controlling the organization's activities and are more likely to be associated with improving the current situation. Transactional leaders try to build on the existing culture and enhance current practices. Transactional leadership style uses the authority of its office to exchange rewards, such as pay and status. They prefer a more formalized approach to motivation, setting clear goals with explicit rewards or penalties for achievement or non-achievement.

Transactional leadership style may be appropriate in settled environment, in growing or mature industries, and in organizations that are performing well. The style is better suited in persuading people to work efficiently and run operations smoothly.

- (b) Acquisition of or merger with an existing concern is an instant means of achieving the expansion. It is an attractive and tempting proposition in the sense that it circumvents the time, risks and skills involved in screening internal growth opportunities, seizing them and building up the necessary resource base required to materialise growth. Organizations consider merger and acquisition proposals in a systematic manner, so that the marriage will be mutually beneficial, a happy and lasting affair.

Apart from the urge to grow, acquisitions and mergers are resorted to for purposes of achieving a measure of synergy between the parent and the acquired enterprises. Synergy may result from such bases as physical facilities, technical and managerial skills, distribution channels, general administration, research and development and so on. Only positive synergistic effects are relevant in this connection which denote that the positive effects of the merged resources are greater than the some of the effects of the individual resources before merger or acquisition.