

MOCK TEST PAPER
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) Kunal Ltd. received a specific grant of Rs. 60 lakhs for acquiring the plant of Rs. 300 lakhs during 2012-13 having useful life of 10 years. The grant received was credited to deferred income in the balance sheet. During 2015-16, due to non-compliance of conditions laid down for the grant, the company had to refund the whole grant to the Government. Balance in the deferred income on that date was Rs. 42 lakhs and written down value of plant was Rs. 210 lakhs.
- (i) What should be the treatment of the refund of the grant and the effect on cost of the fixed asset and the amount of depreciation to be charged during the year 2015-2016 in profit and loss account?
- (ii) What should be the treatment of the refund, if grant was deducted from the cost of the plant during 2012-13 assuming plant account showed the balance of Rs. 168 lakhs as on 1.4.2015?
- (b) Meena Limited could not recover an amount of Rs. 16 lakhs from a debtor. The company is aware that the debtor is in great financial difficulty. The accounts of the company for the year ended 31-3-2017 were finalized by making a provision @ 25% of the amount due from that debtor. In May 2017, the debtor became bankrupt and nothing is recoverable from him. Do you advise the company to provide for the entire loss of Rs. 16 lakhs in books of account for the year ended 31-3-2017?
- (c) On 1st April, 2016, Perfect Construction Ltd. obtained a loan of Rs. 64 crores to be utilized as under:
- (i) Construction of sealink across two cities:
(work was held up totally for a month during the year due to high water levels) : Rs. 50 crores
- (ii) Purchase of equipments and machineries : Rs. 6 crores
- (iii) Working capital : Rs. 4 crores
- (iv) Purchase of vehicles : Rs. 1,00,00,000
- (v) Advance for tools/cranes etc. : Rs. 1,00,00,000
- (vi) Purchase of technical know-how : Rs. 2 crores
- (vii) Total interest charged by the bank for the year ending 31st March, 2017 : Rs. 1,60,00,000
- Show the treatment of interest by Perfect Construction Ltd.
- (d) Annual lease rent = Rs. 80,000 at the end of each year
Lease period = 5 years

Guaranteed residual value = Rs. 28,000

Fair value at the inception (beginning) of lease = Rs. 3,00,000

Interest rate implicit on lease is 12.6%. The present value factors at 12.6% are 0.89, 0.79, 0.7, 0.622, 0.552 at the end of first, second, third, fourth and fifth year respectively.

Show the Journal entry to record the asset taken on finance lease in the books of the lessee.

(4 x 5 = 20 Marks)

2. (a) G Ltd. came up with public issue of 30,00,000 Equity shares of Rs. 10 each at Rs. 15 per share. A, B and C took underwriting of the issue in 3 : 2 : 1 ratio.

Applications were received for 27,00,000 shares.

The marked applications were received as under:

A	8,00,000 shares
B	7,00,000 shares
C	6,00,000 shares

Commission payable to underwriters is at 5% on the face value of shares.

- (i) Compute the liability of each underwriter as regards the number of shares to be taken up.
- (ii) Pass journal entries in the books of G Ltd. to record the transactions relating to underwriters.
- (b) The following particulars relate to a Limited Company which has gone into voluntary liquidation. You are required to prepare the Liquidator's Statement of Account allowing for his remuneration @ 2½% on all assets realized excluding call money received and 2% on the amount paid to unsecured creditors including preferential creditors.

Share capital issued:

10,000 Preference shares of Rs. 100 each fully paid up.

50,000 Equity shares of Rs. 10 each fully paid up.

30,000 Equity shares of Rs. 10 each, Rs. 8 paid up.

Assets realized Rs. 20,00,000 excluding the amount realized by sale of securities held by partly secured creditors.

	Rs.
Preferential creditors	50,000
Unsecured creditors	18,00,000
Partly secured creditors (Assets realized Rs. 3,20,000)	3,50,000
Debenture holders having floating charge on all assets of the company	6,00,000
Expenses of liquidation	10,000

A call of Rs. 2 per share on the partly paid equity shares was duly received except in case of one shareholder owning 1,000 shares.

Also calculate the percentage of amount paid to the unsecured creditors to the total unsecured creditors.

(8 + 8 = 16 Marks)

3. From the following balances extracted from the books of General Insurance Company Limited as on 31.3.2017 you are required to prepare Revenue Accounts in respect of Fire and marine Insurance business for the year ended 31.3.2017 and a Profit and Loss Account for the same period:

	Rs.		Rs.
Directors' Fees	80,000	Interest received	19,000
Dividend received	1,00,000	Fixed Assets (1.4.2016)	90,000
Provision for Taxation (as on 1.4. 2016)	85,000	Income-tax paid during the year	60,000

	Fire	Marine
	Rs.	Rs.
Outstanding Claims on 1.4. 2016	28,000	7,000
Claims paid	1,00,000	80,000
Reserve for Unexpired Risk on 1.4.2016	2,00,000	1,40,000
Premiums Received	4,50,000	3,30,000
Agent's Commission	40,000	20,000
Expenses of Management	60,000	45,000
Re-insurance Premium (Dr.)	25,000	15,000

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

- Depreciation on Fixed Assets to be provided at 10% p.a.
- Interest accrued on investments Rs. 10,000.
- Closing provision for taxation on 31.3.2017 to be maintained at Rs. 1,24,138.
- Claims outstanding on 31.3.2017 were Fire Insurance Rs. 10,000; Marine Insurance Rs. 15,000.
- Premium outstanding on 31.3.2017 were Fire Insurance Rs. 30,000; Marine Insurance Rs. 20,000.
- Reserve for unexpired risk to be maintained at 50% and 100% of net premiums in respect of Fire and Marine Insurance respectively.
- Expenses of management due on 31.3.2017 were Rs. 10,000 for Fire Insurance and Rs. 5,000 in respect of marine Insurance. **(16 Marks)**

4. (a) X Ltd has three departments A, B and C. From the particulars given below compute:
- the departmental results and
 - the values of stock as on 31st Dec. 2016

1.

	A	B	C
	Rs.	Rs.	Rs.
Stock (on 1.1. 2016)	24,000	36,000	12,000
Purchases	1,46,000	1,24,000	48,000
Actual sales	1,72,500	1,59,400	74,600
Gross Profit on normal selling price	20%	25%	33 1/3%

2. During the year certain items were sold at discount and these discounts were reflected in the value of sales shown above. The items sold at discount were:

	A Rs.	B Rs.	C Rs.
Sales at normal price	10,000	3,000	1,000
Sales at actual price	7,500	2,400	600

- (b) Mohan, having head office at Mumbai has a branch at Nagpur. The head office does wholesale trade only at cost plus 80%. The goods are sent to branch at the wholesale price viz., cost plus 80%. The branch at Nagpur is wholly engaged in retail trade and the goods are sold at cost to H.O. plus 100%.

Following details are furnished for the year ended 31st March, 2017:

	Head Office (Rs.)	Branch (Rs.)
Opening stock (as on 1.4.2016)	2,25,000	-
Purchases	25,50,000	-
Goods sent to branch (Cost to H.O. plus 80%)	9,54,000	-
Sales	27,81,000	9,50,000
Office expenses	90,000	8,500
Selling expenses	72,000	6,300
Staff salary	65,000	12,000

You are required to prepare Trading and Profit and Loss Account of the head office and branch for the year ended 31st March, 2017. **(8 + 8 = 16 Marks)**

5. (a) A, B and C are partners sharing profits and losses in the ratio of 5:3:2. Their capitals were Rs. 9,600, Rs. 6,000 and Rs. 8,400 respectively.

After paying creditors, the liabilities and assets of the firm were:

	Rs.		Rs.
Liability for interest on loans from:		Investments	1,000
Spouses of partners	2,000	Furniture	2,000
Partners	1,000	Machinery	1,200
		Stock	4,000

The assets realised in full in the order in which they are listed above. B is insolvent.

You are required to prepare a statement showing the distribution of cash as and when available, applying maximum possible loss procedure.

- (b) S Ltd. (a Public Sector Company) provides consultancy and engineering services to its clients. In the year 2016-17, the Government has set up a commission to decide about the pay revision. The pay will be revised with respect from 1-1-2012 based on the recommendations of the commission. The company makes the provision of Rs. 680 lakhs for pay revision in the financial year 2016-17 on the estimated basis as the report of the commission is yet to come. As per the contracts with the client on cost plus job, the billing is done on the actual payment made to the employees and allocated to jobs based on hours booked by these employees on each job.

The company discloses through notes to accounts:

“Salaries and benefits include the provision of Rs. 680 lakhs in respect of pay revision. The amount chargeable from reimbursable jobs will be billed as per the contract when the actual payment is made”.

The accountant feels that the company should also book/recognise the income by Rs. 680 lakhs in Profit and Loss Account as per the terms of the contract. Otherwise, it will be the violation of matching concept & understatement of profit. Comment on the opinion of the Accountant with reference to relevant accounting standards. **(10 + 6 = 16 Marks)**

6. From the following information, prepare Profit and Loss Account of ABC Bank Ltd. for the year ended 31.3. 2017:

	(Rs. in '000)
Interest and Discount	8,860
(Includes interest accrued on investments)	
Other Income	220
Interest expended	2,720
Operating expenses	2,830
Interest accrued on Investments	10
Additional Information:	
(a) Rebate on bills discounted to be provided for	30
(b) Classification of Advances:	
(i) Standard assets	4,000
(ii) Sub-standard assets	2,240
(iii) Doubtful assets—(fully unsecured)	390
(iv) Doubtful assets – covered fully by security	
Less than 1 year	100
More than 1 year, but less than 3 years	600
More than 3 years	600
(v) Loss assets	376
(c) Provide 35% of the profit towards provision for taxation.	
(d) Transfer 25% of the profit to Statutory Reserve.	

(16 Marks)

7. (a) 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:
- Share Capital
 - Trade Receivables
 - Investments
 - Fixed Assets.
- (b) P Ltd. launched a project for producing product A in Nov. 2014. The company incurred Rs. 30 lakhs towards Research and Development expenses upto 31st March, 2016. Due to

unfavourable market conditions the management feels that it is not possible to manufacture and sell the product in the market for next so many years.

The management hence wants to defer the expenditure write off to future years.

Advise the company as per the applicable Accounting Standard.

- (c) Zoo Ltd. had issued 30,000, 15% convertible debentures of Rs. 100 each on 1st April, 2013. The debentures are due for redemption on 1st March, 2016. 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 2500 debentures did not exercise the option. Calculate the number of equity shares to be allotted to the Debenture holders exercising the option to the maximum.
- (d) W paid a premium to other partners of the firm at the time of his admission to the firm, with a condition that the will not be dissolved before expiry of five years. The firm is dissolved after three years. W claims refund of premium.
- (i) List the criteria for the calculation of the amount of refund.
- (ii) Also list any two conditions when no claim in this respect will arise.
- (e) On 1st April, 2015, a company offered 100 shares to each of its 500 employees at Rs. 50 per share. The employees are given a year to accept the offer. The shares issued under the plan shall be subject to lock-in on transfer for three years from the grant date. The market price of shares of the company on the grant date is Rs. 60 per share. Due to post-vesting restrictions on transfer, the fair value of shares issued under the plan is estimated at Rs. 56 per share. On 31st March, 2016, 400 employees accepted the offer and paid Rs. 50 per share purchased. Nominal value of each share is Rs. 10. Record the issue of share in the books of the company under the aforesaid plan.

(4 x 4 = 16 Marks)

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SUGGESTED ANSWERS/HINTS

1. (a) As per AS-12, 'Accounting for Government Grants', "the amount refundable in respect of a grant related to specific fixed asset should be recorded by reducing the deferred income balance. To the extent the amount refundable exceeds any such deferred credit, the amount should be charged to profit and loss statement.

(i) In this case the grant refunded is Rs. 60 lakhs and balance in deferred income is Rs. 42 lakhs, Rs. 18 lakhs shall be charged to the profit and loss account for the year 2015-16. There will be no effect on the cost of the fixed asset and depreciation charged will be on the same basis as charged in the earlier years.

(ii) If the grant was deducted from the cost of the plant in the year 2012-13 then, AS-12 states that the amount refundable in respect of grant which relates to specific fixed assets should be recorded by increasing the book value of the assets, by the amount refundable. Where the book value of the asset is increased, depreciation on the revised book value should be provided prospectively over the residual useful life of the asset. Therefore, in this case, the book value of the plant shall be increased by Rs. 60 lakhs. The increased cost of Rs.60 lakhs of the plant should be amortized over 7 years (residual life). Depreciation charged during the year 2015-16 shall be $(1,68 + 60)/7$ years = Rs. 32.57 lakhs presuming the depreciation is charged on SLM.

(b) As per AS 4, 'Contingencies and Events Occurring after the Balance Sheet Date', adjustments to assets and liabilities are required for events occurring after the balance sheet date if such event provides/relates to additional information to the conditions existing at the balance sheet date and is also materially affecting the valuation of assets and liabilities on the balance sheet date.

As per the information given in the question, the company was aware that the debtor was already in a great financial difficulty at the time of closing of accounts. Bankruptcy of the debtor in May 2017 is only an additional information to the condition existing on the balance sheet date. Also the effect of a debtor becoming bankrupt is material as total amount of Rs. 16 lakhs will be a loss to the company. Therefore, the company is advised to provide for the entire amount of Rs. 16 lakhs in the books of account for the year ended 31st March, 2017.

(c) According to AS 16 'Borrowing costs', qualifying asset is an asset that necessarily takes substantial period of time to get ready for its intended use.

As per para 6 of the standard, borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalised as part of the cost of that asset. Other borrowing costs should be recognised as an expense in the period in which they are incurred.

The treatment of interest by Perfact Construction Ltd. can be shown as:

	Qualifying Asset	Interest to be capitalized	Interest to be charged to Profit & Loss A/c	
		Rs.	Rs.	
Construction of sea-link	Yes	1,25,00,000		$[1,60,00,000*(50/64)]$

Purchase of equipments and machineries	No	15,00,000	[1,60,00,000*(6/64)]
Working capital	No	10,00,000	[1,60,00,000*(4/64)]
Purchase of vehicles	No	2,50,000	[1,60,00,000*(1/64)]
Advance for tools, cranes etc.	No.	2,50,000	[1,60,00,000*(1/64)]
Purchase of technical know-how	No	<u>5,00,000</u>	[1,60,00,000*(2/64)]
Total		<u>1,25,00,000</u>	<u>35,00,000</u>

(d) Journal entry in the books of Lessee

		Rs.	Rs.
Asset A/c	Dr.	2,99,776	
To Lessor			2,99,776
(Being recognition of finance lease as an asset and a liability)			

Working Note:

Year	Lease Payments Rs.	Discounting Factor (12.6%)	Present Value Rs.
1	80,000	0.89	71,200
2	80,000	0.79	63,200
3	80,000	0.70	56,000
4	80,000	0.622	49,760
5	80,000	0.552	44,160
5	28,000 (GRV)	0.552	15,456
			2,99,776

2. (a) (i) Computation of liability of underwriters in respect of shares

	(In shares)		
	A	B	C
Gross liability (Total Issue – Promoters etc.) in agreed ratio of 3 : 2 : 1	15,00,000	10,00,000	5,00,000
Less: Unmarked applications (Subscribed shares – marked shares) in 3 : 2 : 1	<u>(3,00,000)</u>	<u>(2,00,000)</u>	<u>(1,00,000)</u>
Marked shares as per agreed ratio	12,00,000	8,00,000	4,00,000
Less: Marked applications actually received	<u>(8,00,000)</u>	<u>(7,00,000)</u>	<u>(6,00,000)</u>
Shortfall / surplus in marked shares	4,00,000	1,00,000	(2,00,000)
Surplus of C distributed to A & B in 3:2 ratio	<u>(1,20,000)</u>	<u>(80,000)</u>	<u>2,00,000</u>
Net liability for underwriting shares	<u>2,80,000</u>	<u>20,000</u>	<u>Nil</u>

(ii) Journal Entries in the books of G Ltd.

		Rs.	Rs.
A's Account	Dr.	42,00,000	
B's Account	Dr.	3,00,000	

To Share Capital Account			30,00,000
To Securities Premium Account			15,00,000
(Being the shares to be taken up by the underwriters)			
Underwriting Commission Account	Dr.	15,00,000	
To A's Account			7,50,000
To B's Account			5,00,000
To C's Account			2,50,000
(Being the underwriting commission due to the underwriters)			
Bank Account	Dr.	34,50,000	
To A's Account			34,50,000
(Being the amount received from underwriter A for the shares taken up by him after adjustment of his commission)			
B's Account	Dr.	2,00,000	
To Bank Account			2,00,000
(Being the amount paid to underwriter B after adjustment of the shares taken by him against underwriting commission due to him)			
C's Account	Dr.	2,50,000	
To Bank Account			2,50,000
(Being the underwriting commission paid to C)			

Note: C had sold in excess of the underwriting obligation and hence he will not be required to purchase any shares but will get commission for underwriting.

(b) (i) Liquidator's Statement of Account

	<i>Rs.</i>			<i>Rs.</i>
To Assets Realised	20,00,000	By Liquidator's remuneration		
To Receipt of call money on 29,000 equity shares @ 2 per share	58,000	2.5% on 23,20,000*	58,000	
		2% on 50,000	1,000	
		2% on 13,12,745 (W.N.3)	<u>26,255</u>	85,255
		By Liquidation Expenses		10,000
		By Debenture holders having a floating charge on all assets		6,00,000
		By Preferential creditors		50,000
		By Unsecured creditors		<u>13,12,745</u>
	<u>20,58,000</u>			<u>20,58,000</u>

* Total assets realised excluding call money = Rs. 20,00,000 + Rs. 3,20,000 = Rs. 23,20,000

(ii) **Percentage of amount paid to unsecured creditors to total unsecured creditors**

$$= \frac{13,12,745}{18,30,000} \times 100 = 71.73\%$$

Working Notes:

1. Unsecured portion in partly secured creditors = Rs. 3,50,000 - Rs. 3,20,000 = Rs. 30,000
2. Total unsecured creditors = 18,00,000 + 30,000 (W.N.1) = Rs. 18,30,000
3. Liquidator's remuneration on payment to unsecured creditors

Cash available for unsecured creditors after all payments including payment to preferential creditors & liquidator's remuneration on it = Rs. 13,39,000

$$\text{Liquidator's remuneration on unsecured creditors} = \frac{2}{102} \times 13,39,000 = \text{Rs. } 26,255$$

or on Rs. 13,12,754 x 2/100 = Rs. 26,255

3.

Form B – RA (Prescribed by IRDA)

General Insurance Co. Ltd

Revenue Account for the year ended 31st March, 2017

Fire and Marine Insurance Businesses

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

Schedules forming part of Revenue Account

Schedule –1

<i>Premiums earned (net)</i>		<i>Fire Current Year</i>	<i>Marine Current Year</i>
		<i>Rs.</i>	<i>Rs.</i>
Premiums from direct business written		4,80,000	3,50,000
Less: Premium on reinsurance ceded		<u>(25,000)</u>	<u>(15,000)</u>
Total Premium earned		4,55,000	3,35,000

Less: Change in provision for unexpired risk		<u>(27,500)</u>	<u>(1,95,000)</u>
		<u>4,27,500</u>	<u>1,40,000</u>
Schedule – 2			
Claims incurred (net)		<u>82,000</u>	88,000
Schedule – 4			
Operating expenses related to insurance business			
Expenses of Management		70,000	50,000

Form B-PL

General Insurance Co. Ltd.

Profit and Loss Account for the year ended 31st March, 2017

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

Working Notes:

		<i>Fire</i>	<i>Marine</i>
		<i>Rs.</i>	<i>Rs.</i>
1.	Claims under policies less reinsurance		
	Claims paid during the year	1,00,000	80,000
	Add: Outstanding on 31 st March, 2017	<u>10,000</u>	<u>15,000</u>
		1,10,000	95,000
	Less: Outstanding on 1 st April, 2016	<u>(28,000)</u>	<u>(7,000)</u>
		<u>82,000</u>	<u>88,000</u>
2.	Expenses of management		
	Expenses paid during the year	60,000	45,000
	Add: Outstanding on 31 st March, 2017	<u>10,000</u>	<u>5,000</u>
		<u>70,000</u>	<u>50,000</u>
3.	Premiums less reinsurance		
	Premiums received during the year	4,50,000	3,30,000

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

Add: Outstanding on 31 st March, 2017	<u>30,000</u>	<u>20,000</u>
	4,80,000	3,50,000
Less: Reinsurance premiums	<u>(25,000)</u>	<u>(15,000)</u>
	<u>4,55,000</u>	<u>3,35,000</u>

4. Reserve for unexpired risks is 50% of net premium for fire insurance and 100% of net premium for marine insurance. Reserve for unexpired risks for fire insurance = Rs. 4,55,000 x 50% = Rs. 2,27,500. Opening Balance in reserves for unexpired risk for fire insurance was Rs. 2,00,000. Hence, additional transfer to reserve for fire insurance in the year will be Rs. 27,500. On similar basis of calculation, the additional transfer to reserve for marine insurance will be Rs. 1,95,000

5. Provision for taxation account

	Rs.		Rs.
31.3.2017 To Bank A/c (taxes paid)	60,000	1.4.2016 By Balance b/d	85,000
31.3.2017 To Balance c/d	1,24,138	31.3.2017 By P & L A/c (Bal Fig)	99,138
	<u>1,84,138</u>		<u>1,84,138</u>

4. (a) 1. Calculation of Departmental Results (Actual Gross Profit):

	A (Rs.)	B (Rs.)	C (Rs.)
Actual Sales	1,72,500	1,59,400	74,600
Add back: Discount (Refer W.N.)	<u>2,500</u>	<u>600</u>	<u>400</u>
Normal sale	<u>1,75,000</u>	<u>1,60,000</u>	<u>75,000</u>
Gross profit % on normal sales	20%	25%	33.33%
Normal gross profit	35,000	40,000	25,000
Less: Discount	<u>(2,500)</u>	<u>(600)</u>	<u>(400)</u>
Actual gross profit	<u>32,500</u>	<u>39,400</u>	<u>24,600</u>

2. Computation of value of stock as on 31st Dec. 2016

Departments	A Rs.	B Rs.	C Rs.
Stock (on 1.1. 2016)	24,000	36,000	12,000
Add: Purchases	<u>1,46,000</u>	<u>1,24,000</u>	<u>48,000</u>
	1,70,000	1,60,000	60,000
Add: Actual gross profit	<u>32,500</u>	<u>39,400</u>	<u>24,600</u>
	2,02,500	1,99,400	84,600
Less: Actual Sales	<u>(1,72,500)</u>	<u>(1,59,400)</u>	<u>(74,600)</u>
Closing stock as on 31.12.2016 (bal.fig.)	<u>30,000</u>	<u>40,000</u>	<u>10,000</u>

Working Note:

Calculation of discount on sales:

Departments	A Rs.	B Rs.	C Rs.
Sales at normal price	10,000	3,000	1,000

Less: Sales at actual price	(7,500)	(2,400)	(600)
	<u>2,500</u>	<u>600</u>	<u>400</u>

(b)

Trading and Profit and Loss A/c

For the year ended 31st March 2017

	Head office Rs.	Branch Rs.		Head office Rs.	Branch Rs.
To Opening stock	2,25,000	-	By Sales	27,81,000	9,50,000
To Purchases	25,50,000	-	By Goods sent to branch	9,54,000	-
To Goods received from head office	-	9,54,000	By Closing stock (W.N.1 & 2)	7,00,000	99,000
To Gross profit c/d	<u>16,60,000</u>	<u>95,000</u>			
	<u>44,35,000</u>	<u>10,49,000</u>		<u>44,35,000</u>	<u>10,49,000</u>
To Office expenses	90,000	8,500	By Gross profit b/d	16,60,000	95,000
To Selling expenses	72,000	6,300			
To Staff salaries	65,000	12,000			
To Branch Stock Reserve (W.N.3)	44,000	-			
To Net Profit	<u>13,89,000</u>	<u>68,200</u>			
	<u>16,60,000</u>	<u>95,000</u>		<u>16,60,000</u>	<u>95,000</u>

Working Notes:

(1)	Calculation of closing stock of head office:	Rs.
	Opening Stock of head office	2,25,000
	Goods purchased by head office	<u>25,50,000</u>
		27,75,000
	Less: Cost of goods sold [37,35,000* x 100/180]	<u>(20,75,000)</u>
		<u>7,00,000</u>
(2)	Calculation of closing stock of branch:	Rs.
	Goods received from head office [At invoice value]	9,54,000
	Less: Invoice value of goods sold [9,50,000 x 180/200]	<u>(8,55,000)</u>
		<u>99,000</u>
(3)	Calculation of unrealized profit in branch stock:	
	Branch stock	Rs. 99,000
	Profit included	80% of cost
	Hence, unrealized profit would be = Rs. 99,000 x 80/180 =	Rs. 44,000

* Rs. 27,81,000 + Rs. 9,54,000

5. (a)

<i>Realisation</i>	<i>Interest on loans from partners' spouses</i>	<i>Interest on loans</i>				
			A	B	C	Total
Rs.	Rs.	Rs.	Rs.	Rs.	Rs.	Rs.
Balances due (1)	2,000	1,000	9,600	6,000	8,400	24,000
(i) Sale of investments	1,000	<u>(1,000)</u>				
		1,000				
(ii) Sale of furniture	2,000	<u>(1,000)</u>				
(iii) Sale of machinery	1,200					
Maximum possible loss	Rs. 22,800					
(total of capitals Rs. 24,000 less cash available Rs. 1,200) allocated to partners in the profit sharing ratio i.e. 5 : 3 : 2			<u>(11,400)</u>	<u>(6,840)</u>	<u>(4,560)</u>	<u>(22,800)</u>
Amounts at credit			(1,800)	(840)	3,840	1,200
Deficiency of A and B written off against C			<u>1,800</u>	<u>840</u>	<u>(2,640)</u>	
Amount paid (2)			–	–	1,200	1,200
Balances in capital accounts (1 – 2) = (3)			9,600	6,000	7,200	22,800
(iv) Sale of stock	4,000					
Maximum possible loss	<u>18,800</u> (22,800 – 4,000)					
Allocated to partners in the ratio 5 : 3 : 2			<u>(9,400)</u>	<u>(5,640)</u>	<u>(3,760)</u>	<u>(18,800)</u>
Amounts at credit and cash paid (4)			200	360	3,440	(4,000)
Balances in capital accounts left unpaid —Loss (3 – 4) = (5)			<u>9,400</u>	<u>5,640</u>	<u>3,760</u>	18,800

- (b) As per AS 29, 'Provisions, Contingent Liabilities and Contingent Assets', where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement should be recognised when, and only when, it is virtually certain that reimbursement will be received if the enterprise settles the obligation. The reimbursement should be treated as a separate asset. The amount recognised for the reimbursement should not exceed the amount of the provision.

Accordingly, potential loss to an enterprise may be reduced or avoided because a contingent liability is matched by a related counter-claim or claim against a third party. In such cases, the amount of the provision is determined after taking into account the probable recovery under the claim if no significant uncertainty as to its measurability or collectability exists. In this case, the provision of salary to employees of Rs. 680 lakhs will be ultimately collected from the client, as per the terms of the contract. Therefore, the liability of Rs. 680 lakhs is matched by the counter claim from the client. Hence, the provision for salary of employees should be matched with the reimbursable asset to be claimed from the client. It appears that the whole amount of Rs. 680 lakhs is recoverable from client and there is no significant uncertainty about the collection. Hence, the net charge to profit and loss account should be nil.

The opinion of the accountant regarding recognition of income of Rs. 680 lakhs is not as per AS-29 and also the concept of prudence will not be followed if Rs. 680 lakhs is simultaneously recognized as income. Rs. 680 lakhs is not the revenue at present but only reimbursement of

claim for which an asset is created. However, the accountant is correct to the extent as that non- recognition of Rs. 680 lakhs as income will result in the understatement of profit. To avoid this, in the statement of profit and loss, expense relating to provision may be presented net of the amount recognized for reimbursement.

6.

ABC Bank Ltd.

Profit and Loss Account for the year ended 31st March, 2017

(Rs. in '000)

	Particulars	Schedule No.	Year ended on 31st March, 2013
I.	Income		
	Interest earned (W.N. 1)	13	8,830
	Other income	14	<u>220</u>
	Total		<u>9,050</u>
II.	Expenditure		
	Interest expended	15	2,720
	Operating expenses	16	2,830
	Provisions and contingencies (W.N. 4)		<u>2,513.95</u>
	Total		<u>8,063.95</u>
III.	Profit/Loss		
	Net profit/(loss) for the year		986.05
	Profit/(loss) brought forward		<u>Nil</u>
	Total		<u>986.05</u>
IV.	Appropriations		
	Transfer to statutory reserve @ 25%		246.51
	Balance carried to balance sheet		<u>739.54</u>
	Total		<u>986.05</u>

Working Notes:

1. Schedule 13 – Interest Earned

(Rs. '000s)			
(i)	Interest and discount	8,860	
	Less: Rebate on bills discounted not provided	(30)	
	Interest accrued on investments	<u>(10)</u>	8,820
(ii)	Interest accrued on investments		<u>10</u>
			<u>8,830</u>

Note: Interest accrued on investments to be shown separately under Interest Earned.

2. Calculation of Provisions and Contingencies

Assets	Amount	% of Provision	Provision
	(Rs. in '000)		(Rs. in '000)
Standard assets	4,000	0.40	16

Sub-standard assets*	2,240	15	336
Doubtful assets (unsecured)	390	100	390
Doubtful assets – covered by security			
Less than 1 year	100	25	25
More than 1 year but less than 3 years	600	40	240
More than 3 years	600	100	600
Loss assets	<u>376</u>	100	<u>376</u>
Total provision	<u>8,306</u>		<u>1,983</u>

***Note:** It is assumed that sub-standard assets are fully secured.

3. **Calculation of provision on tax** = 35% (Total income – Total expenditure)
= 35% of Rs. [(9,050 – (2,720 + 2,830 + 1,983))]
= 35% of Rs. 1,517
= Rs. 530.95

4. **Total provisions and contingencies** = Rs. 1,983 + Rs. 530.95 = Rs. 2,513.95.

7. (a) As per AS 11 'The Effects of Changes in Foreign Exchange Rates', Monetary items are money held and assets and liabilities to be received or paid in fixed or determinable amounts of money.

Foreign currency monetary items should be reported using the closing rate at each balance sheet date. However, in certain circumstances, the closing rate may not reflect with reasonable accuracy the amount in reporting currency that is likely to be realised from, or required to disburse, a foreign currency monetary item at the balance sheet date. In such circumstances, the relevant monetary item should be reported in the reporting currency at the amount which is likely to be realised from or required to disburse, such item at the balance sheet date.

Share capital	Non-monetary
Trade receivables	Monetary
Investments	Non-monetary
Fixed assets	Non-monetary

- (b) As per AS 26 "Intangible Assets", expenditure on research should be recognised as an expense when it is incurred. An intangible asset arising from development (or from the development phase of an internal project) should be recognized if and only if, an enterprise can demonstrate all of the conditions specified in para 44 of the standard. An intangible asset (arising from development) should be derecognised when no future economic benefits are expected from its use according to the provisions of AS 26. Therefore, the management cannot defer the expenditure write off to future years and the company is required to expense the entire amount of Rs. 30 lakhs in the Profit and Loss account of the year ended 31st March, 2016.

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

	No. of debenture
Total number of debentures	30,000
Less: Debenture holders not opted for conversion	<u>(2,500)</u>
	<u>27,500</u>
Option for conversion	20%

Number of debentures for conversion $(27,500 \times \frac{20}{100})$	5,500
Redemption value at a premium of 5% $(5,500 \times \text{Rs. } 105)$	Rs. 5,77,500
Number of equity shares to be allotted $\frac{\text{Rs. } 5,77,500}{\text{Rs. } 15}$	38,500 shares

- (d) If the firm is dissolved before the term expires, as is the case, W being a partner who has paid premium on admission will have to be repaid / refunded

The criteria for calculation of refund amount are:

- Terms upon which admission was made,
- The time period for which it was agreed that the firm will not be dissolved,
- The time period for which the firm has already been in existence.

No claim for refund will arise if:

- The firm is dissolved due to death of a partner,
- If the dissolution of the firm is basically because of misconduct of W,
- If the dissolution is through an agreement and such agreement does not have a stipulation for refund of premium.

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

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

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

Vesting period = 1 month

Expenses recognized in 2015-16 = Rs. 2,40,000

Date	Particulars		Rs.	Rs.
31.03.2016	Bank (40,000 shares x Rs. 50)	Dr.	20,00,000	
	Employees compensation expense A/c	Dr.	2,40,000	
	To Share Capital (40,000 shares x Rs.10)			4,00,000
	To Securities Premium (40,000 shares x Rs. 46)			18,40,000
	(Being option accepted by 400 employees & payment made @ Rs. 56 share)			
	Profit & Loss A/c	Dr.	2,40,000	
	To Employees compensation expense A/c			2,40,000
	(Being Employees compensation expense transferred to Profit & Loss A/c)			

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

Question No. 1 is compulsory.

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

Time Allowed – 3 Hours

Maximum Marks – 100

1. Discuss the following:
 - (a) Weaknesses in the design of the internal control system and non-compliance with identified control procedures amongst other conditions or events which increase the risk of fraud or error.
 - (b) The report of an independent auditor is the only real safeguard available to the various parties interested in the financial affairs of the entity. It is due to the independence of the auditor, leading to an objective report, that the risk of people being misled by untrue or fraudulent financial statement is minimized.
 - (c) Even when information to be used as audit evidence is obtained from sources external to the entity, circumstances may exist that could affect its reliability. While recognising that exceptions may exist, generalisations about the reliability of audit evidence may be useful.
 - (d) SA 320 on 'Materiality in Planning and Performing an Audit' requires that the auditor should consider materiality and its relationship with audit risk when conducting an audit.

(5 x 4 = 20 Marks)
2. State with reason (in short) whether the following statements are correct or incorrect (Answer any eight):
 - (i) Fraudulent financial reporting does not involves intentional misstatements including omissions of amounts or disclosures in financial statements to deceive financial statement users.
 - (ii) An auditor conducting an audit in accordance with SAs is responsible for obtaining absolute assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error.
 - (iii) 'Significant Risk' is an identified and assessed risk of material misstatement that, in the auditor's judgment, requires special audit consideration.
 - (iv) Teeming and lading is one of the techniques of inflating cash payments.
 - (v) Observation consists of seeking information of knowledgeable persons, both financial and non- financial, within the entity or outside the entity.
 - (vi) Sufficiency is the measure of the quality of audit evidence.
 - (vii) As per section 138 of the Companies Act, 2013 private companies are not required to appoint internal auditor.
 - (viii) The first auditor of a Government company was appointed by the Board in its meeting after 10 days from the date of registration.
 - (ix) Director's relative can act as an auditor of the company.
 - (x) If an LLP (Limited Liability Partnership Firm) is appointed as an auditor of a company, every partner of a firm shall be authorized to act as an auditor.

(8 x 2 = 16 Marks)

3. How will you vouch and/or verify the following:
- Sale proceeds of Scrap Material.
 - Trade Marks and Copyrights.
 - Machinery acquired under Hire-purchase system.
 - Work-in-progress. **(4 x 4 = 16 Marks)**
4. (a) State the circumstances which could lead to any of the following in an Auditor's Report:
- Modification of opinion
 - Disclaimer of opinion
 - Adverse opinion
 - Qualified opinion. **(4 x 2 = 8 Marks)**
- (b) State the significant difficulties encountered during audit with reference to SA-260 (Communication with Those Charged with Governance). **(4 Marks)**
- (c) Explain what do you mean by Analytical procedures. How such procedures are helpful in auditing? **(4 Marks)**
5. (a) What are accounting estimates according to the Standards on Auditing 540? Give examples. **(6 Marks)**
- (b) "An auditor who before the completion of the engagement is requested to change the engagement to one which provides a lower level of assurance should consider the appropriateness of doing so." Discuss. **(6 Marks)**
- (c) How would you assess the reliability of internal control system in Computerised Information System (CIS) environment? **(4 Marks)**
6. (a) Anandbhai & Co. Ltd. issued shares to the equity shareholders in the proportion of one bonus share for every three existing shares. As an auditor of the Company, how would you verify this issue? **(6 Marks)**
- (b) An audit of Expenditure is one of the major components of Government Audit. In the context of 'Government Expenditure Audit', write in brief, what do you understand by:
- Audit against Rules and Orders
 - Audit of Sanctions
 - Audit against Provision of Funds
 - Propriety Audit
 - Performance Audit. **(5 x 2 = 10 Marks)**
7. Write short notes on **any four** of the following:
- Issue of Shares at a Discount
 - Filling of a casual vacancy of auditor in respect of a company audit.
 - Appointment of First Auditor of a Government Company.
 - Meaning of the term "subsequent events" as used in the SA 560.
 - General principles of verification of Assets **(4 x 4 = 16 Marks)**

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

1. (a) **Conditions which Increases the Risk of Fraud or Error:** In planning and performing an examination, the auditor should take into consideration the risk of material misstatements of the financial information caused by fraud or error. Weaknesses in the design of the internal control system and non-compliance with identified control procedures amongst other conditions or events which increase the risk of fraud or error are-
- (i) Weaknesses in the design of internal control system and non-compliance with the laid down control procedures, e.g., a single person is responsible for the receipt of all dak and marking it to the relevant sections or two persons are responsible for receipt of dak but the same is not followed in actual practice, etc.
 - (ii) Doubts about the integrity or competence of the management, e.g., domination by one person, high turnover rate of employees, frequent change of legal counsels or auditors, significant and prolonged understaffing of the accounts department, etc.
 - (iii) Unusual pressures within the entity, for example, industry is doing well but the company is not performing accordingly, heavy dependence on a single line of product, inadequate working capital, entity needs raising share prices to support the market price in the wake of public offer, etc.
 - (iv) Unusual transactions such as transactions with related parties, excessive payment for certain services to lawyers, etc.
 - (v) Problems in obtaining sufficient and appropriate audit evidence, e.g., inadequate documentation, significant differences between the figures as per the accounting records and confirmation received from third parties, etc.

- (b) **Importance of Audit by an Independent Professional Auditor:** The principal advantage of an independent audit lies in the fact that the society is able to get an informed, objective and forthright opinion on the financial statements of enterprises which are used in making significant economic decisions by interested segments of the society, e.g., shareholders, trade payables, bankers, etc. Irrespective of the fact whether audit is compulsory, statutory or voluntary, the audit of accounts by an independent professional auditor becomes important for every individual and every type of organisation.

It is only through audited accounts by an independent professional auditor that the shareholders of a company are assured that the funds invested by them are safe and they are being used for only the purposes for which they were raised and collected. The chief utility of audit lies in ensuring reliable financial statements on the basis of which the state of affairs may be easy to understand. Information contained in the statement of accounts of a business are primarily intended for the owners.

However, many others make use of the information for different purposes-

- Management of the business uses it for decision-making purposes.
- Lenders and trade payables examine it to establish the degree of safety of their money.

- Government levies tax putting a prima facie reliance on the statements and regulates the socio-economic state of affairs on a summary view of the information contained in various accounting statement made available to it.
- Investors review the information for making investment decisions.
- Financial analysts can use the information to assess the performance of an entity.

Financial statements are of great significance to workers as well. They want to be assured that reasonable and legitimate share of the revenue earned by the organisation has been paid to them as bonus and the distribution pattern has not violated the norms of social justice.

To ensure the acceptable degree of reliability and accuracy of the financial statements, examination and appraisal of accounts and the financial picture by an independent auditor is necessary.

In the company form of organisation, there is a divorce between ownership and management - shareholders are so scattered that they have no direct control on the day-to-day administration of the company while in a proprietary concern, accounts may be audited to get funds from financial institution, etc. and a partnership firm may get its accounts audited to decide questions such as valuation of goodwill at the time of admission, retirement and death of a partner.

The report of an independent auditor is, therefore, the only real safeguard available to the various parties interested in the financial affairs of the entity. It is due to the independence of the auditor, leading to an objective report, that the risk of people being misled by untrue or fraudulent financial statement is minimized. As a by-product, managements get attuned to open and truthful financial statements.

(c) **Reliability of Audit Evidence:** SA 500 on “Audit Evidence” provides that the reliability of information to be used as audit evidence, and therefore of the audit evidence itself, is influenced by its source and its nature, and the circumstances under which it is obtained, including the controls over its preparation and maintenance where relevant. Therefore, generalisations about the reliability of various kinds of audit evidence are subject to important exceptions. Even when information to be used as audit evidence is obtained from sources external to the entity, circumstances may exist that could affect its reliability. For example, information obtained from an independent external source may not be reliable if the source is not knowledgeable, or a management’s expert may lack objectivity. While recognising that exceptions may exist, the following generalisations about the reliability of audit evidence may be useful:

- (1) The reliability of audit evidence is increased when it is obtained from independent sources outside the entity.
- (2) The reliability of audit evidence that is generated internally is increased when the related controls, including those over its preparation and maintenance, imposed by the entity are effective.
- (3) Audit evidence obtained directly by the auditor (for example, observation of the application of a control) is more reliable than audit evidence obtained indirectly or by inference (for example, inquiry about the application of a control).
- (4) Audit evidence in documentary form, whether paper, electronic, or other medium, is more reliable than evidence obtained orally (for example, a contemporaneously written record of a meeting is more reliable than a subsequent oral representation of the matters discussed).

(5) Audit evidence provided by original documents is more reliable than audit evidence provided by photocopies or facsimiles, or documents that have been filmed, digitized or otherwise transformed into electronic form, the reliability of which may depend on the controls over their preparation and maintenance.

(d) **Relationship between Materiality and Audit Risk:** SA 320 on 'Materiality in Planning and Performing an Audit' requires that the auditor should consider materiality and its relationship with audit risk when conducting an audit. Materiality depends on the size and the nature of the items judged in the particular circumstances of its misstatement.

The audit should be planned so that audit risk is kept at an acceptably low level. There is an inverse relationship between Materiality and the degree of audit risk. Higher the materiality level the lower the audit risk and vice-versa. After the auditor has assessed the inherent and control risks, he should consider the level of detection risk that he is prepared to accept and, based upon his judgment, select appropriate substantive audit procedures. If the auditor does not perform any substantive procedures, detection risk, that is, the risk that the auditor will fail to detect a misstatement, will be high.

The auditor's assessment of audit risk may change during the course of an audit according to the need and development of the circumstances.

2. (i) **Incorrect:** Fraudulent financial reporting involves intentional misstatements including omissions of amounts or disclosures in financial statements to deceive financial statement users. It can be caused by the efforts of management to manage earnings in order to deceive financial statement users by influencing their perceptions as to the entity's performance and profitability.
- (ii) **Incorrect:** An auditor conducting an audit in accordance with SAs is responsible for obtaining reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error.
- (iii) **Correct:** SA 315 "Identifying and Assessing the Risk of Material Misstatement through understanding the Entity and its Environment" defines 'significant risk' as an identified and assessed risk of material misstatement that, in the auditor's judgment, requires special audit consideration.
- (iv) **Incorrect:** Teeming and Lading is one of the techniques of suppressing cash receipts and not of inflating cash payments. Money received from one customer is misappropriated and the account is adjusted with the subsequent receipt from another customer and so on.
- (v) **Incorrect:** Inquiry consists of seeking information of knowledgeable persons, both financial and non- financial, within the entity or outside the entity.
- (vi) **Incorrect:** Appropriateness is the measure of the quality of audit evidence. On the other hand, sufficiency is the measure of the quantity of audit evidence.
- (vii) **Incorrect:** Section 138 of the Companies Act, 2013 requires every private company to appoint an internal auditor having turnover of ₹ 200 crore or more during the preceding financial year; or outstanding loans or borrowings from banks or public financial institutions exceeding ₹ 100 crore or more at any point of time during the preceding financial year.
- (viii) **Incorrect:** According to section 139(7) of the Companies Act, 2013, in the case of a Government company, the first auditor shall be appointed by the Comptroller and Auditor-General of India within 60 days from the date of registration of the company. If CAG fails to make the appointment within 60 days, the Board shall appoint in next 30 days.
- (ix) **Incorrect:** As per section 141(3) of the Companies Act, 2013, a person shall not be eligible for appointment as an auditor of a company whose relative is a Director or is in the employment of the Company as a director or key Managerial Personnel.

- (x) **Incorrect:** As per section 141(2) of the Companies Act, 2013, where a firm including a limited liability partnership (LLP) is appointed as an auditor of a company, only the partners who are Chartered Accountants shall be authorised to act and sign on behalf of the firm.

3. (a) Sale Proceeds of Scrap Material:

- (i) Review the internal control on scrap materials, as regards its generation, storage and disposal and see whether it was properly followed at every stage.
- (ii) Ascertain whether the organisation is maintaining reasonable records for the sale and disposal of scrap materials.
- (iii) Review the production and cost records for determination of the extent of scrap materials that may arise in a given period.
- (iv) Compare the income from the sale of scrap materials with the corresponding figures of the preceding three years.
- (v) Check the rates at which different types of scrap materials have been sold and compare the same with the rates that prevailed in the preceding year.
- (vi) See that scrap materials sold have been billed and check the calculations on the invoices.
- (vii) Ensure that there exists a proper procedure to identify the scrap material and good quality material is not mixed up with it.
- (viii) Make an overall assessment of the value of the realisation from the sale of scrap materials as to its reasonableness.

(b) Trade Marks and Copyrights:

- (i) Obtain schedule of Trade Marks and Copyrights duly signed by the responsible officer and scrutinise the same and confirm that all of them are shown in the Balance Sheet.
- (ii) Examine the written agreement in case of assignment of Copyrights and Assignment Deed in case of transfer of trade marks. Also ensure that trade marks and copyrights have been duly registered.
- (iii) Verify existence of copyright by reference to contract between the author & the entity and note down the terms of payment of royalty.
- (iv) See that the value has been determined properly and the costs incurred for the purpose of obtaining the trade marks and copyrights have been capitalised.
- (v) Ascertain that the legal life of the trade marks and copyrights have not expired.
- (vi) Ensure that amount paid for both the intangible assets is properly amortised having regard to appropriate legal and commercial considerations, as per the principles enunciated under AS 26 on Intangible Assets.

(c) Machinery Acquired Under Hire-Purchase System:

- (i) Examine the Board's Minute Book approving the purchase on hire-purchase terms.
- (ii) Examine the hire-purchase agreement carefully and note the description of the machinery, cost of the machinery, hire purchase charges, and terms of payment and rate of purchase.
- (iii) Assets acquired under Hire Purchase System should be recorded at the full cash value with corresponding liability of the same amount. In case cash value is not readily available, it should be calculated presuming an appropriate rate of interest.

- (iv) Hire purchased assets are shown in the balance sheet with an appropriate narration to indicate that the enterprise does not have full ownership thereof. The interest payable along with each installments, whether separately or included therein should be debited to the interest account and not to the asset account.
- (d) **Work-in-Progress:** The audit procedures regarding work-in-progress are similar to those used for raw materials and finished goods. However, the auditor has to carefully assess the stage of completion of the work-in-progress for assessing the appropriateness of its valuation. For this purpose, the auditor may examine the production/costing records (i.e., cost sheets), hold discussions with the personnel concerned, and obtain expert opinion, where necessary. The auditor may advise his client that where possible the work-in-progress should be reduced to the minimum before the closing date. Cost sheets of work-in-progress should be verified as follows-
- (i) Ascertain that the cost sheets are duly attested by the works engineer and works manager.
 - (ii) Test the correctness of the cost as disclosed by the cost records by verification of quantities and cost of materials, wages and other charges included in the cost sheets by reference to the records maintained in respect thereof.
 - (iii) Compare the unit cost or job cost as shown by the cost sheet with the standard cost or the estimated cost expected.
 - (iv) Ensure that the allocation of overhead expenses had been made on a rational basis.
 - (v) Compare the cost sheet in detail with that of the previous year. If they vary materially, investigate the cause thereof.
 - (vi) Ensure that the Work-in-Progress as at Balance Sheet date has been appropriately disclosed in Balance Sheet as per the requirements of Part I of Schedule III of the Companies Act, 2013.
4. (a) (i) **Modification of Opinion:** The auditor shall modify the opinion in the auditor's report when-
- (1) The auditor concludes that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement; or
 - (2) The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement.
- (ii) **Disclaimer of Opinion:** The auditor shall disclaim an opinion when the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, and the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive.
- The auditor shall disclaim an opinion when, in extremely rare circumstances involving multiple uncertainties, the auditor concludes that, notwithstanding having obtained sufficient appropriate audit evidence regarding each of the individual uncertainties, it is not possible to form an opinion on the financial statements due to the potential interaction of the uncertainties and their possible cumulative effect on the financial statements.
- (iii) **Adverse Opinion:** The auditor shall express an adverse opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements.
- (iv) **Qualified Opinion:** The auditor shall express a qualified opinion when-
- (i) The auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are material, but not pervasive, to

the financial statements; or

- (ii) The auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, but the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive.

(b) **Significant Difficulties Encountered During the Audit:** As per SA 260 “Communication with Those Charged with Governance”, significant difficulties encountered during the audit may include such matters as:

- ◆ Significant delays in management providing required information.
- ◆ An unnecessarily brief time within which to complete the audit.
- ◆ Extensive unexpected effort required to obtain sufficient appropriate audit evidence.
- ◆ The unavailability of expected information.
- ◆ Restrictions imposed on the auditor by management.
- ◆ Management’s unwillingness to make or extend its assessment of the entity’s ability to continue as a going concern when requested.

(c) **SA 520 ‘Analytical Procedures’:** As per SA 520, the term “analytical procedures” means evaluations of financial information through analysis of plausible relationships among both financial and non-financial data. Analytical procedures also encompass such investigation as is necessary of identified fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount. The auditor’s choice of procedures, methods and level of application is a matter of professional judgement.

Analytical procedures include the consideration of comparisons of the entity’s financial information with, for example: comparable information for prior periods; anticipated results of the entity, such as budgets or forecasts, or expectations of the auditor, such as an estimation of depreciation; and similar industry information, such as a comparison of the entity’s ratio of sales to accounts receivable with industry averages or with other entities of comparable size in the same industry.

Analytical procedures also include consideration of relationships, for example: among elements of financial information that would be expected to conform to a predictable pattern based on the entity’s experience, such as gross margin percentages; and between financial information and relevant non-financial information, such as payroll costs to number of employees.

Various methods may be used to perform analytical procedures. These methods range from performing simple comparisons to performing complex analyses using advanced statistical techniques. Analytical procedures may be applied to consolidated financial statements, components and individual elements of information.

Analytical procedures are used for the following purposes:

- (a) To obtain relevant and reliable audit evidence when using substantive analytical procedures; and
- (b) To design and perform analytical procedures near the end of the audit that assist the auditor when forming an overall conclusion as to whether the financial statements are consistent with the auditor’s understanding of the entity.

5. (a) **Accounting Estimates:** According to the SA 540, “Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosure”, accounting estimate means an approximation of a monetary amount in the absence of a precise means of measurement. This

term is used for an amount measured at fair value where there is estimation uncertainty, as well as for other amounts that require estimation. SA 540 addresses only accounting estimates involving measurement at fair value, the term “fair value accounting estimates” is used.

Because of the uncertainties inherent in business activities, some financial statement items can only be estimated. Further, the specific characteristics of an asset, liability or component of equity, or the basis of or method of measurement prescribed by the financial reporting framework, may give rise to the need to estimate a financial statement item. Some financial reporting frameworks prescribe specific methods of measurement and the disclosures that are required to be made in the financial statements, while other financial reporting frameworks are less specific.

Some accounting estimates involve relatively low estimation uncertainty and may give rise to lower risks of material misstatements, for example:

- Accounting estimates arising in entities that engage in business activities that are not complex.
- Accounting estimates that are frequently made and updated because they relate to routine transactions.

For some accounting estimates, however, there may be relatively high estimation uncertainty, particularly where they are based on significant assumptions, for example:

- Accounting estimates relating to the outcome of litigation.
- Fair value accounting estimates for derivative financial instruments not publicly traded.
- Additional examples of accounting estimates are:
 - Allowance for doubtful accounts.
 - Inventory obsolescence.
 - Warranty obligations.
 - Depreciation method or asset useful life.
 - Provision against the carrying amount of an investment where there is uncertainty regarding its recoverability.
 - Outcome of long term contracts.
 - Financial Obligations / Costs arising from litigation settlements and judgments.

- (b) Acceptance of a Change in Engagement:** An auditor who, before the completion of the engagement, is requested to change the engagement to one which provides a lower level of assurance, should consider the appropriateness of doing so.

A request from the client for the auditor to change the engagement may result from a change in circumstances affecting the need for the service, a misunderstanding as to the nature of an audit or related service originally requested or a restriction on the scope of the engagement, whether imposed by management or caused by circumstances. The auditor would consider carefully the reason given for the request, particularly the implications of a restriction on the scope of the engagement, especially any legal or contractual implications.

If the auditor concludes that there is reasonable justification to change the engagement and if the audit work performed complied with the SAs applicable to the changed engagement, the report issued would be appropriate for the revised terms of engagement. In order to avoid confusion, the report would not include reference to-

- (i) the original engagement; or

- (ii) any procedures that may have been performed in the original engagement, except where the engagement is changed to an engagement to undertake agreed-upon procedures and thus reference to the procedures performed is a normal part of the report.

The auditor should not agree to a change of engagement where there is no reasonable justification for doing so.

If the terms of the audit engagement are changed, the auditor and management shall agree on and record the new terms of the engagement in an engagement letter or other suitable form of written agreement.

If the auditor is unable to agree to a change of the terms of the audit engagement and is not permitted by management to continue the original audit engagement, the auditor shall -

- (i) Withdraw from the audit engagement where possible under applicable law or regulation; and
- (ii) Determine whether there is any obligation, either contractual or otherwise, to report the circumstances to other parties, such as those charged with governance, owners or regulators.

(c) Reliability of Internal Control System in CIS Environment: For evaluating the reliability of internal control system in CIS environment, the auditor would consider the following -

- (i) That authorised, correct and complete data is made available for processing.
- (ii) That it provides for timely detection and corrections of errors.
- (iii) That in case of interruption due to mechanical, power or processing failures, the system restarts without distorting the completion of entries and records.
- (iv) That it ensures the accuracy and completeness of output.
- (v) That it provides security to application softwares & data files against fraud etc.
- (vi) That it prevents unauthorised amendments to programs.

6. (a) Verification of Issue of Bonus Shares: Section 63 of the Companies Act, 2013 allows a company to issue fully paid-up bonus shares to its members, in any manner whatsoever, out of-

- (i) its free reserves;
- (ii) the securities premium account; or
- (iii) the capital redemption reserve account.

The auditor should ensure that no issue of bonus shares shall be made by capitalising reserves created by the revaluation of assets.

Further, he should also ensure the compliance of condition for capitalization of profits or reserves for the issuing fully paid-up bonus shares like -

- (i) it is authorised by its articles;
- (ii) it has, on the recommendation of the Board, been authorised in the general meeting of the company;
- (iii) it has not defaulted in payment of interest or principal in respect of fixed deposits or debt securities issued by it;
- (iv) it has not defaulted in respect of the payment of statutory dues of the employees, such as, contribution to provident fund, gratuity and bonus;
- (v) the partly paid-up shares, if any outstanding on the date of allotment, are made fully paid-up;

- (vi) it complies with such conditions as may be prescribed like the company which has once announced the decision of its Board recommending a bonus issue, shall not subsequently withdraw the same;
 - (vii) the bonus shares shall not be issued in lieu of dividend.
- (b) **Government Expenditure Audit:** Audit of government expenditure is one of the major components of government audit conducted by the office of C&AG. The basic standards set for audit of expenditure are to ensure that there is provision of funds authorised by competent authority fixing the limits within which expenditure can be incurred. Briefly, these standards are explained below:
- (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 in fructuous expenditure even though the expenditure has been incurred in conformity with the existing rules and regulations. Audit aims to secure a reasonably high standard of public financial morality by looking into the wisdom, faithfulness and economy of transactions.
 - (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. Efficiency-cum-performance audit, wherever used, is an objective examination of the financial and operational performance of an organisation, programme, authority or function and is oriented towards identifying opportunities for greater economy, and effectiveness.

7. (a) **Issue of Shares at a Discount:** According to Section 53 of the Companies Act, 2013, except sweat equity issued as mentioned in section 54, any share issued by a company at a discounted price shall be void.

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

- (b) **Filling of a Casual Vacancy:** As per Section 139(8) of the Companies Act, 2013, any casual vacancy in the office of an auditor shall-
- (i) In the case of a company other than a company whose accounts are subject to audit by an auditor appointed by the Comptroller and Auditor-General of India, be filled by the Board of Directors within 30 days.

If such casual vacancy is as a result of the resignation of an auditor, such appointment shall also be approved by the company at a general meeting convened within 3 months of the recommendation of the Board and he shall hold the office till the conclusion of the

next annual general meeting;

- (ii) In the case of a company whose accounts are subject to audit by an auditor appointed by the Comptroller and Auditor-General of India, be filled by the Comptroller and Auditor-General of India within 30 days.

It may be noted that in case the Comptroller and Auditor-General of India does not fill the vacancy within the said period the Board of Directors shall fill the vacancy within next 30 days.

- (c) **Appointment of First Auditor of a Government Company:** Section 139(7) of the Companies Act, 2013 provides that in the case of a Government company or any other company owned or controlled, directly or indirectly, by the Central Government, or by any State Government, or Governments, or partly by the Central Government and partly by one or more State Governments, the first auditor shall be appointed by the Comptroller and Auditor-General of India within 60 days from the date of registration of the company.

In case the Comptroller and Auditor-General of India does not appoint such auditor within the above said period, the Board of Directors of the company shall appoint such auditor within the next 30 days. Further, in the case of failure of the Board to appoint such auditor within next 30 days, it shall inform the members of the company who shall appoint such auditor within 60 days at an extraordinary general meeting. Auditors shall hold office till the conclusion of the first annual general meeting.

- (d) **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 upto 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.
- (e) **General Principles of Verification of Assets:** It is not sufficient for the auditors only to verify correctness of the amount of assets shown in the balance sheet, he must verify them by actual inspection or otherwise and establish the existence of assets.

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

- (i) **Cost** - In regard to assets, verification procedure need not generally be extended to determination of the correctness of costs and authority to incur costs unless the items concerned were purchased during the accounting period under review. In such cases the auditor should check the correctness of costs through normal vouching method. He should ensure that adequate distinction has been made between 'revenue' and 'capital' nature of costs.
- (ii) **Ownership** - Where ownership of assets is evidenced by documents of title etc. as in the case of immovable property, a reference should be made to such documents. If the documents are held by third person the auditor should either obtain a certificate directly from that party or arrange to inspect them at the third party's place of business.
- (iii) **Valuation** - It must be ascertained that all assets are valued in accordance with appropriate accounting policy. For the valuation made, the basis must be consistently applied, unless circumstances necessitated a change. Even then a disclosure is required for the change and its monetary effect.
- (iv) **Existence** - Physical inspection should be done wherever possible. Where physical inspection is not possible, the possibility of obtaining indirect evidence be considered e.g. machinery imported held in customs godown or materials sent to subcontractor for

job work or fabrication. In such circumstances certifying of such parties should be obtained and if considered necessary even physical verification may be requested.

- (v) **Presentation in accounts** - Material assets must be properly disclosed and correctly described in the accounts. It should be seen that the description given to them is clear and complete and is not misleading e.g. stating loans on the assets side of the balance sheet "as dependent upon realization" is just misleading as was held in the case of London and General Bank Ltd. care must be taken to see that disclosures required under the statute or statement issued by ICAI are complied with.

MOCK TEST PAPER
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) What are the advantages of using Data Flow Diagram (DFD)?
 - (ii) Explain the term Micro-Architecture.
 - (iii) What do you understand by the term “Telecommunications Control Software”?
 - (iv) Define “Information System”. Also, briefly mention the components of the Information System.
 - (v) Discuss some disadvantages of Cloud Computing. **(2 x 5 = 10 Marks)**
2.
 - (a) Differentiate between Hardware Encryption and Software Encryption. **(4 Marks)**
 - (b) Discuss the risks associated with e-Commerce. **(4 Marks)**
3.
 - (a) Discuss about ‘Core Banking System’ and its elements. **(4 Marks)**
 - (b) Discuss Human Resource Management System (HRMS), in brief. **(4 Marks)**
4.
 - (a) Differentiate between Hardware Virtualization and Network Virtualization. **(4 Marks)**
 - (b) Discuss in brief “Grid Computing Security”. **(4 Marks)**
5.
 - (a) Discuss some of the reasons of failure of Business Process Management Systems (BPMS). **(4 Marks)**
 - (b) Discuss Business Process Management Life Cycle (BPM-L Cycle). **(4 Marks)**
6.
 - (a) Discuss multiple types of cloud in Cloud Computing. **(4 Marks)**
 - (b) Discuss Information System Life Cycle, in brief. **(4 Marks)**
7. Write short notes on any **four** of the following.
 - (a) Process Management
 - (b) Application Software
 - (c) Virtual Private Network (VPN)
 - (d) Business Intelligence
 - (e) Application based on Source of Application **(4 x 2 = 8 Marks)**

MOCK TEST PAPER
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) ABC Ltd. is a marketing services company which provides consultancy to its clients. It has persuaded its entire staff to sign a new contract which does not allow them to work for any rival company for a period of two years. Evaluate and explain the factor according to Porter's Five Forces Model. **(3 Marks)**
- (b) A manufacturing company launched an extremely innovative product two years ago and attained high sales growth. Although the sales are still high, but have fallen in recent months due to a number of rivals launching similar products. The company has started investing in advertising etc. Identify and explain the stage of the product life cycle within which this product exists? **(3 Marks)**
- (c) XYZ is a large supermarket chain. It is considering the purchase of a number of farms that provide XYZ with a significant amount of its fresh produce. XYZ feels that by purchasing the farms, it will have greater control over its supply chain. Identify and explain which type of diversification XYZ follows. **(3 Marks)**
- (d) A company manufactures high quality bicycles and earns high profits. In recent years, its profits are declining due to the entry of competitors which provide cheaper, high quality bicycles from abroad where labour costs are lower. The company has decided to adjust its strategy and adopt a focus approach, targeting its bicycles towards professional athletes. This will increase the margin of profits. Evaluate and explain the strategy which it follows? **(3 Marks)**
- (e) Specify the steps that are needed to initiate & bring changes in the strategic building of any organization. **(3 Marks)**
2. (a) State with reasons which of the following statements is correct/incorrect:
 - (i) Cooperation is generated automatically in businesses owned by members of the same family.
 - (ii) The concept of experience curve is relevant for a number of areas in strategic management. **(2 × 2 = 4 Marks)**
- (b) Explain the meaning of the following concepts:
 - (i) Opportunity
 - (ii) Outbound logistics
 - (iii) Key success factors **(3 × 1 = 3 Marks)**
3. Write short notes on the following:
 - (a) Strategic Group Mapping **(2 Marks)**
 - (b) Best-cost provider strategy **(2 Marks)**
 - (c) Components of Value Chain **(3 Marks)**

4. What is Corporate Strategy? How would you argue that 'corporate strategy 'ensures the correct alignment of the firm with its environment'? **(7 Marks)**
5. What are the issues to be considered while implementing strategies? **(7 Marks)**
6. Distinguish between the TQM and Traditional Management Practices. **(7 Marks)**
7. What are strategic roles of a human resource manager in a large manufacturing and distribution company? **(7 Marks)**

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

1. (i) Advantages of using Data Flow Diagram (DFD) are as follows:
- It aids in describing the boundaries of the system.
 - It is beneficial for communicating existing system knowledge to the users.
 - A straightforward graphical technique which is easy to recognize.
 - DFDs can provide a detailed representation of system components.
 - It is used as the part of system documentation file.
 - DFDs are easier to understand by technical and nontechnical audiences
 - It supports the logic behind the data flow within the system.
- (ii) **Micro Architecture**, also known as **Computer Organization**, 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. This describes the data paths, data processing elements and data storage elements, and describes how they should implement ISA. The Micro architecture can be seen as how the ISA does and what it does. It's how everything is ultimately organized on the chip or processor.
- Micro architecture is the term used to describe the resources and methods used to achieve architecture specification. The term typically includes the way in which these resources are organized as well as the design techniques used in the processor to reach the target cost and performance goals. The micro architecture essentially forms a specification for the logical implementation.
- (iii) **Telecommunications Control Software**: This consists of programs that control telecommunications activities and manage the functions of telecommunications networks. They include Telecommunication Monitors (mainframe host computers), Network Operating Systems (microcomputer network servers) for network servers, Network Management Components and Communication Packages (Microcomputer Web browsers). This software can reside on almost any component of the network and can provide such features as performance monitoring, activity monitoring, priority assigning, transmission error correction and network problem mitigation.
- (iv) **Information System**: Information System (IS) is a combination of people, hardware, software, communication devices, network and data resources that processes (can be storing, retrieving, transforming information) data and information for a specific purpose. The system needs inputs from user (key in instructions and commands, typing, scanning) which will then be processed (calculating, reporting) using technology devices such as computers, and produce output (printing reports, displaying results) that will be sent to another user or other system via a network and a feedback method that controls the operation. **People, Hardware, Software, Data and Networks** are the five basic resources of information systems.

(v) Disadvantages of Cloud Computing are as follows:

- **Technical Issues:** This technology is always prone to outages and other technical issues. Even the best cloud service providers run into this kind of trouble, in spite of keeping up high standards of maintenance. We will invariably be stuck in case of network and connectivity problems.
- **Security in the Cloud:** Surrendering all the company's sensitive information to a third-party cloud service provider could potentially put the company to great risk.
- **Prone to Attack:** Storing information in the cloud could make the company vulnerable to external hack attacks and threats. Nothing on the Internet is completely secure and hence, there is always the lurking possibility of stealth of sensitive data.

2. (a) **Hardware Encryption:** Hardware Encryption devices are available at a reasonable cost, and can support high-speed traffic. If the Internet is being used to exchange information among branch offices or development collaborators, for instance, use of such devices can ensure that all traffic between these offices is secure.

Software Encryption: These are typically employed in conjunction with specific applications. Certain electronic mail packages, for example, provide encryption and decryption for message security.

(b) Some of the risks that are associated with e-Commerce are multi-faceted and are as follows:

- ◆ **Problem of anonymity:** There is need to identify and authenticate users in the virtual global market where anyone can sell to or buy from anyone, anything from anywhere.
- ◆ **Repudiation of contract:** There is possibility that the electronic transaction in the form of contract, sale order or purchase by the trading partner or customer may be denied.
- ◆ **Lack of authenticity of transactions:** The electronic documents that are produced during an e-Commerce transaction may not be authentic and reliable.
- ◆ **Data Loss or theft or duplication:** The data transmitted over the Internet may be lost, duplicated, tampered with or replayed.
- ◆ **Attack from hackers:** Web servers used for e-Commerce may be vulnerable to hackers.
- ◆ **Denial of Service:** Service to customers may be denied due to non-availability of system as it may be affected by viruses, e-mail bombs and floods.
- ◆ **Non-recognition of electronic transactions:** e-Commerce transactions, as electronic records and digital signatures may not be recognized as evidence in courts of law.
- ◆ **Lack of audit trails:** Audit trails in e-Commerce system may be lacking and the logs may be incomplete, too voluminous or easily tampered with
- ◆ **Problem of piracy:** Intellectual property may not be adequately protected when such property is transacted through e-Commerce

3. (a) **Core Banking System:** Core Banking System may be defined as the set of basic software components that manage the services provided by a bank to its customers through its branches (branch network). In other words, the platform where communication technology and information technology are merged to suit core needs of banking is known as Core Banking Solutions (CBS). Normal core banking functions will include deposit accounts, loans, mortgages and payments. Banks make these services available across multiple channels like ATMs, Internet banking, and branches.

The various elements of core banking include:

- ◆ Making and servicing loans;
- ◆ Opening new accounts;

- ◆ Processing cash deposits and withdrawals;
- ◆ Processing payments and cheques;
- ◆ Calculating interest;
- ◆ Customer relationship management (CRM) activities;
- ◆ Managing customer accounts;
- ◆ Establishing criteria for minimum balances, interest rates, number of withdrawals allowed and so on;
- ◆ Establishing interest rates; and
- ◆ Maintaining records for all the bank's transactions.

(b) **Human Resource Management Systems (HRMS):** A Human Resources Management System (HRMS) is a software application that coalesce many human resources functions, together with benefits administration, payroll, recruiting and training, and performance analysis and assessment into one parcel. In other words, HRMS refers to the systems and processes at the intersection between human resource management (HRM) and information technology.

Some of the key modules of HRMS are as below:

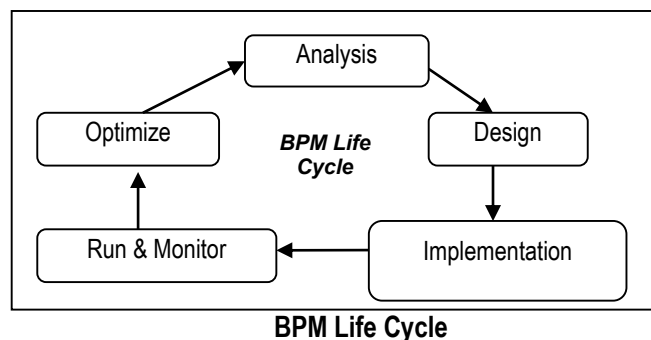
- **Workforce Management:** Integrated across the strategic Human Capital Management (HCM) solution, Workforce Management provides powerful tools to effectively manage labor rules, ensure compliance, and control labor costs and expenses.
- **Time and Attendance Management:** The time and attendance module gathers standardized time and work related efforts.
- **Payroll Management:** This module of the system is designed to automate manual payroll functions and facilitate salary, deductions etc. calculations, eliminates errors and free up HR staff for more productive tasks.
- **Training Management:** The module tracks the trainer or training organization, costs associated with training schedules, training locations, required supplies and equipment and registered attendees.
- **Compensation Management:** Compensation Management allows integrating employee processes, information and programs with organizational processes and strategies to achieve optimal organizational results.
- **Recruitment Management:** This module helps in hiring the right people with the right target skills and includes processes for managing open positions/requisitions, applicant screening, assessments, selection and hiring, correspondence, reporting and cost analysis.
- **Personnel Management:** The personnel management comprises of HR master-data, personnel administration, recruitment and salary administration.
- **Organizational Management:** Organizational management includes, organizational structure, staffing schedules & job description.
- **Employee Self Service (ESS):** The employee self-service module allows employees to query HR related data and perform some HR transactions over the system. The module also lets supervisors approve Over-Time requests from their subordinates through the system without overloading the task on HR department.
- **Analytics:** The Analytics module enables organizations to extend the value of an HRMS implementation by extracting HR related data for use with other business intelligence platforms.

4. (a) **Hardware Virtualization:** Hardware Virtualization or Platform Virtualization refers to the creation of a virtual machine that acts like a real computer with an operating system. Software executed on these virtual machines is separated from the underlying hardware resources. For example, a computer that is running Microsoft Windows may host a virtual machine that looks like a computer with the Linux operating system; based software that can be run on the virtual machine. The basic idea of Hardware virtualization is to consolidate many small physical servers into one large physical server so that the processor can be used more effectively. The software that creates a virtual machine on the host hardware is called a hypervisor or Virtual Machine Manager. The hypervisor controls the processor, memory and other components by allowing several different operating systems to run on the same machine without the need for a source code. The operating system running on the machine will appear to have its own processor, memory and other components.

Network Virtualization: Network virtualization is a method of combining the available resources in a network by splitting up the available bandwidth into channels, each of which is independent from the others, and each of which can be assigned (or reassigned) to a server or device in real time. This allows a large physical network to be provisioned into multiple smaller logical networks and conversely allows multiple physical LANs to be combined into a larger logical network. This behaviour allows administrators to improve network traffic control, enterprise and security. Network virtualization involves platform virtualization, often combined with resource virtualization. Various equipment and software vendors offer network virtualization by combining any of the Network hardware such as switches and network interface cards (NICs); Network elements such as firewalls and load balancers; Networks such as virtual LANs (VLANs); Network storage devices; Network machine-to-machine elements such as telecommunications devices; Network mobile elements such as laptop computers, tablet computers, smart phones and Network media such as Ethernet and Fibre Channel. Network virtualization is intended to optimize network speed, reliability, flexibility, scalability, and security.

- (b) **Grid Computing Security:** Grid systems and applications require standard security functions which are Authentication, Access Control, Integrity, Privacy, and Non-Repudiation. Authentication and access control issues are to provide authentication to verify the users, process which have user's computation and resources used by the processes to authenticate; and to allow local access control mechanisms to be used without change. To develop security architecture, following constraints are taken from the characteristics of grid environment and application.
- **Single Sign-on:** A user should authenticate once and they should be able to acquire resources, use them, and release them and to communicate internally without any further authentication.
 - **Protection of Credentials:** User passwords, private keys, etc. should be protected.
 - **Interoperability with local security solutions:** Access to local resources should have local security policy at a local level. Despite of modifying every local resource there is an inter-domain security server for providing security to local resource.
 - **Exportability:** The code should be exportable i.e. they cannot use a large amount of encryption at a time. There should be a minimum communication at a time.
 - **Support for secure group communication:** In a communication, there are number of processes which coordinate their activities. This coordination must be secure and for this there is no such security policy.
 - **Support for multiple implementations:** There should be a security policy which should provide security to multiple sources based on public and private key cryptography.

5. (a) Some of the reasons for failure of Business Process Management Systems (BPMS) include the following:
- ◆ Superficial or deficient executive involvement
 - ◆ Deficient project management
 - ◆ Breakdown in gap analysis
 - ◆ Limited options for customization of the BPM software is required
 - ◆ Not flexible enough or too complicated to be customized to meet the precise workflow and business process.
 - ◆ Failure to identify future business needs
 - ◆ Inadequate assessment of the need for change management
 - ◆ Persistent compatibility problems with the diverse legacy systems of the partners.
 - ◆ Resources not available when desirable
 - ◆ Software fails to meet business needs
 - ◆ System may be over-engineered when compared to the actual requirements.
 - ◆ Technological obsolescence.
- (b) **BPM Life Cycle (BPM-L Cycle):** An Enterprise Resource Planning (ERP) application divides BPM into the following phases:
- (i) **Analysis phase:** This involves analysis of the current environment and current processes, identification of needs and definition of requirements.
 - (ii) **Design phase:** This involves evaluation of potential solutions to meet the identified needs, business process designing and business process modeling.



- (iii) **Implementation phase:** This involves project preparation, blue printing, realization, final preparation, go live and support.
 - (iv) **Run and Monitor phase:** This involves business process execution or deployment and business process monitoring.
 - (v) **Optimize:** Iterate for continuous improvement.
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 public or a large industry group and is administrated by third parties or vendors over the Internet, and services are offered on pay-per-use basis. It is widely used in the development, deployment and management of enterprise applications, at affordable costs; and 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. 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 must 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 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.

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 that 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, analysing 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) Applications based on 'Source of Application' are as follows:

- **Custom-built Application:** Whether they are for one function or integrate processes across the company like an ERP – these are the easiest ones to customize. These applications can however be configured to meet a company's requirements. Customization involves additional coding while configuration is based on settings which are inputted by the user. Example – Billing, Inventory, Attendance etc.
- **Packaged Software:** These are the standard applications which are not free but are licensed. Customization to suit business requirements may or may not be allowed. For Example -Tally, Oracle 9i, etc.
- **Leased 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.

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

1. (a) **Bargaining power of suppliers:** ABC Ltd. has managed to tie with its staff, who are the key suppliers to the organization. This reduces their power to leave and move to one of ABC's Ltd. rivals. 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.
- (b) **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. The product is still experiencing strong growth. This has been reduced as the large number of new competitors are entering. It has yet to reach maturity as it is still growing strongly.
- (c) **Backward vertical integration:** Backward integration is a step towards, creation of effective supply by entering business of input providers. Strategy employed to expand profits and gain greater control over production of a product whereby a company will purchase or build a business that will increase its own supply capability or lessen its cost of production (as in the case for XYZ).
- (d) **Turnaround strategy:** When firms are losing their grips over market, profits due to several internal and external factors, and if they have to survive under the competitive environment they have to identify danger signals as early as possible and undertake rectification steps immediately.
- (e) The changes in the environmental forces often require businesses to make modifications in their existing strategies and bring out new strategies. For initiating strategic change, three steps can be identified as under:
- (i) **Recognize the need for change:** The first step is to diagnose facets of the corporate culture that are strategy supportive or not. The idea is to determine where the lacuna lies and scope for change exists.
 - (ii) **Create a shared vision to manage change:** Objectives and vision of both individuals and organization should coincide. Senior managers need to constantly and consistently communicate the vision not only to inform but also to overcome resistance.
 - (iii) **Institutionalize the change:** Creating and sustaining a different attitude towards change is essential to ensure that the firm does not slip back into old ways of thinking or doing things. All these changes should be set up as a practice to be followed by the organization and be able to transfer from one level to another as a well settled practice.
2. (a) (i) **Incorrect:** Although, cooperation should generate automatically in businesses owned by members of a same family, many times internal strifes and tussles lead to challenges in cooperation. Sometimes, quarrels and conflicts among the managing members of the family on family matters tend to distort their behaviour in management of business and thereby damage its functioning. Family owned organisations often face succession and ownership issues that are tough to resolve and lead fights and divisions.

- (ii) **Correct:** Experience curve results from a variety of factors such as learning effects, economies of scale, product redesign and technological improvements in production. The concept of experience curve is relevant for a number of areas in strategic management. For instance, experience curve is considered a barrier for new firms contemplating entry in an industry. It is also used to build market share and discourage competition.
- (b) (i) An **opportunity** is a favourable condition in the organization's environment which enables it to consolidate and strengthen its position. An example of an opportunity is growing demand for the products or services that a company provides.
 - (ii) **Outbound logistics** relate to collection, storage and distribution of the product to customers. It includes all activities such as storage/warehousing of finished goods, order processing, scheduling deliveries, operation of delivery vehicles, etc.
 - (iii) **Key success factors** vary from industry to industry and even from time to time within the same industry as driving forces and competitive conditions change. Only rarely does an industry have more than three or four key success factors at any one time. And even among these three or four, one or two usually outrank the others in importance.
3. (a) **Strategic group mapping** is a technique for displaying the different markets or competitive positions that rival firms occupy in the industry. A strategic group is a cluster of firms in an industry with similar competitive approaches and market positions. An industry contains only one strategic group when all sellers pursue essentially identical strategies and have comparable market positions. It involves plotting firms on a two-variable map using pairs of differentiating characteristics such as price/quality range; geographic coverage and so on.
- (b) **Best-cost provider strategy:** Best-cost provider strategy involves providing customers more value for the money by emphasizing low cost and better quality difference. It can be done:
- (a) through offering products at lower price than what is being offered by rivals for products with comparable quality and features or
 - (b) charging similar price as by the rivals for products with much higher quality and better features.
- (c) **Value chain.** It describes the activities within an organization that go to make up a product / service. Value chain of a manufacturing organization comprises of primary and supportive activities.
- Primary Activities are inclusive of:**
- inbound logistics,
 - operations,
 - outbound logistics,
 - marketing and sales; and
 - services.
- Supportive Activities** relate to:
- procurement,
 - human resource management,
 - technology development; and
 - infrastructure.
4. Corporate strategy helps an organisation to achieve and sustain success. It is basically concerned with the choice of businesses, products and markets. It is often correlated with the growth of the firm.

Corporate strategy in the first place ensures the growth of the firm and its correct alignment with the environment. Corporate strategies are concerned with the broad and long-term questions of what businesses the organization is in or wants to be in, and what it wants to do with those businesses. They set the overall direction the organization will follow. It serves as the design for filling the strategic planning gap. It also helps to build the relevant competitive advantages. A right fit between the firm and its external environment is the primary contribution of corporate strategy. Basically the purpose of corporate strategy is to harness the opportunities available in the environment and countering the threats embedded therein. With the help of corporate strategy, organizations match their unique capabilities with the external environment so as to achieve its vision and mission.

5. The different issues involved in strategy implementation cover practically everything that is included in the discipline of management studies. A strategist, therefore, has to bring to his or her task a wide range of knowledge, skills, attitudes, and abilities. The implementation tasks put to test the strategists' abilities to allocate resources, design structures, formulate functional policies, and take into account the leadership styles required, besides dealing with various other issues.
 - ◆ The strategic plan devised by the organization proposes the manner in which the strategies could be put into action. Strategies, by themselves, do not lead to action.
 - ◆ Strategies should lead to plans. For instance, if stability strategies have been formulated, they may lead to the formulation of various plans. Plans result in different kinds of programmes. A programme is a broad term, which includes goals, policies, procedures, rules, and steps to be taken in putting a plan into action.
 - ◆ Programmes lead to the formulation of projects. A project is a highly specific programme for which the time schedule and costs are predetermined. It requires allocation of funds based on capital budgeting by organizations.
 - ◆ Projects create the needed infrastructure for the day-to-day operations in an organization. They may be used for setting up new or additional plants, modernising the existing facilities, installation of newer systems, and for several other activities that are needed for the implementation of strategies.

Implementation of strategies is not limited to formulation of plans, programmes, and projects. Projects would also require resources. After that is provided, it would be essential to see that a proper organizational structure is designed, systems are installed, functional policies are devised, and various behavioural inputs are provided so that plans may work.

Given below in sequential manner the issues in strategy implementation which are to be considered:

- ◆ Project implementation
 - ◆ Procedural implementation
 - ◆ Resource allocation
 - ◆ Structural implementation
 - ◆ Functional implementation
 - ◆ Behavioural implementation
6. Total Quality Management is different from traditional management practices, requiring changes in organisational processes, beliefs and attitudes, and behaviours. 'Traditional management' means the way things are usually done in most organisations in the absence of a TQM focus. The nature of TQM differs from common management practices in many respects. Some of the key differences are as follows:
 - (i) **Strategic Planning and Management:** Quality planning and strategic business planning is indistinguishable in TQM. Customer satisfaction, defect rates and process cycle times receive very high attention on TQM which is not the case in traditional management.

- (ii) **Changing Relationships with customers and suppliers:** Distinguishable, innovation is essential to meet and exceed customers' needs. In TQM quality is defined as product and services. Traditional management places customers outside of the enterprises and within the domain of marketing and sales.
 - (iii) **Organizational Structure:** TQM is also distinguishable as it views enterprise as a system of interdependent processes. Every process contains sub-processes and is also contained within a higher process.
 - (iv) **Organizational Change:** In TQM the environment in which the enterprise interacts is considered to be changing constantly. Management's job, therefore, is to provide the leadership for continual improvement and innovation in processes and systems, products, and services. TQM recognises the inevitability of external change and focuses on shaping the future.
 - (v) **Teamwork:** In TQM, individuals cooperate in team structure such as quality circles, steering committees, and self-directed work teams. Departments work together toward system optimization through cross-functional teamwork.
 - (vi) **Motivation and Job Design:** TQM managers provide leadership and motivation rather than overt intervention in the processes of their subordinates who are viewed as process managers rather than functional specialists.
7. The prominent areas where the human resource manager can play strategic role are as follows:
1. **Providing purposeful direction:** The human resource management must be able to lead people and the organization towards the desired direction involving people. The management has 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.
 2. **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.
 3. **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.
 4. **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.
 5. **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.
 6. **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.
 7. **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.