

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: Three hours)

(Maximum Marks: 100)

1. (a) From the following information, you are required to compute the basic and adjusted Earnings per Share:

| | |
|--|----------------------|
| Net profit for 2015-16 | 11 lakh |
| Net profit for 2016-17 | 15 lakh |
| No. of shares issued before rights issue | 5 lakhs |
| Right issue | One for every 5 held |
| Right issue price | 15 per share |
| Last date of exercising right option | 1-06-2016 |
| Fair value of shares before right issue | 21 per share |

- (b) A Ltd. sold machinery having WDV of ₹ 40 lakhs to B Ltd. for ₹ 50 lakhs and the same machinery was leased back by B Ltd. to A Ltd. The lease back is operating lease. You are required to comment on the accounting treatment as per AS 19 in the following situations:
- Sale price of ₹ 50 lakhs is equal to fair value.
 - Fair value is ₹ 45 lakhs and sale price is ₹ 38 lakhs.
 - Fair value is ₹ 40 lakhs and sale price is ₹ 50 lakhs.
 - Fair value is ₹ 46 lakhs and sale price is ₹ 50 lakhs
 - Fair value is ₹ 35 lakhs and sale price is ₹ 39 lakhs.
- (c) Sun Ltd. has entered into a sale contract of ₹ 5 crores with X Ltd. during 2015-2016 financial year. The profit on this transaction is ₹ 1 crore. The delivery of goods to take place during the first month of 2016-2017 financial year. In case of failure of Sun Ltd. to deliver within the schedule, a compensation of ₹ 1.5 crores is to be paid to X Ltd. Sun Ltd. planned to manufacture the goods during the last month of 2015-2016 financial year. As on balance sheet date (31.3.2016), the goods were not manufactured and it was unlikely that Sun Ltd. will be in a position to meet the contractual obligation.
- Should Sun Ltd. provide for contingency as per AS 29?
 - Should provision be measured as the excess of compensation to be paid over the profit?
- (d) Omega Limited has borrowed a sum of US \$ 10,00,000 at the beginning of Financial Year 2016-17 for its residential project at 4 %. The interest is payable at the end of the Financial Year. At the time of availment exchange rate was ₹ 56 per US \$ and the rate as on 31st March, 2017 was ₹ 62 per US \$. If Omega Limited borrowed the loan in India in Indian Rupee equivalent, the pricing of loan would have been 10.50%.

You are required to compute Borrowing Cost and exchange difference for the year ending 31st March, 2017 as per applicable Accounting Standards. **(4 x 4 = 16 marks)**

2. (a) From the following information as on 31st March, 2016 of Xeta Insurance Co. Ltd. engaged in fire insurance business, prepare the Revenue Account, reserving 50% of the net premiums for unexpired risks and an additional reserve of ₹ 7,00,000:

| Particulars | Amount ₹ |
|--|-------------|
| Reserve for unexpired risk on 31st March, 2015 | 15,00,000 |
| Additional reserve on 31st March, 2015 | 3,00,000 |
| Claims paid | 19,20,000 |
| Estimated liability in respect of outstanding claims on 31st March, 2015 | 1,95,000 |
| Estimated liability in respect of outstanding claims on 31st March, 2016 | 2,70,000 |
| Expenses of management (including ₹ 90,000 incurred in connection with claims) | 8,40,000 |
| Re-insurance premium paid | 2,25,000 |
| Re-insurance recoveries | 60,000 |
| Premiums | 33,60,000 |
| Interest and dividend (gross before TDS) | 1,50,000 |
| Profit on sale of investments | 30,000 |
| Commission | 50,000 |

- (b) M/s P and Co., had four departments A, B, C and D. Each department being managed by manager whose commission was 10% of the respective departmental profit, subject to a minimum of ₹ 6,000 in each case. Inter-departmental transfers took place at a 'loaded' price as follows:

From Department A to Department B 10% above cost

From Department A to Department D 20% above cost

From Department C to Department D 20% above cost

From Department C to Department B 20% above cost

For the year ending on 31st March, 2016 the firm had already prepared and closed the departmental Trading and Profit and Loss Account. Subsequently, it was discovered that the closing stocks of departments had included interdepartmentally transferred goods at loaded price instead of cost price. From the following information prepare a statement recomputing the departmental profit or loss:

| | Dept. A ₹ | Dept. B ₹ | Dept. C ₹ | Dept. D ₹ |
|---|--------------|---|--------------|---|
| Final Profit (Loss) | (38,000) | 50,400 | 72,000 | 1,08,000 |
| Inter departmental transfers included at loaded price in the departmental stock | | 70,000 (₹ 22,000 from Dept. A and ₹ 48,000 from Dept. C) | - | 4,800 (₹ 3,600 from Dept. C and ₹ 1,200 from Dept. A) |

(10 + 6 = 16 Marks)

3. (a) XYZ is having its Branch at Kolkata. Goods are invoiced to the branch at 20% profit on sale. Branch has been instructed to send all cash daily to head office. All expenses are paid by head office except petty expenses which are met by the Branch Manager.

From the following particulars, you are required to prepare branch account in the books of Head Office.

| | (₹) | | (₹) |
|--|----------|--|--------|
| Stock on 1 st April 2017 (invoice price) | 30,000 | Discount allowed to debtors | 160 |
| Sundry Debtors on 1 st April, 2017 | 18,000 | Expenses paid by head office: | |
| Cash in hand as on 1 st April, 2017 | 800 | Rent | 1,800 |
| Office furniture on 1 st April, 2017 | 3,000 | Salary | 3,200 |
| Goods invoiced from the head office (invoice price) | 1,60,000 | Stationery & Printing | 800 |
| Goods returned to Head Office | 2,000 | Petty expenses paid by the branch | 600 |
| Goods returned by debtors | 960 | Depreciation to be provided on branch furniture at 10% p.a. | |
| Cash received from debtors | 60,000 | Stock on 31 st March, 2018 (at invoice price) | 28,000 |
| Cash Sales | 1,00,000 | | |
| Credit sales | 60,000 | | |

- (b) Ganesh Ltd. has head office at Delhi (India) and branch at New York. New York branch is an integral foreign operation of Ganesh Ltd. New York branch furnishes you with its trial balance as on 31st March, 2016 and the additional information given thereafter:

| | Dr. (\$) | Cr. (\$) |
|--------------------------------------|----------|----------|
| Stock on 1 st April, 2015 | 300 | — |
| Purchases and sales | 800 | 1,500 |
| Sundry Debtors and creditors | 400 | 300 |
| Bills of exchange | 120 | 240 |
| Sundry expenses | 1,080 | — |
| Bank balance | 420 | — |
| Delhi office A/c | — | 1,080 |
| | 3,120 | 3,120 |

The rates of exchange may be taken as follows:

- on 1.4.2015 @ ₹40 per US \$
- on 31.3.2016 @ ₹42 per US \$
- average exchange rate for the year @ ₹ 41 per US \$.

New York branch account showed a debit balance of ₹ 44,380 on 31.3.2016 in Delhi books and there were no items pending reconciliation.

You are asked to prepare trial balance of New York in ₹ in the books of Ganesh Ltd.

- (c) A company has its share capital divided into shares of ₹ 10 each. On 1-1-20X1, it granted 5,000 employees stock options at ₹ 50, when the market price was ₹ 140. The options were to be exercised between 1-3-20X2 to 31-03-20X2. The employees exercised their options for 4,800 shares only; remaining options lapsed.

You are required to pass the necessary journal entries for the year ended 31-3-20X2, with regard to employees' stock options. **(8 + 4 + 4 = 16 Marks)**

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

Balance Sheet as at 31-3-2016

| <i>Liabilities</i> | | ₹ | <i>Assets</i> | ₹ |
|--------------------|-----------------|-----------------|-------------------|-----------------|
| Capital Accounts : | | | Land and Building | 2,00,000 |
| L | 3,00,000 | | Plants | 2,00,000 |
| M | 2,00,000 | | Trade receivables | 1,00,000 |
| N | <u>1,00,000</u> | 6,00,000 | Inventories | 1,50,000 |
| Current Accounts: | | | Cash | 1,00,000 |
| L | 50,000 | | Current Account: | |
| M | <u>30,000</u> | 80,000 | N | 50,000 |
| Trade payables | | 1,20,000 | | |
| | | <u>8,00,000</u> | | <u>8,00,000</u> |

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

- (i) Preet Limited will issue the following securities in consideration for transfer of business:
 10,000 equity shares @ ₹ 15 each, 15,000 preference shares @ ₹ 15 each; and 20,000 debentures @ ₹ 14.725.
- (ii) The agreed value of assets and liabilities of partnership firm are as follows:
 Land & Building – ₹ 3,00,000, Plants – ₹ 1,50,000, Inventory – ₹ 1,40,000, Trade Receivables – ₹ 97,500, and Trade Payables – ₹ 1,18,000.

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

You are required to prepare Realization Account, Cash Account, Partners' Current and Capital Accounts at the time of closing the books of the firm. **(16 Marks)**

5. The Balance Sheet of Lion Limited as on 31-03-2016 is given below:

| <i>Particulars</i> | <i>Note No.</i> | <i>Amount (₹ in lakh)</i> |
|--|-----------------|-------------------------------|
| <u>Equity & Liabilities</u> | | |
| <u>Shareholders' Funds</u> | | |
| Shares' Capital | 1 | 1,400 |
| Reserves & Surplus | 2 | (522) |
| <u>Non-Current Liabilities</u> | | |
| Long term Borrowings | 3 | 700 |
| <u>Current Liabilities</u> | | |
| Trade Payables | 4 | 102 |
| Other Liabilities | 5 | 24 |
| Total | | <u>1704</u> |
| Assets | | |
| <u>Non-Current Assets</u> | | |
| <u>Fixed Assets</u> | | |
| Tangible Assets | 6 | 750 |

| <u>Current Assets</u> | | |
|-------------------------|----|-------------|
| Current Investments | 7 | 200 |
| Inventories | 8 | 300 |
| Trade Receivables | 9 | 450 |
| Cash & Cash Equivalents | 10 | 4 |
| Total | | 1704 |

Notes to Accounts:

| | | ₹ in Lakhs |
|------|--|--------------|
| (1) | Share Capital | |
| | Authorised : | |
| | 200 lakh shares of ₹ 10 each | 2,000 |
| | 8 lakh, 8% Preference Shares of ₹ 100 each | <u>800</u> |
| | | <u>2,800</u> |
| | Issued, Subscribed and paid up: | |
| | 100 lakh Equity Shares of ₹ 10 each, full paid up | 1,000 |
| | 4 lakh 8% Preference Shares of ₹ 100 each, fully paid up | <u>400</u> |
| | Total | <u>1400</u> |
| (2) | Reserves and Surplus | |
| | Debit balance of Profit & Loss A/c | (522) |
| (3) | Long Term Borrowings | |
| | 6% Debentures (Secured by Freehold Property) | 400 |
| | Directors' Loan | <u>300</u> |
| | | <u>700</u> |
| (4) | Trade Payables | |
| | Trade payables for Goods | 102 |
| (5) | Other Current Liabilities | |
| | Interest Accrued and Due on 6% Debentures | 24 |
| (6) | Tangible Assets | |
| | Freehold Property | 550 |
| | Plant & Machinery | <u>200</u> |
| | | <u>750</u> |
| (7) | Current Investment | |
| | Investment in Equity Instruments | 200 |
| (8) | Inventories | |
| | Finished Goods | 300 |
| (9) | Trade Receivables | |
| | Trade receivables for Goods | 450 |
| (10) | Cash and Cash Equivalents | |
| | Balance with Bank | 4 |

The Board of Directors of the company decided upon the following scheme of reconstruction with the consent of respective shareholders:

- (1) Preference Shares are to be written down to ₹ 80 each and Equity Shares to ₹ 2 each.
- (2) Preference Shares Dividend in arrears for 3 years to be waived by 2/3rd and for balance 1/3rd, Equity Shares of ₹ 2 each to be allotted.
- (3) Debenture holders agreed to take one Freehold Property at its book value of ₹ 300 lakh in part payment of their holding. Balance Debentures to remain as liability of the company.
- (4) Interest accrued and due on Debentures to be paid in cash.
- (5) Remaining Freehold Property to be valued at ₹ 400 lakh.
- (6) All investments sold out for ₹ 250 lakh.
- (7) 70% of Directors' loan to be waived and for the balance, Equity Shares of ₹ 2 each to be allowed.
- (8) 40% of Trade receivables and 80% of Inventories to be written off.
- (9) Company's contractual commitments amounting to ₹ 600 lakh have been settled by paying 5% penalty of contract value.

You are required to:

- (a) Pass Journal Entries for all the transactions related to internal reconstruction;
- (b) Prepare Capital Reduction Account; and
- (c) Prepare notes on Share Capital and Tangible Assets to Balance Sheet, immediately after the implementation of scheme of internal reconstruction. **(16 Marks)**

6. (a) Paper Limited comes out with a public issue of share capital on 01-01-2016 of 30,00,000 equity shares of ₹ 10 each at a premium of 5%. ₹ 2.50 is payable on application (on or before 31-01-2016) and ₹ 3 on allotment (31-3-2016) including premium.

This issue was underwritten by two underwriters namely White and Black, equally, the commission being 4% of the issue price. Each of the underwriters underwrites 60,000 shares firm. Subscriptions including firm underwriting came for 28,80,000 shares, the distribution of forms being White: 15,60,000; Black; 10,80,000 and Unmarked 2,40,000.

One of the allottees (using forms marked with name of White) for 6,000 shares fails to pay the amount due to allotment, all the other money due being received in full including any due from the shares devolving upon the underwriters. The commission due was paid separately.

6,000 shares of one allottee who failed to pay the allotment money were finally forfeited by 30-06-2016 and were re-allotted for payment in cash of ₹ 4 per share.

You are required to prepare each underwriter's liability (in shares) in statement form assuming that the benefit of firm underwriting is given to individual underwriter.

- (b) SMM Ltd. has the following capital structure as on 31st March, 2017: ₹ in crore

| | Particulars | |
|-------|--|-------|
| (i) | Equity share capital (shares of ₹ 10 each) | 1,200 |
| (ii) | Reserves: | |
| | General Reserves | 1,080 |
| | Securities Premium | 400 |
| | Profit & Loss | 200 |
| | Infrastructure Development Reserve (Statutory Reserve) | 320 |
| (iii) | Loan Funds | 3,200 |

The company has offered buy back price of ₹ 30 per equity share. You are required to calculate maximum permissible number of equity shares that can be bought back in the above situation and also required to pass necessary Journal Entries. **(4 + 12 = 16 Marks)**

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

- (a) Explain the nature of Limited Liability Partnership. Who can be a designated partner in a Limited Liability Partnership?
- (b) A company had issued 30,000, 14% convertible debentures of ₹ 100 each on 1st April, 2014. The debentures are due for redemption on 1st July, 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 ₹ 10) at a price of ₹ 15 per share. Debenture holders holding 2,500 debentures did not exercise the option. Calculate the number of equity shares to be allotted to the debenture holders exercising the option to the maximum.
- (c) ABC Ltd. has entered into a binding agreement with XYZ Ltd. to buy a custom-made machine amounting to ₹ 4,00,000. As on 31st March, 2016 before delivery of the machine, ABC Ltd. had to change its method of production. The new method will not require the machine ordered and so it shall be scrapped after delivery. The expected scrap value is 'NIL'.

Show the treatment of machine in the books of ABC Ltd.

- (d) A fixed asset is purchased for ₹ 20 lakhs. Government grant received towards it is ₹ 8 lakhs. Residual Value is ₹ 4 lakhs and useful life is 4 years. Assume depreciation on the basis of Straight Line method. Asset is shown in the balance sheet net of grant. After 1 year, grant becomes refundable to the extent of ₹ 5 lakhs due to non compliance with certain conditions. Pass journal entries for second year.
- (e) The Board of Directors of New Graphics Ltd. in its Board Meeting held on 18th April, 2017, considered and approved the Audited Financial results along with Auditors Report for the Financial Year ended 31st March, 2017 and recommended a dividend of ₹ 2 per equity share (on 2 crore fully paid up equity shares of ₹ 10 each) for the year ended 31st March, 2017 and if approved by the members at the forthcoming Annual General Meeting of the company on 18th June, 2017, the same will be paid to all the eligible shareholders.

Discuss on the accounting treatment and presentation of the said proposed dividend in the annual accounts of the company for the year ended 31st March, 2017 as per the applicable Accounting Standard and other Statutory Requirements. **(4 x 4 = 16 Marks)**

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ANSWERS

1. (a) Computation of theoretical ex-rights fair value per share

Fair value of all outstanding shares immediately prior to exercise of rights + Total amount received from exercise of rights

$$\frac{\text{Number of shares outstanding prior to exercise + number of shares issued in the exercise}}{(\text{₹ } 21.00 \times 5,00,000 \text{ shares}) + (\text{₹ } 15.00 \times 1,00,000 \text{ shares})}$$

$$\frac{}{5,00,000 \text{ shares} + 1,00,000 \text{ shares}}$$

Theoretical ex-rights fair value per share = ₹ 20.00

(a) Computation of adjustment factor

(b)
$$\frac{\text{Fair value per share prior to exercise of rights}}{\text{Theoretical ex - rights value per share}} = \frac{\text{₹ } (21.00)}{\text{₹ } (20.00)} = 1.05$$

Computation of earnings per share

| | Year 2015-16 | Year 2016-17 |
|---|--------------|--------------|
| EPS for the year 2015-16 as originally reported: (₹ 11,00,000/5,00,000 shares) | ₹ 2.20 | |
| EPS for the year 2015-16 restated for rights issue: [₹ 11,00,000/ (5,00,000 shares x 1.05)] | ₹ 2.10 | |
| EPS for the year 2016-17 including effects of rights issue ₹ 15,00,000 $(5,00,000 \times 1.05 \times 2 / 12) + (6,00,000 \times 10 / 12)$ | | ₹ 2.55 |

(b) Following will be the treatment in the given cases:

- (i) When sales price of ₹ 50 lakhs is equal to fair value, A Ltd. should immediately recognise the profit of ₹ 10 lakhs (i.e. 50 – 40) in its books.
- (ii) When fair value of leased machinery is ₹ 45 lakhs & sales price is ₹ 38 lakhs, then loss of ₹ 2 lakhs (40 – 38) to be immediately recognised by A Ltd. in its books provided loss is not compensated by future lease payment.
- (iii) When fair value is ₹ 40 lakhs & sales price is ₹ 50 lakhs then, profit of ₹ 10 lakhs is to be deferred and amortised over the lease period.
- (iv) When fair value is ₹ 46 lakhs & sales price is ₹ 50 lakhs, profit of ₹ 6 lakhs (46-40) to be immediately recognised in its books and balance profit of ₹ 4 lakhs (50-46) is to be amortised/deferred over lease period.
- (v) When fair value is ₹ 35 lakhs & sales price is ₹ 39 lakhs, then the loss of ₹ 5 lakhs (40-35) to be immediately recognised by A Ltd. in its books and profit of ₹ 4 lakhs (39-35) should be amortised/deferred over lease period.

- (c) (i)** AS 29 “Provisions, Contingent Liabilities and Contingent Assets” provides that when an enterprise has a present obligation, as a result of past events, that probably requires an outflow of resources and a reliable estimate can be made of the amount of obligation, a provision should be recognised. Sun Ltd. has the obligation to deliver the goods within the

scheduled time as per the contract. It is probable that Sun Ltd. will fail to deliver the goods within the schedule and it is also possible to estimate the amount of compensation. Therefore, Sun Ltd. should provide for the contingency amounting ₹ 1.5 crores as per AS 29.

- (ii) Provision should not be measured as the excess of compensation to be paid over the profit. The goods were not manufactured before 31st March, 2016 and no profit had accrued for the financial year 2015-2016. Therefore, provision should be made for the full amount of compensation amounting ₹ 1.50 crores.
- (d) (i) Interest for the period 2016-17
 $= \text{US \$ } 10 \text{ lakhs} \times 4\% \times ₹ 62 \text{ per US\$} = ₹ 24.80 \text{ lakhs}$
- (ii) Increase in the liability towards the principal amount
 $= \text{US \$ } 10 \text{ lakhs} \times ₹ (62 - 56) = ₹ 60 \text{ lakhs}$
- (iii) Interest that would have resulted if the loan was taken in Indian currency
 $= \text{US \$ } 10 \text{ lakhs} \times ₹ 56 \times 10.5\% = ₹ 58.80 \text{ lakhs}$
- (iv) Difference between interest on local currency borrowing and foreign currency borrowing = ₹ 58.80 lakhs - ₹ 24.80 lakhs = ₹ 34 lakhs.

Therefore, out of ₹ 60 lakhs increase in the liability towards principal amount, only ₹ 34 lakhs will be considered as the borrowing cost. Thus, total borrowing cost would be ₹ 58.80 lakhs being the aggregate of interest of ₹ 24.80 lakhs on foreign currency borrowings plus the exchange difference to the extent of difference between interest on local currency borrowing and interest on foreign currency borrowing of ₹ 34 lakhs.

Hence, ₹ 58.80 lakhs would be considered as the borrowing cost to be accounted for as per AS 16 and the remaining ₹ 26 lakhs (60 - 34) would be considered as the exchange difference to be accounted for as per AS 11.

2. (a) **Name of the Insurer: Xeta Insurance Company Limited**
Registration No. and Date of registration with IRDA:
Revenue Account for the year ended 31st March, 2016

| Particulars | Schedule | Amount (₹) |
|--|-----------|------------|
| Premium earned (net) | 1 | 26,67,500 |
| Profit on sale of investment | | 30,000 |
| Others | | - |
| Interest and dividend (gross) | | 1,50,000 |
| Total (A) | | 28,47,500 |
| Claims incurred (Net) | 2 | 20,25,000 |
| Commission | 3 | 50,000 |
| Operating expenses related to insurance | 4 | 7,50,000 |
| Total (B) | | 28,25,000 |
| Operating profit from insurance business | (A) - (B) | 22,500 |

Schedule -1 Premium earned (net)

| | ₹ |
|------------------|-----------|
| Premium received | 33,60,000 |

| | |
|---|------------------|
| Less: Premium on reinsurance ceded | (2,25,000) |
| Net Premium | 31,35,000 |
| Less: Adjustment for change in Reserve for Unexpired risk (as per W.N.) | (4,67,500) |
| Total premium earned | 26,67,500 |

Schedule -2 Claims incurred (net)

| | ₹ |
|---|------------|
| Claims paid | 19,20,000 |
| Add: Expenses regarding claims | 90,000 |
| | 20,10,000 |
| Less: Re-insurance recoveries | (60,000) |
| | 19,50,000 |
| Add: Claims outstanding as on 31 st March, 2016 | 2,70,000 |
| | 22,20,000 |
| Less: Claims outstanding as on 31 st March, 2015 | (1,95,000) |
| | 20,25,000 |

Schedule -3 Commission

| | ₹ |
|-----------------|--------|
| Commission paid | 50,000 |

Schedule-4 Operating expenses related to Insurance Business

| | ₹ |
|--|----------|
| Expenses of management (₹ 8,40,000 – ₹ 90,000) | 7,50,000 |

Working Note:

Calculation for change in Reserve for Unexpired risk:

| | | ₹ |
|---|-----------------|-------------|
| Reserve for Unexpired Risk as on 31 st March, 2016 | 15,67,500 | |
| Additional Reserve as on 31 st March, 2016 | <u>7,00,000</u> | 22,67,500 |
| Less: Reserve for Unexpired Risk as on 31 st March, 2015 | 15,00,000 | |
| Additional Reserve as on 31 st March, 2015 | <u>3,00,000</u> | (18,00,000) |
| | | 4,67,500 |

(b) Statement showing the re-computation of Departmental Profit or Loss

| | Particulars | Dept. A ₹ | Dept. B ₹ | Dept. C ₹ | Dept. D ₹ |
|----------|--|--------------|--------------|--------------|--------------|
| A | Final Profit/(Loss) (Computed earlier) | (38,000) | 50,400 | 72,000 | 1,08,000 |
| B | Add: Departmental Manager's Commission @ 10% of Deptt. Profit subject to a minimum of ₹ 6,000 [Working Note (i)] | 6,000 | 6,000 | 8,000 | 12,000 |
| C | Profit before Deptt. Manager's commission (A+B) | (32,000) | 56,400 | 80,000 | 1,20,000 |

| | | | | | |
|---|--|----------|---------|---------|----------|
| D | Less: Profit earned through transfer of goods at loaded price remaining in stock at transfer department (W.N. 2) | (2,200) | _____ - | (8,600) | _____ - |
| E | Correct Departmental Profit (before manager's commission) (C-D) | (34,200) | 56,400 | 71,400 | 1,20,000 |
| F | Less: Manager's commission @ 10% of profit subject to a minimum of ₹ 6,000 | (6,000) | (6,000) | (7,140) | (12,000) |
| G | Departmental Profit after Manager's commission (E-F) | (40,200) | 50,400 | 64,260 | 1,08,000 |

Working Note:

1. Manager's Commission:

| | Deptt. Profit/Loss | Commission | |
|---|--------------------|------------|--|
| A | (-) 38,000 | 6,000 | |
| B | 50,400 | 6,000 | i.e. (50,400 x 1/9 = ₹ 5,600 less than ₹ 6,000 |
| C | 72,000 | 8,000 | i.e. (72,000 x 1/9 = ₹ 8,000) |
| D | 1,08,000 | 12,000 | i.e. (1,08,000 x 1/9 = ₹ 12,000) |

2. Unrealised Profit on stock transfer:

| | | ₹ |
|---------|---|--------------|
| Dept. A | ₹ 22,000 to Deptt. B @ 110%, Profit thereon 22,000 x 10/110 | 2,000 |
| | ₹ 1,200 to Deptt. D @ 120% Profit thereon 1,200 x 20/120 | <u>200</u> |
| | | <u>2,200</u> |
| Dept. C | ₹ 48,000 to Deptt. B 120% Profit thereon 48,000 x 20/120 | 8,000 |
| | ₹ 3,600 to Deptt. D @ 120 % Profit thereon 3,600 x 20/120 | <u>600</u> |
| | | <u>8,600</u> |

3. (a)

In the books of Head Office – XYZ

Kolkata Branch Account (at invoice)

| | ₹ | | ₹ |
|---------------------------------------|----------|--|---------------|
| To Balance b/d | | By Stock reserve (opening) | 6,000 |
| Stock | 30,000 | By Remittances: | |
| Debtors | 18,000 | Cash Sales | 1,00,000 |
| Cash in hand | 800 | Cash from Debtors | <u>60,000</u> |
| Furniture | 3,000 | By Goods sent to branch (loading) | 32,000 |
| To Goods sent to branch | 1,60,000 | By Goods returned by branch (Return to H.O.) | 2,000 |
| To Goods returned by branch (loading) | 400 | By Balance c/d | |
| To Bank (expenses paid by H.O.) | | Stock | 28,000 |
| Rent | 1,800 | Debtors | 16,880 |
| Salary | 3,200 | Cash (800-600) | 200 |
| | | Furniture (3,000-300) | 2,700 |

| | | | |
|--|-----|----------|----------|
| Stationary & printing | 800 | 5,800 | |
| To Stock reserve (closing) | | 5,600 | |
| To Profit transferred to General Profit & Loss A/c | | 24,180 | |
| | | 2,47,780 | 2,47,780 |

Working Note:

Debtors Account

| | ₹ | | ₹ |
|---------------------------|--------|-----------------------------|--------|
| To Balance b/d | 18,000 | By Cash account | 60,000 |
| To Sales account (credit) | 60,000 | By Sales return account | 960 |
| | | By Discount allowed account | 160 |
| | | By Balance c/d | 16,880 |
| | 78,000 | | 78,000 |

Note: It is assumed that goods returned by branch are at invoice price.

(b)

In the books of Ganesh Ltd.

**New York Branch Trial Balance in (₹)
as on 31st March, 2016**

| | Conversion rate per US \$ (₹) | Dr. ₹ | Cr. ₹ |
|------------------------------|----------------------------------|----------|----------|
| Stock on 1.4.15 | 40 | 12,000 | |
| Purchases and sales | 41 | 32,800 | 61,500 |
| Sundry debtors and creditors | 42 | 16,800 | 12,600 |
| Bills of exchange | 42 | 5,040 | 10,080 |
| Sundry expenses | 41 | 44,280 | |
| Bank balance | 42 | 17,640 | |
| Delhi office A/c | – | | 44,380 |
| | | 1,28,560 | 1,28,560 |

(c)

Journal Entries in the books of company

| Date | Particulars | Dr. ₹ | Cr. ₹ |
|-----------|--|--------------|----------|
| 1-3-X2 to | Bank A/c | Dr. 2,40,000 | |
| 31-3-X2 | Employees compensation expenses A/c | Dr. 4,32,000 | |
| | To Equity Share Capital A/c | | 48,000 |
| | To Securities Premium A/c | | 6,24,000 |
| | (Being allotment to employees 4,800 shares of ₹ 10 each at a premium of ₹ 130 at an exercise price of ₹ 50 each) | | |
| 31-3-X2 | Profit and Loss account | Dr. 4,32,000 | |
| | To Employees compensation expenses A/c | | 4,32,000 |
| | (Being transfer of employees compensation expenses) | | |

Working Note:

1. Employee Compensation Expenses = Discount between Market Price and option price = ₹ 140 – ₹ 50 = ₹ 90 per share = ₹ 90 x 4,800 = ₹ 4,32,000/- in total.
2. The Employees Compensation Expense is transferred to Securities Premium Account.
3. Securities Premium Account = ₹ 50 – ₹ 10 = ₹ 40 per share + ₹ 90 per share on account of discount of option price over market price = ₹ 130 per share = ₹ 130 x 4,800 = ₹ 6,24,000/- in total.

4.

Realization Account

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

Cash Account

| | ₹ | | ₹ |
|--------------------|--------|--------------------|--------|
| To N's Capital A/c | 46,000 | By L's Capital A/c | 23,000 |
| | | By M's Capital A/c | 23,000 |
| | 46,000 | | 46,000 |

Partners' Current Accounts

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

Partners' Capital Accounts

| | L | M | N | | L | M | N |
|--|----------|--------|--------|--------------------|----------|----------|----------|
| | ₹ | ₹ | ₹ | | ₹ | ₹ | ₹ |
| To N's Current A/c | - | - | 42,100 | By Balance b/d | 3,00,000 | 2,00,000 | 1,00,000 |
| To Preference Shares in Preet Ltd. A/c | 1,12,500 | 67,500 | 45,000 | By L's Current A/c | 69,750 | | |
| To Debentures A/c | 1,47,250 | 88,350 | 58,900 | By M's Current A/c | | 41,850 | |

| | | | | | | | |
|----------------------|----------|----------|----------|-------------------------|----------|----------|----------|
| To Cash A/c | 23,000 | 23,000 | - | By Cash A/c (bal. fig.) | | | 46,000 |
| To Equity Shares A/c | 87,000 | 63,000 | - | | | | |
| | 3,69,750 | 2,41,850 | 1,46,000 | | 3,69,750 | 2,41,850 | 1,46,000 |

Working Notes:

1. Calculation of Purchase consideration

Net Payment Method

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

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

5. Journal Entries in the books of Lion Ltd.

| | Particulars | | Debit (₹ in lakhs) | Credit (₹ in lakhs) |
|-------|---|-----|-----------------------|------------------------|
| (i) | 8% Preference share capital A/c (₹ 100 each) | Dr. | 400 | |
| | To 8% Preference share capital A/c (₹ 80 each) | | | 320 |
| | To Capital Reduction A/c | | | 80 |
| | (Being the preference shares of ₹ 100 each reduced to ₹ 80 each as per the approved scheme) | | | |
| (ii) | Equity share capital A/c (₹ 10 each) | Dr. | 1,000 | |
| | To Equity share capital A/c (₹ 2 each) | | | 200 |
| | To Capital Reduction A/c | | | 800 |
| | (Being the equity shares of ₹ 10 each reduced to ₹ 2 each) | | | |
| (iii) | Capital Reduction A/c | Dr. | 32 | |
| | To Equity share capital A/c (₹ 2 each) | | | 32 |
| | (Being 1/3 rd arrears of preference share dividend of 3 years to be satisfied by issue of 8 lakhs equity shares of ₹ 2 each) | | | |
| (iv) | 6% Debentures A/c | Dr. | 300 | |
| | To Freehold property A/c | | | 300 |
| | (Being claim of Debenture holders settled in part by transfer of freehold property) | | | |
| (v) | Accrued debenture interest A/c | Dr. | 24 | |
| | To Bank A/c | | | 24 |
| | (Being accrued debenture interest paid) | | | |
| (vi) | Freehold property A/c | Dr. | 150 | |

| | | | | |
|--------|---|-----|-----|-----|
| | To Capital Reduction A/c (Being appreciation in the value of freehold property) | | | 150 |
| (vii) | Bank A/c | Dr. | 250 | |
| | To Investments A/c | | | 200 |
| | To Capital Reduction A/c (Being investment sold at profit) | | | 50 |
| (viii) | Director's loan A/c | Dr. | 300 | |
| | To Equity share capital A/c (₹ 2 each) | | | 90 |
| | To Capital Reduction A/c (Being director's loan waived by 70% and balance being discharged by issue of 45 lakhs equity shares of ₹ 2 each) | | | 210 |
| (ix) | Capital Reduction A/c | Dr. | 972 | |
| | To Profit and loss A/c | | | 522 |
| | To Trade receivables A/c (450x 40%) | | | 180 |
| | To Inventories-in-trade A/c (300x 80%) | | | 240 |
| | To Bank A/c (600 x 5%) (Being certain value of various assets, penalty on cancellation of contract, profit and loss account debit balance written off through Capital Reduction Account) | | | 30 |
| (x) | Capital Reduction A/c | | 286 | |
| | To Capital reserve A/c (Being balance transferred to capital reserve account as per the scheme) | | | 286 |

Capital Reduction Account

| | | (₹ in lakhs) | | | (₹ in lakhs) |
|----|----------------------|--------------|----|--------------------------|--------------|
| To | Equity Share Capital | 32 | By | Preference Share Capital | 80 |
| To | Trade receivables | 180 | By | Equity Share Capital | 800 |
| To | Finished Goods | 240 | By | Freehold Property | 150 |
| To | Profit & Loss A/c | 522 | By | Bank | 50 |
| To | Bank A/c | 30 | By | Director's Loan | 210 |
| To | Capital Reserve | <u>286</u> | | | |
| | | <u>1,290</u> | | | <u>1,290</u> |

Notes to Balance Sheet

| | | (₹ in lakhs) | (₹ in lakhs) |
|----|---|--------------|--------------|
| 1. | <u>Share Capital</u> | | |
| | <u>Authorized:</u> | | |
| | 200 lakhs Equity shares of ₹ 2 each | | <u>400</u> |
| | 8 lakhs 8% Preference shares of ₹ 80 each | | <u>640</u> |
| | | | <u>1,040</u> |
| | <u>Issued:</u> | | |
| | 161 lakhs equity shares of ₹ 2 each | | 322 |

| | | | |
|----|---|--------------|------------|
| | 4 lakhs Preference Shares of ₹ 80 each | | <u>320</u> |
| | | | <u>642</u> |
| 2. | <u>Tangible Assets</u> | | |
| | Freehold Property | 550 | |
| | Less: Utilized to pay Debenture holders | <u>(300)</u> | |
| | | 250 | |
| | Add: Appreciation | <u>150</u> | 400 |
| | Plant and Machinery | | <u>200</u> |
| | | | <u>600</u> |

6. (a) **Statement showing liability of underwriters**

| | Particulars | Basis | White | Black |
|---|--|-------|--------------------|--------------------|
| A | Gross Liability [No. of Shares] | 1:1 | 15,00,000 | 15,00,000 |
| B | Less: Marked Applications {Net of firm underwriting} | | <u>(15,00,000)</u> | <u>(10,20,000)</u> |
| C | Balance [A-B] | | - | 4,80,000 |
| D | Less: Unmarked Applications | 1:1 | <u>(1,20,000)</u> | <u>(1,20,000)</u> |
| E | Balance [C-D] | | (1,20,000) | 3,60,000 |
| F | Less: Firm Underwriting | | <u>(60,000)</u> | <u>(60,000)</u> |
| G | Balance | | (1,80,000) | 3,00,000 |
| H | Credit for White 's Oversubscription | | <u>1,80,000</u> | <u>(1,80,000)</u> |
| I | Net Liability | | - | 1,20,000 |
| J | Add: Firm Underwriting | | <u>60,000</u> | <u>60,000</u> |
| K | Total Liability [No. Shares] | | 60,000 | 1,80,000 |

(b) **Statement determining the maximum number of shares to be bought back**

Number of shares (in crore)

| Particulars | When loan fund is ₹ 3,200 crore |
|--|---------------------------------|
| Shares Outstanding Test (W.N.1) | 30 |
| Resources Test (W.N.2) | 24 |
| Debt Equity Ratio Test (W.N.3) | 32 |
| Maximum number of shares that can be bought back [least of the above] | 24 |

Journal Entries for the Buy Back

| | | ₹ in crore | |
|-----|---|------------|--------|
| | | Debit | Credit |
| (a) | Equity share buyback account | Dr. 720 | |
| | To Bank account | | 720 |
| | (Being payment for buy back of 24 crores equity shares of ₹ 10 each @ ₹ 30 per share) | | |
| (b) | Equity share capital account | Dr. 240 | |
| | Premium Payable on buyback account | Dr. 480 | |
| | To Equity share buyback account | | 720 |

| | | | | |
|-----|---|-----|-----|-----|
| | (Being cancellation of shares bought back) | | | |
| | Securities Premium account | Dr. | 400 | |
| | General Reserve / Profit & Loss A/c | Dr. | 80 | |
| | To Premium Payable on buyback account | | | 480 |
| | (Being Premium Payable on buyback account charged to securities premium and general reserve/Profit & Loss A/c) | | | |
| (c) | General Reserve / Profit & Loss A/c | Dr. | 240 | |
| | To Capital redemption reserve account | | | 240 |
| | (Being transfer of free reserves to capital redemption reserve to the extent of nominal value of share capital bought back out of redeemed through free reserves) | | | |

Working Notes:

1. Shares Outstanding Test

| Particulars | (Shares in crores) |
|-------------------------------|--------------------|
| Number of shares outstanding | 120 |
| 25% of the shares outstanding | 30 |

2. Resources Test

| Particulars | |
|---|------------------|
| Paid up capital (₹ in crores) | 1,200 |
| Free reserves (₹ in crores) (1,080 + 400 + 200) | <u>1,680</u> |
| Shareholders' funds (₹ in crores) | <u>2,880</u> |
| 25% of Shareholders fund (₹ in crores) | ₹ 720 crores |
| Buy back price per share | ₹ 30 |
| Number of shares that can be bought back | 24 crores shares |

3. Debt Equity Ratio Test: Loans cannot be in excess of twice the Equity Funds post Buy Back

| | Particulars | |
|-----|--|-------------------|
| (a) | Loan funds (₹) | 3,200 |
| (b) | Minimum equity to be maintained after buy back in the ratio of 2:1 (₹) (a/2) | 1,600 |
| (c) | Present equity shareholders fund (₹) | 2,880 |
| (d) | Future equity shareholders fund (₹) (see W.N.4) | 2,560 (2,880-320) |
| (e) | Maximum permitted buy back of Equity (₹) [(d) – (b)] | 960 |
| (f) | Maximum number of shares that can be bought back @ ₹ 30 per share | 32 crore shares |
| | As per the provisions of the Companies Act, 2013, company | Qualifies |

4 Amount transferred to CRR and maximum equity to be bought back will be calculated by simultaneous equation method

Suppose amount transferred to CRR account is 'x' and maximum permitted buy-back of equity is 'y' Then

Equation 1: (Present Equity- Transfer to CRR)- Minimum Equity to be maintained = Maximum Permitted Buy Back

$$= (2,880 - x) - 1,600 = y$$

$$= 1280 - x = y \quad (1)$$

Equation 2: Maximum Permitted Buy Back X Nominal Value Per Share/Offer Price Per Share

$$= \left(\frac{y}{30} \times 10 \right) = x \quad \text{Or} \quad 3x = y \quad (2)$$

by solving the above two equations we get

$$x = ₹ 320$$

$$y = ₹ 960$$

7. (a) **Nature of Limited Liability Partnership:** A limited liability partnership is a body corporate formed and incorporated under the LLP Act, 2008 and is a legal entity separate from that of its partners. A limited liability partnership shall have perpetual succession and any change in the partners of a limited liability partnership shall not affect the existence, rights or liabilities of the limited liability partnership.

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

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

(b) Calculation of number of equity shares to be allotted

| | <i>Number of debentures</i> |
|---|-----------------------------|
| Total number of debentures | 30,000 |
| Less: Debenture holders who have not opted for conversion | <u>(2,500)</u> |
| Debenture holders who opted for conversion | <u>27,500</u> |
| Option for conversion | 20% |
| Number of debentures to be converted (20% of 27,500) | 5,500 |
| Redemption value of 5,500 debentures at a premium of 5% [5,500 x (100+5)] | ₹ 5,77,500 |
| Equity shares of ₹ 10 each issued on conversion [₹ 5,77,500/ ₹ 15] | 38,500 shares |

- (c) A liability is recognized when outflow of economic resources in settlement of a present obligation can be anticipated and the value of outflow can be reliably measured. In the given case, ABC Ltd. should recognize a liability of ₹ 4,00,000 payable to XYZ Ltd.

When flow of economic benefit to the enterprise beyond the current accounting period is considered improbable, the expenditure incurred is recognized as an expense rather than as an asset. In the present case, flow of future economic benefit from the machine to the enterprise is improbable. The entire amount of purchase price of the machine should be recognized as an expense.

Hence ABC Ltd. should charge the amount of ₹ 4,00,000 (being loss due to change in production method) to Profit and loss statement and record the corresponding liability (amount payable to XYZ Ltd.) for the same amount in the books for the year ended 31st March, 2016.

(d) **Journal Entries**

| Year | Particulars | | ₹ in lakhs (Dr.) | ₹ in lakhs (Cr.) |
|------|---|-----|---------------------|---------------------|
| 2nd | Fixed Asset Account | Dr. | 5 | |
| | To Bank Account | | | 5 |
| | (Being government grant on asset partly refunded which increased the cost of fixed asset) | | | |
| | Depreciation Account (W.N.) | Dr. | 3.67 | |
| | To Fixed Asset Account | | | 3.67 |
| | (Being depreciation charged on SLM on revised value of fixed asset prospectively) | | | |
| | Profit & Loss Account | Dr. | 3.67 | |
| | To Depreciation Account | | | 3.67 |
| | (Being depreciation transferred to Profit and Loss Account at the end of year 2) | | | |

Working Note:

Depreciation for Year 2

| | ₹ in lakhs |
|---|------------|
| Cost of the Asset | 20 |
| Less: Government grant received | <u>(8)</u> |
| | 12 |
| Less: Depreciation for the first year $\left[\frac{12-4}{4} \right]$ | <u>2</u> |
| | 10 |
| Add: Government grant refundable | <u>5</u> |
| | <u>15</u> |
| Depreciation for the second year $\left[\frac{15-4}{3} \right]$ | 3.67 |

- (e) As per the amendment in AS 4 "Contingencies and Events Occurring After the Balance Sheet Date" vide Companies (Accounting Standards) Amendments Rules, 2016 dated 30th March, 2016, the events which take place after the balance sheet date, are sometimes reflected in the financial statements because of statutory requirements or because of their special nature. However, dividends declared after the balance sheet date but before approval of financial statements are not recognized as a liability at the balance sheet date because no statutory obligation exists at that time. Hence such dividends are disclosed in the notes to financial statements.

Provision for proposed dividends is not required to be made as per the amendment in AS 4. Such proposed dividends are to be disclosed in the notes to financial statements. Accordingly, the dividend of ₹ 4 crores recommended by New Graphics Ltd. in its Board meeting on 18th April, 2017 shall not be accounted for in the books for the year 2016-17 irrespective of the fact that it pertains to the year 2016-17 and will be paid after approval in the Annual General Meeting of the members/shareholders.

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) Matters indicating auditor about non-compliance of laws & regulations by management. **(5 Marks)**
 - (b) “Disclosure of significant accounting policies followed is necessary if the view presented is to be properly appreciated.” **(5 Marks)**
 - (c) Guidance Notes issued by the ICAI are mandatory in nature. **(5 Marks)**
 - (d) “Inquiry is one of the audit procedures to obtain audit evidence.” **(5 Marks)**
2. State with reason (in short) whether the following statements are correct or incorrect (Answer any **eight**):
 - (i) Director's relative can act as an auditor of the company.
 - (ii) A company shall disclose by way of notes additional information regarding aggregate expenditure and income for an item which exceeds ₹ 1,00,000.
 - (iii) Where at any AGM, no auditor is appointed or re-appointed, the existing auditor shall continue to be the auditor of the company.
 - (iv) The risk of not detecting a material misstatement resulting from fraud is higher than the risk of not detecting one resulting from error.
 - (v) As per SA 570, the objective of the Auditor is to obtain sufficient appropriate audit evidence about the appropriateness of management's use of consistency assumption in the preparation and presentation of the financial statements.
 - (vi) A company can issue its sweat equity shares at discounted price.
 - (vii) Internal control can provide absolute assurance.
 - (viii) Manner of rotation of auditor will not be applicable to company A, which is having paid up share capital of ₹ 45 crores and having public borrowing from nationalized bank of ₹ 40 crore because it is a Private Limited Company.
 - (ix) The overall objective of audit does not change in Computer Information System (CIS) environment.
 - (x) Substantive procedure may be defined as an audit procedure designed to evaluate the operating effectiveness of controls in preventing, or detecting and correcting, material misstatements at the assertion level. **(2 x 8 = 16 Marks)**
3. How will you vouch/verify the following:
 - (a) Sale of Scrap
 - (b) Advertisement Expenses
 - (c) Assets acquired on Lease
 - (d) Investment in Shares and Debentures of Subsidiary. **(4 x 4 = 16 Marks)**

4. Discuss with reference to SAs:
- (a) What auditor shall do after the identification of significant related party transactions outside the entity's normal course of business? **(4 Marks)**
 - (b) What are the factors that may influence the degree of estimation uncertainty associated with an accounting estimate? **(6 Marks)**
 - (c) What are the factors that may influence the auditor's decision on whether to use an auditor's expert, when management has used a management's expert in preparing the financial statements? **(6 Marks)**
5. (a) Internal Control System can provide only reasonable but not absolute assurance that its objective relating to prevention and detection of errors/frauds, safeguarding of assets etc., are achieved. Briefly explain the inherent limitations that the system suffers. **(6 Marks)**
- (b) The auditor of X Ltd. did not report on the matters specified under sub-section (1) of section 143 of the Companies Act, 2013, as he was satisfied that no comment is required. However, the management of the company wanted the auditor to disclose the findings of enquiry thinking that it would provide a good impression on the stakeholders. Now, agreeing with the thought of the management, the auditor is thinking to disclose his findings of enquiry. Comment. **(4 Marks)**
- (c) Mention any eight special steps involved in conducting the audit of an Educational Institution? **(6 Marks)**
6. (a) As an auditor what are the essential points to be borne in mind while examining a voucher? **(4 Marks)**
- (b) "Y Ltd. utilised its securities premium to declare 45% dividend." State the provisions related to application of securities premium account and comment on the statement given. **(6 Marks)**
- (c) "Audit of the accounts of stores and inventories has been developed as a part of expenditure audit with reference to the duties and responsibilities entrusted to C&AG." Discuss. **(6 Marks)**
7. Write short notes on any **four** of the following:
- (a) Audit Note Book.
 - (b) Examination in Depth.
 - (c) Companies exempted from reporting under Companies (Auditor's Report) Order, 2016.
 - (d) Verification procedure for Splitting of one share of the face value of ₹ 10 into 10 shares of ₹ 1 each.
 - (e) Assertions used by auditor to consider potential misstatements about presentation and disclosure at the period end. **(4 x 4 = 16 Marks)**

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

1. (a) **Matters indicating Auditor about Non-Compliance with Laws and Regulations by Management:** As per SA 250 on “Consideration of Laws and Regulation in an Audit of Financial Statements”, the following are examples or matters indicating to the auditor about non-compliance with laws and regulations by management-

- (i) Investigations by regulatory organisations and government departments or payment of fines or penalties.
- (ii) Payments for unspecified services or loans to consultants, related parties, employees or government employees.
- (iii) Sales commissions or agent’s fees that appear excessive in relation to those ordinarily paid by the entity or in its industry or to the services actually received.
- (iv) Purchasing at prices significantly above or below market price.
- (v) Unusual payments in cash, purchases in the form of cashiers’ cheques payable to bearer or transfers to numbered bank accounts.
- (vi) Unusual payments towards legal and retainership fees.
- (vii) Unusual transactions with companies registered in tax havens.
- (viii) Payments for goods or services made other than to the country from which the goods or services originated.
- (ix) Payments without proper exchange control documentation.
- (x) Existence of an information system which fails, whether by design or by accident, to provide an adequate audit trail or sufficient evidence.
- (xi) Unauthorised transactions or improperly recorded transactions.
- (xii) Adverse media comment.

(b) **Disclosure of Accounting Policies:** The view presented in the financial statements of an enterprise of its state of affairs and of the profit or loss can be significantly affected by the accounting policies followed in the preparation and presentation of the financial statements.

The accounting policies followed vary from enterprise to enterprise. Disclosure of significant accounting policies followed is necessary if the view presented is to be properly appreciated. The disclosure of some of the accounting policies followed in the preparation and presentation of the financial statements is required by some cases.

The purpose of AS 1 is to promote better understanding of financial statements by establishing through an accounting standard and the disclosure of significant accounting policies and the manner in which such accounting policies are disclosed in the financial statements.

Such disclosure would also facilitate a more meaningful comparison between financial statements of different enterprises.

To ensure proper understanding of financial statements, it is necessary that all significant accounting policies adopted in the preparation and presentation of financial statements should be disclosed. Such disclosure should form part of the financial statements.

It would be helpful to the reader of financial statements if they are all disclosed at one place instead of being scattered over several statements, schedules and notes which form part of financial statements.

Any change in accounting policy, which has a material effect, should be disclosed. The amount by which any item is in the financial statement is affected by such change should also be disclosed to the extent ascertainable. Where such amount is not ascertainable, wholly or in part, the fact should be indicated. If a change is made in the accounting policies, which has not material effect on the financial statements for the current period, which is reasonably expected to have material effect in latter periods, the fact of such change should be appropriately disclosed in the period in which the change is adopted.

- (c) **Guidance Notes:** 'Guidance Notes' are primarily designed to provide guidance to members on matters which may arise in the course of their professional work and on which they may desire assistance in resolving issues which may pose difficulty. Guidance Notes are recommendatory in nature. A member should ordinarily follow recommendations in a guidance note relating to an auditing matter except where he is satisfied that in the circumstances of the case, it may not be necessary to do so.

Similarly, while discharging his attest function, a member should examine whether the recommendations in a guidance note relating to an accounting matter have been followed or not. If the same have not been followed, the member should consider whether keeping in view the circumstances of the case, a disclosure in his report is necessary.

There are, however a few guidance notes in case of which the Council has specifically stated that they should be considered as mandatory on members while discharging their attest function.

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

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

Although corroboration of evidence obtained through inquiry is often of particular importance, in the case of inquiries about management intent, the information available to support management's intent may be limited. In these cases, understanding management's past history of carrying out its stated intentions, management's stated reasons for choosing a particular course of action, and management's ability to pursue a specific course of action may provide relevant information to corroborate the evidence obtained through inquiry. In respect of some matters, the auditor may consider it necessary to obtain written representations from management and, where appropriate, those charged with governance to confirm responses to oral inquiries.

2. (i) **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.
- (ii) **Incorrect:** As per Schedule III to the Companies Act, 2013, a company shall disclose by way of notes additional information regarding aggregate expenditure and income for an item which exceeds 1% of the revenue from the operation or ₹ 1,00,000 whichever is higher.

- (iii) **Correct:** As per section 139(10) of the Companies Act, 2013, where at any AGM, no auditor is appointed or re-appointed, the existing auditor shall continue to be the auditor of the company.
- (iv) **Correct:** The risk of not detecting a material misstatement resulting from fraud is higher than the risk of not detecting one resulting from error. This is because fraud may involve sophisticated and carefully organized schemes designed to conceal it.
- (v) **Incorrect:** As per the objectives given in SA 570 "Going Concern", the auditor is required to obtain sufficient appropriate audit evidence about the appropriateness of management's use of going concern assumption in the preparation and presentation of the financial statements.
- (vi) **Correct:** According to section 53 of the Companies Act, 2013, a company shall not issue shares at a discount. However, exception has been given in the case of an issue of sweat equity shares.
- (vii) **Incorrect:** Internal control can provide only reasonable but not absolute assurance that its objective relating to prevention and detection of errors/frauds, safeguarding of assets etc., are achieved. This is because it suffers from some inherent limitations.
- (viii) **Correct:** According to section 139 of the Companies Act, 2013, the provisions related to rotation of auditor are applicable to all private limited companies having paid up share capital of ₹ 50 crore or more; and all companies having paid up share capital of below threshold limit mentioned above, but having public borrowings from financial institutions, banks or public deposits of ₹ 50 crore or more.

Applying the above to the given problem, it would not be governed by provisions of rotation of auditor.

- (ix) **Correct:** Overall objective of audit does not change in Computer Information System (CIS) environment. But the use of computer changes the processing and storage, retrieval and communication of financial information.
- (x) **Incorrect:** Test of controls may be defined as an audit procedure designed to evaluate the operating effectiveness of controls in preventing, or detecting and correcting, material misstatements at the assertion level.

Whereas substantive procedure may be defined as an audit procedure designed to detect material misstatements at the assertion level.

3. (a) **Sale of Scrap:**

- (i) Review the internal control as regards generation, storage and disposal of scrap.
- (ii) Check whether the organization is maintaining reasonable record for generation of Scrap.
- (iii) Analyze the raw material used, production and generation pattern of scrap and compare the same with figures of earlier year.
- (iv) Check the rates at which scrap has been sold and compare the rate with previous year.
- (v) Vouch sales, with invoices raised, advertisement for tender, rate contract with scrap dealers.
- (vi) Ensure that there exists a proper control procedure to identify scrap and good units and they are not mixed up and sold as scrap.
- (vii) Make an overall assessment of the value of realization from scrap as to its reasonableness.

(b) **Advertisement Expenses:**

- (i) Verify the bill/invoice from advertising agency to ensure that rates charged for different types of advertisement are as per contract.
- (ii) See that advertisement relates to client's business.
- (iii) Inspect the receipt issued by the agency.

- (iv) Ascertain the nature of expenditure – revenue deferred and see that it has been recorded properly.
- (v) Ascertain the period for which payment is made and see that pre-paid is carried forward to balance sheet.
- (vi) Compare the statement of account with the ledger account.
- (vii) See that all outstanding advertisement bills have been provided for.

(c) Assets Acquired on Lease:

- (i) Examine the terms and conditions of the lease deed.
- (ii) If a part of the leasehold property has been sublet, examine the tenant's agreement.
- (iii) Verify relevant document to check the cost of property.
 - (1) In case of acquisition of an asset is on operating lease, lease payment should be recognized as an expense in the Statement of Profit and Loss on a straight line basis over the lease term;
 - (2) In case of acquisition of an asset is on finance lease, ensure all the substantial risks and rewards to ownership are transferred, considering the indication as prescribed in AS-19, the lessee should recognize the lease as an asset and as a liability. Such recognition should be at an amount equal to the fair value of the leased assets at the inception of the lease. Ensure contingent rents are recognized as expense in the statement of profit & loss for the period in case of Finance lease.
- (iv) Ensure assets acquired under finance lease are segregated from the assets owned.
- (v) Ensure that the assets under lease have been properly disclosed as per requirement of Schedule III to the Companies Act, 2013.

(d) Investment in Shares and Debentures of Subsidiary:

- (i) The auditor should obtain a complete schedule of all such investments held, showing particulars as regards the name of the subsidiary company, class of shares or debenture, date of purchase, number of units and denoting numbers, book value, dividend received etc.
- (ii) All the particulars entered in the schedule should be verified with the relevant account in the General Ledger.
- (iii) The auditor should, at the same time, examine all the investments by inspection of the securities, share scrips or certificates, debenture bonds, etc. If any of the securities are held by bankers, he should verify them with their certificate which should disclose the charge, if they are subject to any such charge.
- (iv) The provisions contained in Part I of Schedule III to the Companies Act, 2013 requires that the shares held in a subsidiary should be shown separately.
- (v) The shares or debentures of a subsidiary are valued at cost.
- (vi) If the subsidiary has suffered a loss, then a provision for the proportionate part of the loss should be made in the accounts of the holding company.

4. (a) Identification of Significant Related Party Transaction Outside Business: As per SA 550 on "Related Parties", for identified significant related party transactions outside the entity's normal course of business, the auditor shall-

- (i) Inspect the underlying contracts or agreements, if any, and evaluate whether:

- (1) The business rationale (or lack thereof) of the transactions suggests that they may have been entered into to engage in fraudulent financial reporting or to conceal misappropriation of assets;
 - (2) The terms of the transactions are consistent with management's explanations; and
 - (3) The transactions have been appropriately accounted for and disclosed in accordance with the applicable financial reporting framework; and
- (ii) Obtain audit evidence that the transactions have been appropriately authorized and approved.
- (b) Factors Influencing Degree of Estimation Uncertainty:** According to SA 540 "Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures", the degree of estimation uncertainty associated with an accounting estimate may be influenced by factors such as-
- (i) The extent to which the accounting estimate depends on judgment.
 - (ii) The sensitivity of the accounting estimate to changes in assumptions.
 - (iii) The existence of recognised measurement techniques that may mitigate the estimation uncertainty (though the subjectivity of the assumptions used as inputs may nevertheless give rise to estimation uncertainty).
 - (iv) The length of the forecast period, and the relevance of data drawn from past events to forecast future events.
 - (v) The availability of reliable data from external sources.
 - (vi) The extent to which the accounting estimate is based on observable or unobservable inputs.
- (c) Factors Influencing Auditor's Decision on Whether to Use an Auditor's Expert when Management has used a Management's Expert:** SA 620 "Using the Work of an Auditor's Expert" states that when management has used a management's expert in preparing the financial statements, the auditor's decision on whether to use an auditor's expert may be influenced by such factors as-
- (i) The nature, scope and objectives of the management's expert's work.
 - (ii) Whether the management's expert is employed by the entity, or is a party engaged by it to provide relevant services.
 - (iii) The extent to which management can exercise control or influence over the work of the management's expert.
 - (iv) The management's expert's competence and capabilities.
 - (v) Whether the management's expert is subject to technical performance standards or other professional or industry requirements.
 - (vi) Any controls within the entity over the management's expert's work.
- 5. (a) Limitations of Internal Control system:** Internal control system can provide only reasonable but not absolute assurance that its objective relating to prevention and detection of errors/frauds, safeguarding of assets etc., are achieved. This is because it suffers from some inherent limitations, such as:-
- (i) Management's consideration that cost of an internal control does not exceeds the expected benefits.
 - (ii) Most controls do not tend to be directed at unusual transactions.
 - (iii) The potential of human error due to carelessness, misjudgment and misunderstanding of instructions.

- (iv) The possibility that control may be circumvented through collusion with employees or outsiders.
 - (v) The possibility that a person responsible for exercising control may abuse that authority.
 - (vi) Compliance with procedures may deteriorate because the procedures becoming inadequate due to change in condition.
 - (vii) Manipulation by management with respect to transactions or estimates and judgements required in the preparation of financial statements.
 - (viii) Inherent limitations of Audit.
- (b) Comment on Matters Contained under Section 143(1) of the Companies Act, 2013:** Section 143(1) of the Companies Act, 2013 deals with duties of an auditor requiring him to make an enquiry in respect of specified matters. The matters in respect of which the enquiry has to be made by the auditor are relating to loans and advances, transactions represented merely by book entries, investments sold at less than cost price, loans and advances shown as deposits, etc. Since the law requires the auditor to make an enquiry, the Institute opined that the auditor is not required to report on the matters specified in sub-section (1) unless he has any special comments to make on any of the items referred to therein. If the auditor is satisfied as a result of the enquiries, he has no further duty to report that he is so satisfied. Therefore, the auditor of X Ltd. is correct in non-reporting on the matters specified in section 143(1) of the Companies Act, 2013.
- (c) Audit of an Educational Institution:** The special steps involved in the audit of an educational institution are the following-
- (i) Examine the Trust Deed, or Regulations in the case of school or college and note all the provisions affecting accounts. In the case of a university, refer to the Act of Legislature and the Regulations framed thereunder.
 - (ii) Read through the minutes of the meetings of the Managing Committee or Governing Body, noting resolutions affecting accounts to see that these have been duly complied with, specially the decisions as regards the operation of bank accounts and sanctioning of expenditure.
 - (iii) Check names entered in the Students' Fee Register for each month or term, with the respective class registers, showing names of students on rolls and test amount of fees charged; and verify that there operates a system of internal check which ensures that demands against the students are properly raised.
 - (iv) Check fees received by comparing counterfoils of receipts granted with entries in the cash book and tracing the collections in the Fee Register to confirm that the revenue from this source has been duly accounted for.
 - (v) Total up the various columns of the Fees Register for each month or term to ascertain that fees paid in advance have been carried forward and the arrears that are irrecoverable have been written off under the sanction of an appropriate authority.
 - (vi) Check admission fees with admission slips signed by the head of the institution and confirm that the amount had been credited to a Capital Fund, unless the Managing Committee has taken a decision to the contrary.
 - (vii) See that free studentship and concessions have been granted by a person authorised to do so, having regard to the prescribed Rules.
 - (viii) Confirm that fines for late payment or absence, etc., have either been collected or remitted under proper authority.
 - (ix) Confirm that hostel dues were recovered before students' accounts were closed and their deposits of caution money refunded.

- (x) Verify rental income from landed property with the rent rolls, etc.
- (xi) Vouch income from endowments and legacies, as well as interest and dividends from investment; also inspect the securities in respect of investments held.
- (xii) Verify any Government or local authority grant with the relevant papers of grant. If any expense has been disallowed for purposes of grant, ascertain the reasons and compliance thereof.
- (xiii) Report any old heavy arrears on account of fees, dormitory rents, etc, to the Managing Committee.
- (xiv) Confirm that caution money and other deposits paid by students on admission have been shown as liability in the balance sheet and not transferred to revenue.
- (xv) See that the investments representing endowment funds for prizes are kept separate and any income in excess of the prizes has been accumulated and invested along with the corpus.
- (xvi) Verify that the Provident Fund money of the staff has been invested in appropriate securities.
- (xvii) Vouch donations, if any, with the list published with the annual report. If some donations were meant for any specific purpose, see that the money was utilised for the purpose.
- (xviii) Vouch all capital expenditure in the usual way and verify the same with the sanction for the Committee as contained in the minute book.
- (xix) Vouch in the usual manner all establishment expenses and enquire into any unduly heavy expenditure under any head.
- (xx) See that increase in the salaries of the staff have been sanctioned and minuted by the Committee.
- (xxi) Ascertain that the system ordering inspection on receipt and issue of provisions, foodstuffs, clothing and other equipment is efficient and all bills are duly authorised and passed before payment.
- (xxii) Verify the inventories of furniture, stationery, clothing, provision and all equipment, etc. These should be checked by reference to Inventory Register and values applied to various items should be test checked.
- (xxiii) Confirm that the refund of taxes deducted from the income from investment (interest on securities, etc.) has been claimed and recovered since the institutions are generally exempted from the payment of income-tax.
- (xxiv) Verify the annual statements of accounts and while doing so see that separate statements of account have been prepared as regards Poor Boys Fund, Games Fund, Hostel and Provident Fund of Staff, etc.

- 6. (a) Examining a Voucher:** The essential points to be borne in mind while examining a voucher are-
- (i) that the date of the voucher falls within the accounting period;
 - (ii) that the voucher is made out in the client's name;
 - (iii) that the voucher is duly authorised;
 - (iv) that the voucher comprised all the relevant documents which could be expected to have been received or brought into existence on the transactions having been entered into, i.e., the voucher is complete in all respects; and
 - (v) that the account in which the amount of the voucher is adjusted is the one that would clearly disclose the character of the receipts or payments posted thereto on its inclusion in the final accounts.

After the examination is over, each voucher should be either impressed with a rubber stamp or initialed so that it may not be presented again in support of another entry.

- (b) **Utilisation of Securities Premium:** Section 52 of the Companies Act, 2013 deals with creation of Securities Premium Account for premium received on issues of shares and its application thereon. Section 52(2) lays down that the securities premium account may be applied by the company -
- (i) in paying up unissued shares of the company to be issued to members of the company as fully paid bonus shares;
 - (ii) in writing off the preliminary expenses of the company;
 - (iii) in writing off the expenses of, or the commission paid or discount allowed on, any issue of shares or debentures of the company;
 - (iv) in providing for the premium payable on the redemption of any redeemable preference shares or of any debentures of the company; or
 - (v) for the purchase of its own shares or other securities under section 68.

Thus, it is clear from the above that securities premium can be utilised only for specific purposes. Further, section 123 of the Companies Act, 2013 also specifies the sources from which dividends can be paid and requires the same to be only paid out of current/past profits or any other free reserve.

Hence, declaration of dividends out of securities premium is not proper and, consequently, the auditor shall have to qualify the audit report.

- (c) **Audit of Stores and Inventories:** Audit of the accounts of stores and inventories has been developed as a part of expenditure audit with reference to the duties and responsibilities entrusted to C&AG. Audit is conducted to ascertain whether the Regulations governing purchase, receipt and issue, custody, sale and inventory taking of stores are well devised and properly carried out. The aim is also to bring to the notice of the government any deficiencies in quantities of stores held or any defects in the system of control.

The audit of purchase of stores is conducted in the same manner as audit of expenditure, namely, that these are properly sanctioned, made economical and in accordance with the Rules for purchase laid down by the competent authority. The auditor has to ensure that the prices paid are reasonable and are in agreement with those shown in the contract for the supply of stores, and that the certificates of quality and quantity are furnished by the inspecting and receiving units. Cases of uneconomical purchase of stores and losses attributable to defective or inferior quality of stores are specifically brought by the audit.

Accounts of receipts, issues and balances are checked regarding accuracy, correctness and reasonableness of balances in inventories with particular reference to the specified norms for level of consumption of inventory holding. Any excess or idle inventory is specifically mentioned in the report and periodical verification of inventory is also conducted to ensure their existence. When priced accounts are maintained, the auditor should see that the prices charged are reasonable and have been reviewed from time to time. The valuation of the inventories is seen carefully so that the value accounts tally with the physical accounts and that adjustment of profits or losses due to revaluation, inventory taking or other causes is carried out.

7. (a) **Audit Note Book:** An audit note book is usually a bound book in which a large variety of matters observed during the course of audit are recorded. Audit note books form part of audit working papers and for each year a fresh audit note book is maintained. In case an auditor classifies his working paper into permanent and current, then audit note book shall form part of the current file. It is in any case a part of the permanent record of the auditor available for reference later on, if required.

The audit note book also provides a valuable help to the auditor in picking up the links of work when the concerned assistant is away or the work is stopped temporarily. It is also used for recording the various queries raised in the course of the work and their state of disposal. In respect of disposed queries, explanation obtained and evidence seen would be recorded in the said book, while queries remaining undisposed off would be noted for follow up.

- (b) **Examination in Depth:** It implies examination of a few selected transactions from the beginning to the end through the entire flow of the transaction, i.e., from initiation to the completion of the transaction by receipt or payment of cash and delivery or receipt of the goods. This examination consists of studying the recording of transactions at the various stages through which they have passed. At each stage, relevant records and authorities are examined; it is also judged whether the person who has exercised the authority in relation to the transactions is fit to do so in terms of the prescribed procedure. For example, a purchase of goods may commence when a predetermined re-order level has been reached. The ensuing stages may be summarised thus:
- (i) Requisitions are pre-printed, pre-numbered and authorised;
 - (ii) official company order, also sequentially pre-numbered, authorised and placed with approved suppliers only;
 - (iii) receipt of supplier's invoice;
 - (iv) receipt of supplier's statement;
 - (v) entries in purchases day book;
 - (vi) postings to purchase ledger and purchase ledger control account;
 - (vii) cheque in settlement;
 - (viii) entry on bank statement and returned "paid" cheque (if requested);
 - (ix) cash book entry;
 - (x) posting from cash book to ledger and control account, taking into account any discounts.
 - (xi) receipt of goods, together with delivery/advice note;
 - xii) admission of goods to stores;
 - (xiii) indication, by initials or rubber stamp on internal goods inwards note, of compliance with order regarding specification, quantity and quality;
 - (xiv) entries in stores records.

It should be noted that the above list is not necessarily comprehensive, nor does its constituent stages inevitably take place in the sequence suggested. The important point to note is that from the moment it was realised that once a re-order level had reached, a chain of events was put in motion, together leaving what may be termed as "audit trail". Each item selected for testing must be traced meticulously, and although sample sizes need not be large, they must, of course, be representative.

It is an acceptable practice to check a slightly smaller number of transactions at each successive stage within a depth test, on the statistical grounds (based on probability theory) that the optimum sample size decreases as the auditor's "level of confidence" concerning the functioning of the system increases. Examination in depth has been found indispensable in modern auditing practice and, if intelligently conducted, its reconstruction of the audit trail reveals more about the functioning (or malfunctioning) of the client's system in practice than the haphazard and mechanical approach to testing.

(c) Companies Exempted from Reporting under CARO, 2016

The CARO, 2016 is an additional reporting requirement Order. The order applies to every company including a foreign company as defined in clause (42) of section 2 of the Companies Act, 2013.

However, the Order specifically **exempts** the following class of companies-

- (i) a banking company as defined in clause (c) of section 5 of the Banking Regulation Act, 1949;
- (ii) an insurance company as defined under the Insurance Act, 1938;
- (iii) a company licensed to operate under section 8 of the Companies Act;
- (iv) a One Person Company as defined under clause (62) of section 2 of the Companies Act;
- (v) a small company as defined under clause (85) of section 2 of the Companies Act; and
- (vi) a private limited company, not being a subsidiary or holding company of a public company, having a paid up capital and reserves and surplus not more than ₹ 1 crore as on the balance sheet date and which does not have total borrowings exceeding ₹ 1 crore from any bank or financial institution at any point of time during the financial year and which does not have a total revenue as disclosed in Scheduled III to the Companies Act, 2013 (including revenue from discontinuing operations) exceeding ₹ 10 crore during the financial year as per the financial statements.

It may be noted that the Order shall not be applicable to the auditor's report on consolidated financial statements.

(d) Verification procedure for Splitting of one share of the face value of ₹ 10 into 10 shares of Re. 1 each:

- (i) Confirm that alteration was authorised by articles.
- (ii) Verify the minutes of the Board meeting and ordinary resolution passed in the general meeting in which the approval of members is obtained.
- (iii) Verify also with reference to requisite Form required to be filed with the ROC.
- (iv) Verify that alteration had been effected in copies of Memorandum Articles, etc.
- (v) Verify that proper accounting entries have been passed. Register of members may also be checked to see that the necessary alteration have been effected therein.

(e) Assertions used by Auditor to Consider Potential Misstatements about Presentation and Disclosure at the Period End: According to SA 315 "Identifying and Assessing the Risk of Material Misstatement through understanding the Entity and its Environment", the assertions used by the auditor to consider the different types of potential misstatements that may occur about presentation and disclosure at the period end are-

- (i) Occurrence and rights and obligations — disclosed events, transactions, and other matters have occurred and pertain to the entity.
- (ii) Completeness — all disclosures that should have been included in the financial statements have been included.
- (iii) Classification and understandability — financial information is appropriately presented and described, and disclosures are clearly expressed.
- (iv) Accuracy and valuation — financial and other information are disclosed fairly and at appropriate amounts.

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 do you understand by the term “Organizational Business Processes”?
 - (ii) Define the term “Application Software”.
 - (iii) Explain the term “Public Data Network”.
 - (iv) What do you understand by the term “Information System”?
 - (v) Which are the majorly used channels for delivery of information? (2 x 5 = 10 Marks)
2. (a) Explain the concept of “Mobile Computing” and prepare a list of its business applications. (4 Marks)
 - (b) Discuss key modules of Human Resource Management Systems (HRMS). (4 Marks)
3. (a) Explain the role of “Internetwork Processors” in Telecommunication Networks. (4 Marks)
 - (b) Discuss the benefits of pursuing Business Process Automation. (4 Marks)
4. (a) “Information Systems can support the four levels of decisions which revolves around Strategy, Management, Knowledge and Operations”. Justify the statement. (4 Marks)
 - (b) Differentiate between Thick Client and Thin Client in Telecommunication Networks. (4 Marks)
5. (a) How does the details about the current system is gathered in the “Systems Analysis” phase under System Development Life Cycle (SDLC)? Also, list the activities performed by System Analyst in processing that information. (4 Marks)
 - (b) State the characteristics of Cloud Computing. (4 Marks)
6. Auditor Forum Limited XYZ has two types of employees viz. Permanent and Contractual and intends to develop a computer program for calculating annual performance bonus for its employees. There are three categories - A in which managerial staff is placed; and B and C into which all the non-managerial staff are placed. Employees in category A, contractual employees and employees whose service period is less than nine months are not eligible for the award of bonus. On a scaled score of 1 to 100, the amount of bonus for the eligible employees is determined as follows:

| SCALED SCORE | NO. OF BASIC SALARIES |
|--------------|-----------------------|
| 80 and above | 2.0 |
| 65 – 79 | 1.5 |
| 50 – 64 | 1 |
| Less than 50 | 0.0 |

Prepare a program flowchart showing the process of calculation of bonus.

(8 Marks)

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

- (a) Business Process Management (BPM)
- (b) Bluetooth
- (c) Extranets
- (d) Scorecards
- (e) TALLY

(4 × 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) Briefly describe the impact of corporate culture on an organization. **(3 Marks)**
(b) Briefly outline some of the major reasons due to which all types of firms should engage in 'Strategic Management'. **(3 Marks)**
(c) "Six sigma is not merely a quality initiative, it is a business initiative." Elucidate. **(3 Marks)**
(d) Elaborate the interrelationship between strategy formulation and implementation. **(3 Marks)**
(e) "A Manager working on a strategic decision has to balance socio-cultural opportunities, influences and constraints". Discuss. **(3 Marks)**
2. (a) State with reasons which of the following statements is correct/incorrect:
(i) Major task of strategic management is developing annual objectives & compatible short-term strategies.
(ii) An industry can have more than one strategic group. **(2 × 2 = 4 Marks)**
(b) Explain the meaning of the following concepts:
(i) Logistics Strategy.
(ii) Demarketing.
(iii) Service Marketing. **(3 × 1 = 3 Marks)**
3. Write short notes on the following:
(a) Product life cycle as a S shaped curve. **(2 Marks)**
(b) Functional Structure. **(2 Marks)**
(c) Strategic Decision Making. **(3 Marks)**
4. Explain GE model. How is it useful in making strategic choices? **(7 Marks)**
5. What do you understand by the term business? Are business done for profit alone. Explain various objectives of business. **(7 Marks)**
6. What is the rationale behind Business Process Reengineering (BPR)? What steps would you recommend to implement BPR in an organization? **(7 Marks)**
7. Discuss how mergers and acquisitions are used for business growth. What are the various types of mergers? **(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) **Organizational Business Processes:** Organizational business processes are high-level processes that are typically specified in textual form by their inputs, their outputs, their expected results and their dependencies on other organizational business processes. These business processes act as supplier or consumer processes. To manage incoming raw materials provided by a set of suppliers is an example of an organizational business process. While organizational business processes characterize coarse-grained business functionality, there are multiple operational business processes that contribute to one organizational business process.
 - (ii) **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 and Media Development Software.
 - (iii) **Public Data Network:** A Public Data Network is defined as a network shared and accessed by users not belonging to a single organization. It is a network established and operated by a telecommunications administration, or a recognized private operating agency, for the specific purpose of providing data transmission services for the public. The Internet is an example of a Public Data Network.
 - (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.
 - (v) Delivery channels for information include Intranet; E-mail; Internal newsletters and magazines; Staff briefings, meetings and other face-to-face communications methods; Notice boards in communal areas; Manuals, guides and other printed resources; Hand-held devices (PDAs, etc.); and Social networking sites, like Facebook, WhatsApp, etc.
2. (a) **Mobile Computing:** Mobile Computing, is the use of portable computing devices (such as laptop and handheld computers) in conjunction with mobile communications technologies to enable users to access the Internet and data on their home or work computers from anywhere in the world. It is a human-computer interaction by which a computer is expected to be transported during normal usage. Mobile computing involves Mobile Communication, Mobile Hardware and Mobile Software. Some examples of business applications are as follows:
 - There is increase in workforce productivity as mobile device enables employees to work from anywhere, anytime by accessing and updating information as required. For example: employees can read/respond to emails using laptops, PDAs or smart phones from office, residence and even when on the move.

- Customer service can be improved by responding to customer queries on site or off site. For example: customer complaints can be accessed and responded by accessing past/latest information of client as required.
 - Incident management can be improved by resolving problems faster without limitation of time as the concerned employees can attend to these regardless of their location. Further, escalations can be updated in real time which ensures timely resolution of problems. For example: Computer breakdowns can be serviced by service engineers from their desks/outside by logging into the specific computer, identify problem and resolve it online.
 - Business processes can be transformed by using mobile devices. Enterprises can reengineer core business processes. The new and reengineered processes can focus on utilizing the key features of location and time independence. Enterprises can focus on providing customers and employees with access to information in different ways and provide the latest information. This enables employees, customers, and businesses to be available to one another as per their choice. For example: billing can be done by employees using hand held devices at customer site and the information updated online and deliveries to customers can be fastened.
 - Enterprises can dynamically modify and update their offerings and offer new products and services altogether. For example: enterprises can implement telecommuting with flexible working hours and locations allowing for cost savings and better efficiency.
 - Mobile computing gives users the freedom to roam, with access to data and services at any time and in any place. Most of the high-end ERP and business software applications for SMEs have in-built capabilities of mobile computing enabling users to access data. Used with proper security, enterprises can harness the power of this technology to create innovative opportunities for improving the quality and efficiency of business processes and services. Mobile devices are increasingly acquiring the must-have status for enterprises on account of the increasing acceptance as business tools.
- (b) Key Modules of Human Resource Management Systems (HRMS) are as follows:
- **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. The most advanced modules provide broad flexibility in data collection methods, labor distribution capabilities and data analysis features. Cost analysis and efficiency metrics are the primary functions.
 - **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. Data is generally fed from the human resources and time keeping modules to calculate automatic deposit and manual cheque writing capabilities. This module can encompass all employee-related transactions as well as integrate with existing financial management systems.
 - **Training Management:** Training programs can be entered with future dates which allow managers to track progress of employees through these programs, examine the results of courses taken and reschedule specific courses when needed. The module tracks the trainer or training organization, costs associated with training schedules. The module also tracks training locations, required supplies and equipment and registered attendees. All employees are linked to a skills profile. The skill profile lists the skills brought with them and acquired through training after they were hired. The skills profile is updated automatically through the training module.

- **Compensation Management:** Compensation Management is more than just the means to attract and retain talented employees. In today's competitive labor market, organizations need to fully leverage their human capital to sustain a competitive position. This requires 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. This module 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. Employees may query their attendance record from the system without asking the information from HR personnel. The module also lets supervisors approve OverTime (O.T) 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. For example, organizations combine HR metrics with other business data to identify trends and anomalies in headcount to better predict the impact of employee turnover on future output.
3. (a) **Internetwork Processors:** Telecommunications networks are interconnected by special purpose communications processors called Internetwork Processors. Examples include switches, routers, hubs, bridges, repeaters and gateways.
- **Switch** - Switch is a communications processor that makes connections between telecommunications circuits in a network so that a telecommunications message can reach its intended destination.
 - **Router** – Router is a communications processor that interconnects networks based on different rules or protocols, so that a telecommunications message can be routed to its destination.
 - **Hub** – Hub is a port-switching communications processor. This allows for the sharing of the network resources such as servers, LAN workstations, printers, etc.
 - **Bridge** – Bridge is a communications processor that connects numerous Local Area Networks (LANs). It magnifies the data transmission signal while passing data from one LAN to another.
 - **Repeater** – Repeater is a communications processor that boosts or amplifies the signal before passing it to the next section of cable in a network.
 - **Gateway** – Gateway is a communications processor that connects networks that use different communication architectures.
- (b) Business Process Automation (BPA) is the basic component of an enterprise-wide automation and management scheme for both business and IT workflow. Some benefits of pursuing BPA include the following:
- **Reducing the Impact of Human Error:** BPA removes human participation in the process, which is the source of many errors.
 - **Transforming Data into Information:** BPA can, apart from collecting and storing data also analyze data and make it available in a form that is useful for decision-making.

- **Improving performance and process effectiveness:** In many cases, tasks that must be done manually are the bottleneck in the process. Automating those manual tasks speeds up the effective throughput of the application.
 - **Making users more efficient and effective:** People can focus their energies on the tasks they do best, allowing the computers to handle those that machines are best suited for.
 - **Making the business more responsive:** Enterprises can easily automate new applications and processes as they are introduced that provide greater control over business and IT processes.
 - **Improving Collaboration and Information Sharing:** Business processes designed through a collaborative interface mean IT can integrate its processes with the business side logic that drives day-to-day operations.
 - **Cost Saving:** Automation leads to saving in time and labor costs through higher efficiency and better management of the people involved;
 - **To remain competitive:** To provide the level of products and services as offered by competition.
 - **Fast service to customers:** Automation shortens cycle times in the execution of processes through improved and refined business workflows and help enterprises to serve their customers faster and better.
4. (a) The following classification of Information Systems at four different levels support the four level of decisions - Strategy, Management, Knowledge and Operations.
- **Strategic-Level Systems:** These are totally focused on Strategic and planning issues. These systems are for strategic managers to track and deal with strategic issues and assisting in long-range planning. A principle area is tracking changes in the external conditions (market sector, employment levels, share prices, etc.) and matching these with the internal conditions of the organization.
 - **Management-Level Systems:** These systems are used for the monitoring, controlling, decision-making, and administrative activities of middle management. Some of these systems deal with predictions or “what if...” type questions. e.g. “What would happen to our profits if the completion of the new production plant was delayed by 6 months?” Tracking current progress in accord with plans is another major function of systems at this level.
 - **Knowledge-Level Systems:** These systems support discovery, processing and storage of knowledge and data workers. These further control the flow of paper work and enable group working.
 - **Operational-Level Systems:** These systems support operational managers tracking elementary activities. These can include tracking customer orders, invoice tracking, etc. Operational level systems ensure that business procedures are followed.
- (b) **Thick Client:** A Thick Client (Fat Client) is a client that performs the bulk of any data processing operations itself, and does not necessarily rely on the server. Unlike thin clients, thick clients do not rely on a central processing server because the processing is done locally on the user system, and the server is accessed primarily for storage purposes. For that reason, thick clients often are not well-suited for public environments. To maintain a thick client, IT needs to maintain all systems for software deployment and upgrades, rather than just maintaining the applications on the server. For example – Personal Computer.
- Thin Client:** Thin client uses the resources of the host computer. A thin client generally only presents processed data provided by an application server, which performs the bulk of any required data processing. A thin client machine is going to communicate with a central processing server, meaning there is little hardware and software installed on the user's machine. Unlike thick clients,

thin clients rely on a central processing server for the processing to be done. A device using web application (such as Office Web Apps) is a thin client.

5. (a) **System Analysis:** This is the second phase in SDLC (Systems Development Life Cycle) that examines 'What must the Information System do to solve the problem'? System analyst would be gathering details about the current system and will involve:
- **Interviewing staff:** at different levels from end-users to senior management;
 - **Examine current business:** systems documents and output including current order documents, computer system procedures and reports used by operations and senior management;
 - **Sending out questionnaires:** that have to be carefully constructed to elicit unambiguous answers; and
 - **Observation of current procedures:** by spending time in various departments. A time and motion study can show where procedures could be more efficient or to detect bottlenecks.

The Systems Analyst will:

- Examine data and information flows in the enterprise using data flow diagrams;
- Establish what the proposed system will actually do (not how it will do it);
- Analyze costs and benefits;
- Outline system implementation options. (e.g. in-house or using consultants);
- Consider possible hardware configurations; and
- Make recommendations.

(b) Characteristics of Cloud Computing are as follows:

- **Elasticity and Scalability:** Cloud computing gives us the ability to expand and reduce resources per the specific service requirement. For example, we may need many server resources for the duration of a specific task. We can then release these server resources after we complete our task.
- **Pay-per-Use:** We pay for cloud services only when we use them, either for the short term (for example, for CPU time) or for a longer duration (for example, for cloud-based storage or vault services).
- **On-demand:** Because we invoke cloud services only when we need them, they are not permanent parts of the IT infrastructure. This is a significant advantage for cloud use as opposed to internal IT services. With cloud services, there is no need to have dedicated resources waiting to be used, as is the case with internal services.
- **Resiliency:** The resiliency of a cloud service offering can completely isolate the failure of server and storage resources from cloud users. Work is migrated to a different physical resource in the cloud with or without user awareness and intervention.
- **Multi Tenancy:** Public cloud service providers often can host the cloud services for multiple users within the same infrastructure. Server and storage isolation may be physical or virtual depending upon the specific user requirements.
- **Workload Movement:** This characteristic is related to resiliency and cost considerations. Here, cloud-computing providers can migrate workloads across servers both inside the data center and across data centers. This migration might be necessitated by cost, efficiency considerations, or regulatory considerations for certain types of workloads.

6. Let us define the variables first:

Emp_Ctgy: Employee Category

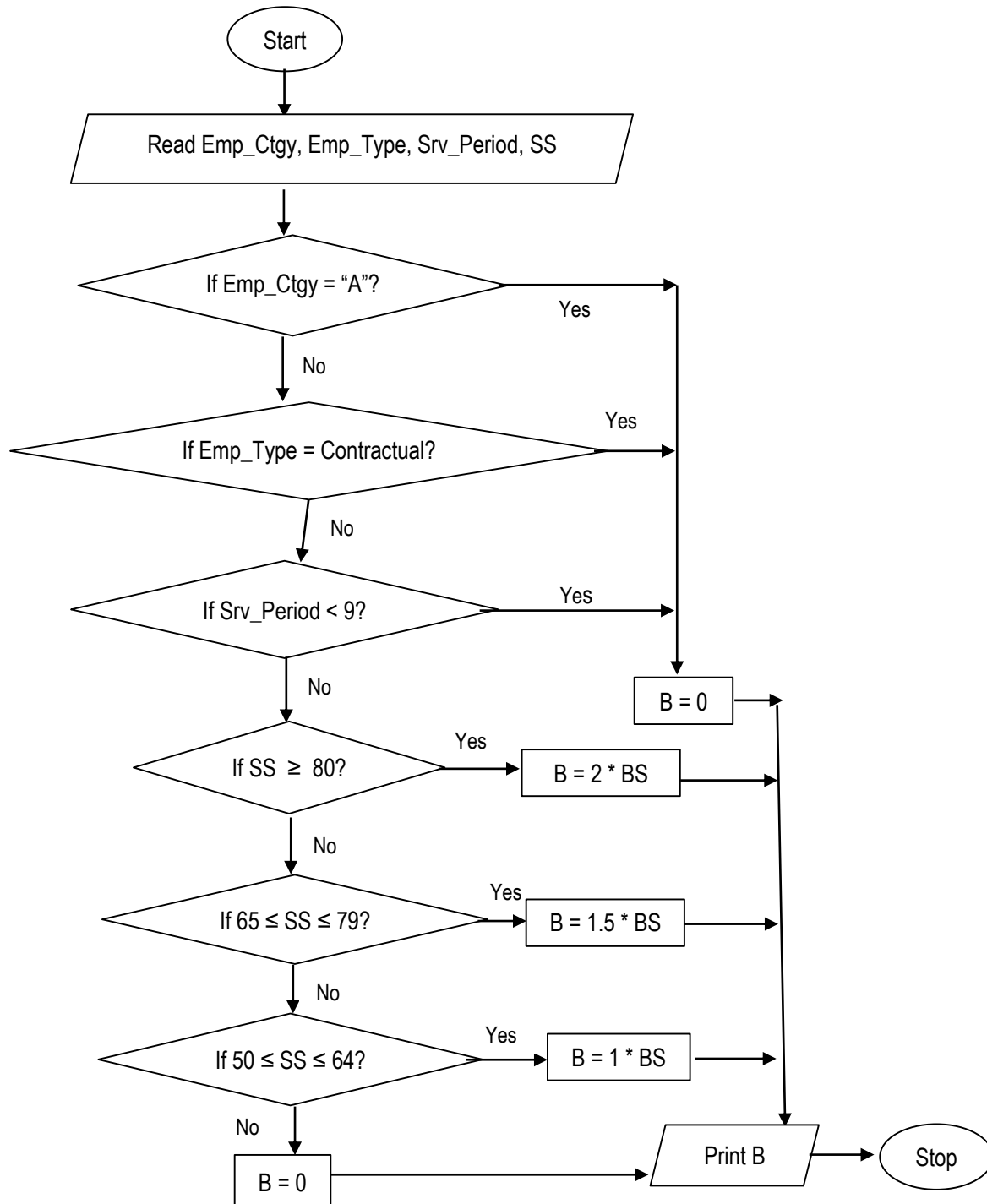
Emp_Type: Employee Type

Srv_Period: Service Period

SS: Scaled Service

BS: Basic Salary

B: Bonus



7. (a) **Business Process Management (BPM):** This refers to the closed loop, iterative management of business processes over their complete lifecycle. In simple terms, BPM is about the management of business processes with the organization being the primary focus. It is the methodology used

by enterprises to improve end-to-end business processes in various stages and aim to grow revenues quickly while controlling resource costs. BPM evaluates the efficacy and usefulness of business processes for reducing costs and ensure value creation. It includes concepts, methods, and techniques to support the design, administration, configuration, enactment, and analysis of business processes. The basis of BPM is the explicit representation of business processes with their activities and the execution constraints between them. Once business processes are defined, they can be subject to analysis, improvement, and enactment.

- (b) **Bluetooth:** Bluetooth is a wireless technology standard for exchanging data over short distances up to 50 meters (164 feet) from fixed and mobile devices, creating Personal Area Networks (PANs) with high levels of security. It is a feature which is used every day through several compatible devices. Bluetooth is really like a very low-power, short-range radio signal through which both data and voice transmissions can be sent. Bluetooth signals are secure from the moment they're sent, so unlike any other wireless network we don't have to worry about turning on security. Few devices that utilize Bluetooth technology are Keyboards and mice, Printers, Cell phones and headsets, PDAs (Personal Digital Assistants), Desktop and laptop computers, Digital cameras, and Remotes: replacing IR (infrared).
- (c) **Extranets:** Extranets are network links that use Internet technologies to interconnect the Intranet of a business with the Intranets of its customers, suppliers, or other business partners. Companies can use Extranets establish direct private network links between themselves, or create private secure Internet links between them called virtual private networks. They use the unsecured Internet as the extranet link between its intranet and consumers and others, but rely on encryption of sensitive data and its own firewall systems to provide adequate security.
- (d) **Scorecards:** This involves providing a visual representation of the enterprise strategy by taking critical metrics and mapping them to strategic goals throughout the enterprise. Scorecards offer a rich, visual gauge to display the performance of specific initiatives, business units, or the enterprise and the individual goals in the context of larger enterprise strategy. Scorecards distil information into a small number of metrics and targets and provide users with an at-a-glance perspective of information. A scorecard has a graphical list of specific, attainable strategic milestones, combined with metrics that serve as benchmarks. Specific measures on how well the company has actually performed specified activities are linked in the scorecard with graphical display highlighting the status of each goal.
- (e) **TALLY:** It is an accounting application that helps entity to automate processes relating to accounting of transactions. It also helps to achieve automation of few processes in inventory management. The latest version has been upgraded to help user achieve TAX compliances also. It has features such as Remote Access Capabilities, Tax Audit and Statutory Compliance, Payroll, Excise for Manufacturers, Multilingual Support, VAT Composition Returns, TDS, VAT (Value Added Tax), Rapid Implementation, Real Time Processing, Dynamic Interactive Reports and Unique Drill-Down Facility, Unlimited Companies and Periods of Accounting.

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

1. (a) Corporate culture refers to values, beliefs, business principles, traditions, ways of operating, and internal work environment. An organization's culture is either an important contributor or an obstacle to successful strategy execution. The beliefs, vision, objectives, business approaches and practices underpinning a company's strategy may be compatible with its culture or not. When they are, the culture becomes a valuable ally in strategy implementation and execution. When the culture is in conflict with some aspect of the company's direction, performance targets or strategy, the culture becomes a stumbling block that impedes successful strategy implementation and execution.

A culture grounded in values, practices, and behavioural norms that match what is needed for good strategy execution helps energize people throughout the company to do their jobs in a strategy-supportive manner, adding significantly to the power and effectiveness of strategy execution.

- (b) Strategic management is essential for the survival and growth of all types of firms. The following are the major reasons due to which firms should engage in strategic management:
- Strategic management helps organisations to be more proactive instead of reactive in shaping its future.
 - Strategic management provides framework for all the major business decisions of an enterprise.
 - Strategic management is concerned with ensuring a good future for the firm.
 - Strategic management serves as a corporate defence mechanism against mistakes and pitfalls.
- (c) Six Sigma is a total management commitment and philosophy of excellence, customer focus, process improvement. Six Sigma is about making every area of the organization better able to meet the changing needs of customers, markets, and technologies - with benefits for employees, customers, and shareholders. So the six sigma is not merely a quality initiative, it is a business initiative.
- (d) While strategy formulation is a process of finalizing strategy, strategy implementation is the managerial exercise of putting a chosen strategy into place. Strategy formulation involves choice between various alternatives. Strategy execution deals with supervising the ongoing pursuit of strategy, making it work, improving the competence with which it is executed and showing measurable progress in achieving the targeted results. Strategic implementation is concerned with translating a decision into action.

It involves allocation of resources to new courses of action that need to be undertaken. There may be a need for adapting the organization's structure to handle new activities as well as training personnel and devising appropriate system.

It is crucial to realize the difference between the formulation and implementation because both require very different skills. A business organization will be successful only when the strategy formulation is sound and implementation is excellent.

- (e) A manager working on a strategic decision has to balance opportunities, influences and constraints. These opportunities emanate from various sources including the socio-cultural elements of environment. Socio-cultural factors consist of factors such as traditions, values and beliefs, literacy and education, the ethical standards, stratification, conflict, cohesiveness and so forth. These factors are also evolving in the sense that there are changes in the preferences, value systems, education level and so on. Managers must segregate the factors that have a bearing on the organisation and consider them while taking strategic decisions. Some of these factors can be managed to an extent, however, there will be several others that are beyond the control of a manager.
2. (a) (i) **Correct:** A strategic manager has to set the long term objectives, future oriented plans by appreciating the competitive environment. Without bifurcating grand strategies and long-term objectives into annual objectives and short-term strategies, implementation of the strategies is not possible. Dividing objectives, into annual plans help to move forward in a systematic manner.
- (ii) **Correct:** An industry contains only one strategic group when all sellers pursue essentially identical strategies and have comparable market positions. At the other extreme, there are as many strategic groups as there are competitors when each rival pursues a distinctively different competitive approach and occupies a substantially different competitive position in the marketplace.
- (b) (i) Logistics is a process that integrates the flow of supplies into, through and out of an organization to achieve a level of service that facilitate movement and availability of materials in a proper manner. When a company creates a logistics strategy, it is defining the service levels at which its logistics is smooth and is cost effective.
- (ii) Demarketing is a marketing strategy to reduce demand temporarily or permanently-the aim is not to destroy demand, but only to reduce or shift it. This happens when the demand is too much to handle. For example, buses are overloaded in the morning and evening, roads are busy for most of times, zoological parks are over-crowded on Saturdays, Sundays and holidays. Here demarketing can be applied to regulate demand.
- (iii) Service Marketing is applying the concepts, tools, and techniques, of marketing to services. Service is any activity or benefit that one party can offer to another that is essentially intangible and non-perishing. These may be from business to consumer and from business to business.
3. (a) Product Life cycle (PLC) which is a graphical depiction of sales over time is an 'S' shaped curve with four stages – introduction, growth, maturity and decline. The pattern is shared by all product group and families though the duration for each phase is different in each case. Identification of PLC stages for a product/service offers useful insights for marketing management.
- (b) Functional structure is widely used because of its simplicity and low cost. A functional structure groups tasks and activities by business function. The functional structure consists of a chief executive officer or a managing director and limited corporate staff with functional line managers in dominant functions such as production, accounting, marketing, R&D, engineering and human resources. Disadvantages of a functional structure are that it forces accountability to the top, minimizes career development opportunities, etc.
- (c) Decision making is a managerial process and function of choosing a particular course of action out of several alternative courses for the purpose of accomplishment of the organizational goals. Decisions are routine, tactical or strategic in nature. Strategic decisions are different from other decisions that are taken at various levels of the organization during day-to-day working of the organizations. They have long term implications, steer organisation to its future path and have organisation wide implications and so on. These decisions are taken considering different internal and external factors. They are also taken with partial or no definite knowledge of different factors affecting the decision situation.

4. The model has been used by General Electric Company (developed by GE with the assistance of the consulting firm McKinsey & Company) known as “Stop-Light” Strategy Model. This model is also known as Business Planning Matrix, GE Nine-Cell Matrix and GE Model. The strategic planning approach in this model has been inspired from traffic control lights. The lights that are used at crossings to manage traffic are: green for go, amber or yellow for caution, and red for stop. This model uses two factors while taking strategic decisions: Business Strength and Market Attractiveness. The vertical axis indicates market attractiveness and the horizontal axis shows the business strength in the industry. The market attractiveness is measured by a number of factors like:

1. Size of the market.
2. Market growth rate.
3. Industry profitability.
4. Competitive intensity.
5. Availability of Technology.
6. Pricing trends.
7. Overall risk of returns in the industry.
8. Opportunity for differentiation of products and services.
9. Demand variability.
10. Segmentation.
11. Distribution structure (e.g. retail, direct, wholesale) etc.

Business strength is measured by considering the typical drivers like:

1. Market share.
2. Market share growth rate.
3. Profit margin.
4. Distribution efficiency.
5. Brand image.
6. Ability to compete on price and quality.
7. Customer loyalty.
8. Production capacity.
9. Technological capability.
10. Relative cost position.
11. Management caliber, etc.

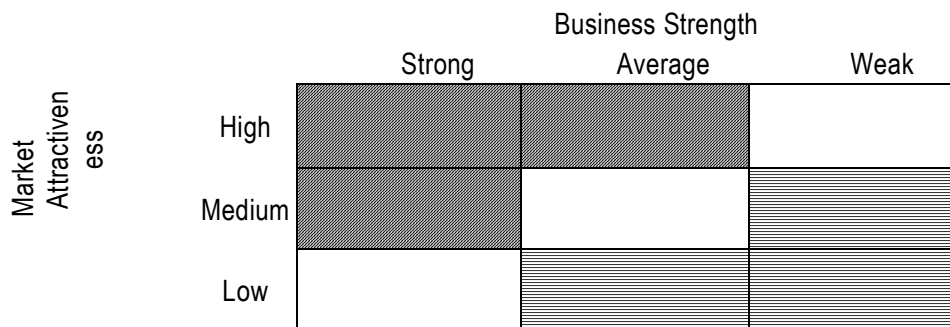
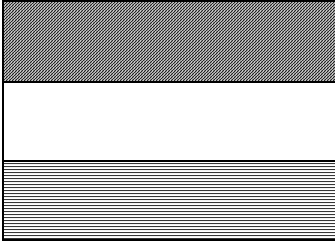


Figure : The GE Portfolio Matrix

| <u>Zone</u> | | <u>Strategic Signals</u> |
|-------------|---|--------------------------|
| Green |  | Invest/Expand |
| Yellow | | Select/Earn |
| Red | | Harvest/Divest |

If a product falls in the green section, the business is at advantageous position. To reap the benefits, the strategic decision can be to expand, to invest and grow. If a product is in the amber or yellow zone, it needs caution and managerial discretion is called for making the strategic choices. If a product is in the red zone, it will eventually lead to losses that would make things difficult for organisations. In such cases, the appropriate strategy should be retrenchment, divestment or liquidation.

5. The prominent areas where the human resource manager can play strategic role are as follows:
 1. **Providing purposeful direction:** The human resource manager must be able to lead people and the organization towards the desired direction involving people. He 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.
6. The term business is wide and amenable to different usages. A business for our purposes can be any activity consisting of purchase, sale, manufacture, processing, and/or marketing of products and/or services. It is said that a business exists for profits. Profit, as a surplus of business, accrues to the owners. It is their share, just as wages are the share of workers. People invest in business for getting return. For business enterprises, profit is often regarded as the overall measure of performance.

Business efficiency is often expressed in terms of percentage of profit to sales volume, to capital employed, to market value of corporate shares and so on. Outside investors also equate profit with the degree of business efficiency and managerial competence and commit their funds in light of such equation and other related assessments.

Peter F Drucker has drawn two important conclusions about what is a business that are useful for an understanding of the term business. The first thing about a business is that it is created and managed by people. There will be a group of people who will take decisions that will determine whether an organization is going to prosper or decline, whether it will survive or will eventually perish. This is true of every business. The second conclusion drawn is that the business cannot be explained in terms of profit.

The economic criterion of maximising profits for a firm has little relevance in the present times. Profit maximization, in simple terms is selling at a higher price than the cost. Profit maximization has been qualified with the long-term perspective and has been modified to include development of wealth, to include several non-financial factors such as goodwill, societal factors, relations and so on.

A business has some purpose. A valid purpose of business is to create customers. It is for the businesses to create a customer or market. It is the customer who determines what a business is. The customer is the foundation of business and keeps it in existence. Organisations seek to balance the objectives in an appropriate manner. Some of the objectives of business are:

1. Survival
 2. Stability
 3. Growth
 4. Efficiency
 5. Profitability
7. Many organizations in order to achieve quick growth, expand or diversify use strategies such as mergers and acquisitions. Mergers and acquisitions also help in deploying surplus funds.

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

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

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

Types of Mergers

1. **Horizontal merger:** Horizontal mergers are combinations of firms engaged in the same industry. It is a merger with a direct competitor. The principal objective behind this type of mergers is to achieve economies of scale in the production process by shedding duplication of installations and functions, widening the line of products, decrease in working capital and fixed assets investment, getting rid of competition and so on. For example, formation of Brook Bond Lipton India Ltd. through the merger of Lipton India and Brook Bond.

2. **Vertical merger:** It is a merger of two organizations that are operating in the same industry but at different stages of production or distribution system. This often leads to increased synergies with the merging firms. If an organization takes over its supplier/producers of raw material, then it leads to backward integration. On the other hand, forward integration happens when an organization decides to take over its buyer organizations or distribution channels. Vertical merger results in operating and financial economies. Vertical mergers help to create an advantageous position by restricting the supply of inputs or by providing them at a higher cost to other players.
3. **Co-generic merger:** In co-generic merger two or more merging organizations are associated in some way or the other related to the production processes, business markets, or basic required technologies. Such merger include the extension of the product line or acquiring components that are required in the daily operations. It offers great opportunities to businesses to diversify around a common set of resources and strategic requirements. For example, an organization manufacturing refrigerators can diversify by merging with another organization having business in kitchen appliances.
4. **Conglomerate merger:** Conglomerate mergers are the combination of organizations that are unrelated to each other. There are no linkages with respect to customer groups, customer functions and technologies being used. There are no important common factors between the organizations in production, marketing, research and development and technology. In practice, however, there is some degree of overlap in one or more of these factors.