

Test Series: October, 2014

MOCK TEST PAPER – 2
INTERMEDIATE (IPC) : GROUP – II
PAPER – 5: ADVANCED ACCOUNTING

Question No. 1 is compulsory.

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

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

Working Notes should form part of the answer.

Time Allowed: 3 Hours

Maximum Marks: 100

1. (a) A company had imported raw materials worth US Dollars 6,00,000 on 5th January, 2010, when the exchange rate was Rs. 43 per US Dollar. The company had recorded the transaction in the books at the above mentioned rate. The payment for the import transaction was made on 5th April, 2012 when the exchange rate was Rs. 47 per US Dollar. However, on 31st March, 2012, the rate of exchange was Rs. 48 per US Dollar. The company passed an entry on 31st March, 2012 adjusting the cost of raw materials consumed for the difference between Rs. 47 and Rs. 43 per US Dollar.

In the background of the relevant accounting standard, is the company's accounting treatment correct? Discuss.

- (b) Sohan Ltd. provides you the following information:

Issued capital	1,00,000 equity shares of Rs. 10 each
Reserves and surplus	Capital reserve Rs. 5,00,000
	Securities premium Rs. 9,00,000
	Revenue reserve Rs. 15,00,000

The company resolved to buy back 10% of its equity share capital @ Rs. 60 per share. Give the necessary journal entries in the books of Sohan Ltd.

- (c) A company went into liquidation whose creditors are Rs. 36,000. This amount of Rs. 36,000 includes Rs. 6,000 on account of wages of 15 men at Rs. 100 per month for 4 months, immediately before the date of winding up, Rs. 9,000 being the salaries of 5 employees at Rs. 300 per month for the previous 6 months, Rent for godown for the last six months amounting to Rs. 3,000, Income-tax deducted out of salaries of employees Rs. 1,000. In addition it is estimated that the company would have to pay Rs. 3,000 as compensation to an employees for injuries suffered by him, which was contingent liability not accepted by the company and not included in above said creditors figure.

Find the amount of Preferential Creditors.

- (d) S. Square Private Limited has taken machinery on lease from S.K. Ltd. The information is as under:

Lease term = 4 years

Fair value at inception of lease = Rs. 20,00,000

Lease rent = Rs. 6,25,000 p.a. at the end of year

Guaranteed residual value = Rs. 1,25,000

Expected residual value = Rs. 3,75,000

Implicit interest rate = 15%

Discounted rates for 1st year, 2nd year, 3rd year and 4th year are 0.8696, 0.7561, 0.6575 and 0.5718 respectively.

Calculate the value of the lease liability as per AS 19. (4x 5 = 20 Marks)

2. P, Q and R are partners sharing profits and losses in the ratio 3 : 2 : 1 after allowing interest on capital @ 9% p.a. Their Balance Sheet as at 31st March, 2014 are as follows:

Liabilities	Rs.	Assets	Rs.
Capital Accounts:		Plant & Machinery	1,08,000
P 50,000		Fixtures	20,000
Q 30,000		Stock	50,000
R <u>20,000</u>	1,00,000	Sundry Debtors	30,000
Reserve Fund	60,000		
Creditors	48,000		
	<u>2,08,000</u>		<u>2,08,000</u>

They applied for conversion of the firm into a Private Limited Company named PQR Pvt. Ltd. and the certificate was received on 01-04-2014. They decided to maintain same profit sharing ratio and to preserve the priority in regard to repayment of capital as far as possible. For that purpose, they decided to insert a clause of issuance of Preference shares in Memorandum of Association in addition to issuance of Equity shares of Rs. 10 each.

On 01-04-2014, the value of goodwill is to be determined on the basis of 2 years' purchase of the average profit from the business of the last 5 years. The particulars of profits are as under:

		Rs.
Year ended 31.03.2010	Profit	10,000
Year ended 31.03.2011	Loss	5,000

Year ended 31.03.2012	Profit	18,000
Year ended 31.03.2013	Profit	27,000
Year ended 31.03.2014	Profit	30,000

The loss for the year ended 31-03-2011 was on account of loss by strike to the extent of 10,000.

It was agreed that rest of the assets are valued on the basis of the Balance Sheet as at 31-03-2014 except Plant & Machinery which is valued at Rs. 1,02,000.

You are required to prepare (a) the Balance Sheet of the Company as at 01-04-2014, (b) Partners' Capital Accounts and (c) Statement showing the final settlement between the partners taking Q's capital as basis. (16 Marks)

3. Sun Ltd. and Moon Ltd. were amalgamated on and from 1st April, 2014. A new company Star Ltd. was formed to take over the business of the existing companies. The draft Balance Sheets of Sun Ltd. and Moon Ltd. as at 31st March, 2014 are given below:

(Rs. in lakhs)					
Liabilities	Sun Ltd.	Moon Ltd.	Assets	Sun Ltd.	Moon Ltd.
Share capital:			Fixed Assets:		
Equity shares of Rs. 100 each	400	375	Land & Building	275	200
12% Preference shares of Rs. 100 each	150	100	Plant & Machinery	175	125
Reserves and surplus:			Investments	75	25
Revaluation reserve	75	50	Current Assets, Loans and Advances:		
General reserve	85	75	Stock	175	125
Investment allowance reserve	25	25	Sundry Debtors	125	150
Profit and Loss Account	25	15	Bills Receivables	25	25
Secured loan:			Cash and Bank balances	150	100
10% Debentures (Rs. 100 each)	30	15			
Current liabilities and provisions:					
Sundry creditors	135	60			
Acceptance	75	35			
	1,000	750		1,000	750

Additional information:

- (a) Star Ltd. will issue 5 equity shares for each equity share of Sun Ltd. and 4 equity shares for each equity share of Moon Ltd. The shares are to be issued @ Rs. 30 each, having a face value of Rs. 10 per share.
- (b) Preference shareholders of the two companies are issued equivalent number of 15% preference shares of Star Ltd. at a price of Rs. 150 per share (face value Rs.100).
- (c) 10% Debentureholders of Sun Ltd. and Moon Ltd. are discharged by Star Ltd., issuing such number of its 15% Debentures of Rs. 100 each so as to maintain the same amount of interest.
- (d) Investment allowance reserve is to be maintained for 4 more years.
- (e) Liquidation expenses are:
Sun Ltd. Rs. 2,00,000
Moon Ltd. Rs. 1,00,000
It was decided that these expenses would be borne by Star Ltd.
- (f) All the assets and liabilities of Sun Ltd. and Moon Ltd. are taken over at book value.
- (g) Authorised equity share capital of Star Ltd. is Rs. 5,00,00,000, divided into equity shares of Rs. 10 each. After issuing required number of shares to the Liquidators of Sun Ltd. and Moon Ltd., Star Ltd. issued balance shares to public. The issue was fully subscribed.

Required :

Prepare the Balance Sheet of Star Ltd. as at 1st April, 2014 after amalgamation has been carried out on the basis of Amalgamation in the nature of purchase. (16 Marks)

4. (a) A Commercial Bank has the following capital funds and assets. Segregate the capital funds into Tier-1 and Tier-II Capitals. Find out the risk-adjusted and risk weighted assets and capital adequacy ratio.

Capital Funds:	(Rs. in crores)
Paid up Equity Share Capital	750
Statutory Reserve	150
Share Premium	150
Capital Reserve (of which Capital Funds Rs. 40 crore were due to revaluation of assets and balance due to sale)	90
Assets:	
Cash balance with RBI	60
Claims on Banks	170
Other Investments	2,300

Loans and Advances:	
Guaranteed by Government of India/State Government	400
Granted to Staff of bank. fully covered by Super Annuation	
Benefits and mortgage of Flat/House	50
Other Loans and Advances	6,170
Premises, Furniture and Fixtures, Other Assets	3,925
Intangible Assets	15
Off-Balance Sheet items:	
Acceptance, Endorsements and Letter of Credit, Guarantees and	1,550
Other obligations.	

- (b) Beta Ltd. has its share capital divided into shares of Rs. 10 each. On 1st April, 2011, it granted 25,000 employees stock options at Rs. 50 when the market price was Rs. 140 per share. The options were to be exercised between 1st January, 2012 and 28th February, 2012. The employees exercised options for 24,000 shares only; the remaining options lapsed. The company closes its books of account on 31st March every year.

You are required to show necessary journal entries reflecting these transactions.

(12 + 4 = 16 Marks)

5. (a) Trading and Profit and Loss Account of Umeed Equipment Co. for the six months ended at 31.3.2012 is presented to you in the following form:

Particulars	Rs.	Particulars	Rs.
Purchases:		Sales:	
Dry cleaners (Dept. X)	70,350	Dry cleaners (Dept. X)	75,000
Dumpsters (Dept. Y)	45,300	Dumpsters (Dept. Y)	50,000
Spares Parts (Dept. Z)	32,200	Spares Parts	12,500
Salaries and wages	24,000	Stock as on 31.3.2012	
Rent	10,900	Dry cleaners (Dept. X)	30,050
Profit	17,250	Dumpsters (Dept. X)	10,150
		Spare Parts (Dept. Z)	<u>22,300</u>
	<u>2,00,000</u>		<u>2,00,000</u>

Other information's are as follows:

- Department 'X' and Department 'Y' represents the show room and Department Z represents the work shop.
- Dry cleaners and Dumpsters are sold at the show room and spare parts at work shop.

- (iii) Salaries and wages were allocated between show room and work shop in the ratio of 3:1. It was decided to allocate the show room salaries and wages in the ratio of 1 : 2 between the departments X and Y.
- (iv) The work shop rent is Rs. 250 per month. The rent of show room is to be divided equally between the departments X and Y.

You are required to prepare Departmental Trading and Profit and Loss Account for each of the three departments X, Y and Z and a General Account.

- (b) Give Journal Entries in the books of Head Office to rectify or adjust the following:
 - (i) Goods sent to Branch Rs. 12,000 stolen during transit. Branch manager refused to accept any liability.
 - (ii) Branch paid Rs. 15,000 as salary to the officer of Head Office on his visit to the branch.
 - (iii) On 28th March, 2012, the H.O. dispatched goods to the Branch invoiced at Rs. 25,000 which was not received by Branch till 31st March, 2012.
 - (iv) A remittance of Rs. 10,000 sent by the branch on 30th March, 2012, received by the Head Office on 1st April, 2012.
 - (v) Head Office made payment of Rs. 25,000 for purchase of goods by Branch and wrongly debited its own purchase account. (10 + 6 = 16 Marks)

6. (a) From the following information of Bigfish Marine Insurance Ltd., prepare the Revenue Account as per the regulations of IRDA for the year ended 31st March, 2014:

Particulars	Amount (Rs.)
Premium received	18,75,000
Premium outstanding on March 31, 2014	1,25,000
Premium paid on reinsurance ceded	2,28,000
Claims paid	10,54,000
Estimated liability in respect of outstanding claims:	
On April 1, 2013	1,89,000
On March 31, 2014	2,25,000
Expenses of management (includes Rs. 45,000 surveyor's fee and Rs. 65,000 legal expenses paid for settlement of claims)	4,85,000
Interest and dividend (Gross)	1,65,250
Income tax on the above	49,575
Profit on sale of investments	46,000
Commission paid	1,94,000

Balance of fund on 1st April, 2013 was Rs. 18,50,000 including additional reserve of Rs. 1,80,000. Additional reserve has to be maintained at 10% of net premium for the year.

- (b) Chaitanya Limited issues 40,000 shares. Issue is underwritten by A, B and C in the ratio of 5:3:2 respectively. Unmarked applications totalled 2,000 whereas marked applications are as follows:

Underwriters	Application (Number of shares)
A	16,000
B	5,700
C	8,300

Calculate the net liability of each one of the underwriters. (12+4 = 16 Marks)

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

- (a) A company with a turnover of Rs. 250 crores and an annual advertising budget of Rs. 2 crores had taken up the marketing of a new product. It was estimated that the company would have a turnover of Rs. 25 crores from the new product. The company had debited to its Profit and Loss account the total expenditure of Rs. 2 crore incurred on extensive special initial advertisement campaign for the new product.

Is the procedure adopted by the company correct?

- (b) An oil company has been contaminating land for several years. It does not clean up because there is no legislation requiring cleaning up. At 31st March 2012, it is virtually certain that a law requiring a clean up of land already contaminated will be enacted shortly after the year end. Is provisioning presently necessary?

- (c) No. of equity shares outstanding 30,00,000
 Basic earnings per share Rs. 5.00
 No. of 12% convertible debentures of Rs. 100 each 50,000
 Each debenture is convertible into 10 equity shares Tax Rate 30%

Compute Diluted Earnings per Share. Working note should form part of the answer.

- (d) A company has filed a legal suit against the debtor from whom Rs. 15 lakh is recoverable as on 31.3.2012. The chances of recovery by way of legal suit are not good as per legal opinion given by the counsel in April, 2012. Can the company provide for full amount of Rs. 15 lakhs as provision for doubtful debts? Discuss in detail.

- (e) Yogya Ltd. received a specific grant of Rs. 300 lakhs for acquiring the plant of Rs. 1,500 lakhs during 2009-10 having useful life of 10 years. The grant received was credited to deferred income and shown in the balance sheet. During 2012-13,

due to non-compliance of conditions laid down for the grant the company had to refund the grant to the Government. Balance in the deferred income on that date was Rs. 210 lakhs and written down value of plant was Rs. 1,050 lakhs.

- (i) What should be the treatment for the refund of the grant and the effect on cost of the fixed asset and the amount of depreciation to be charged during the year 2012-13 in profit and loss account? Assume that depreciation is charged on assets as per straight line method.
- (ii) What should be the treatment of the refund if grant was deducted from the cost of the plant during 2009-10? *(4 x 4 = 16 Marks)*

Test Series: October, 2014

MOCK TEST PAPER – 2
INTERMEDIATE (IPC): GROUP – II
PAPER – 6: AUDITING AND ASSURANCE

Question No.1 is compulsory.

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

Time Allowed – 3 Hours

Maximum Marks – 100

1. (a) In performing an audit of financial statements, the auditor should have or obtain knowledge of the business. Explain in the light of SA 315 "Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment". (5 Marks)
- (b) Explain with reference to the relevant Standard on Auditing- Events or Conditions that may cast doubt about Going Concern Assumption. (5 Marks)
- (c) Auditor of AAS Ltd. was unable to confirm the existence and valuation of imported goods lying with the transporter and accepted a certificate from the management without obtaining other audit evidence. Comment with reference to relevant SA. (5 Marks)
- (d) What are the factors that determine the extent of reliance that the auditor places on results of analytical procedures? Explain with reference to SA-520 on "Analytical Procedures". (5 Marks)
2. State with reason (in short) whether the following statements are correct or incorrect. (Answer any eight):
 - (i) Balance confirmations from debtors/ creditors can only be obtained for balances standing in their accounts at the year-end.
 - (ii) Assets purchased under hire-purchase system were reflected at their full value and the outstanding installments payable have been included under Sundry Creditors.
 - (iii) Auditor has no right to access Minute Books of the Company.
 - (iv) It is necessary to issue audit engagement letter each year for repetitive audits.
 - (v) Permission of Central Government is not required, when the auditors are to be removed before the expiry of their term, but the same is needed when the auditors are changed after the expiry of his term.
 - (vi) Share Premium can be used for Payment of Dividend.

- (vii) Rupees 5 lakhs paid by a pharmacy company to the legal advisor defending the patent of a product treated as Capital Expenditure.
- (viii) SA 230 deals with auditor's responsibilities relating to fraud in an Audit of Financial Statement.
- (ix) A Body Corporate is not qualified for appointment as Auditors of a Company.
- (x) Operational Audit involves examination of all operations and activities of the entity.
(2 x 8 = 16 Marks)
3. (a) What are accounting estimates according to the Standards on Auditing 540? Give examples.
(4 Marks)
- (b) "Doing a statutory audit is full of risk". Narrate the factors which cause the risk.
(4 Marks)
- (c) Comment on the following:
- (i) The auditor of Trilok Ltd. did not report on the matters specified in sub-section (1A) of Section 227 of the Companies Act, 1956, as he was satisfied that no comment is required.
- (ii) Give your comment on "The Central Government has appointed Mr. Sushil, a retired Finance Director of a reputed company, a non-practising member of ICAI, as a special auditor of MM Ltd., on the ground that the company was not being managed on sound business principles. Mr. Ajay, MD of MM Ltd. feels that the appointment of Mr. Sushil is not valid as he does not hold a certificate of practice".
(4 x 2 = 8 Marks)
- 4 How will you vouch and/or verify the following?
- (a) Sale proceeds of Scrap Material.
- (b) Trade Marks and Copyrights.
- (c) Machinery acquired under Hire-purchase system.
- (d) Work-in-progress
(4 x 4 = 16 Marks)
5. (a) An NGO operating in Delhi had collected large scale donations for Tsunami victims. The donations so collected were sent to different NGOs operating in Tamil Nadu for relief operations. This NGO operating in Delhi has appointed you to audit its accounts for the year in which it collected and remitted donations for Tsunami victims. Draft audit programme for audit of receipts of donations and remittance of the collected amount to different NGOs. Mention six points each, peculiar to the situation, which you will like to incorporate in your audit programme for audit of said receipts and remittances of donations.
(8 Marks)
- (b) What special steps are involved in audit of a Cinema Hall?
(8 Marks)

6. (a) One customer from whom Rs. 5 lacs are recoverable for credit sales gives a motor car in full settlement of the dues. The directors estimate that the market value of the motor car transferred is Rs. 5.25 lacs. As on the date of the balance sheet the car has not been registered in the name of the auditee. Comment. *(6 Marks)*
- (b) Explain the important requirements which should be kept in mind to establish or evaluate a system of internal control for application process at Service Bureau? *(6 Marks)*
- (c) In auditing, the auditor checks the specific assertions of the items appearing in the financial statements and opines about the overall assertions they signify. Explain specific assertions and overall assertions in this context. *(4 Marks)*
7. Write short notes on any four of the following:
- (a) Disclosure requirements of bank balances of a limited company
- (b) Substantive Procedures
- (c) Contents of Audit Note-book
- (d) Inherent limitations of Internal Control system
- (e) Types of audits required under law. *(4 x 4 = 16 Marks)*

Test Series: October, 2014

MOCK TEST PAPER – 2

INTERMEDIATE (IPC): GROUP – II

PAPER – 7: INFORMATION TECHNOLOGY AND STRATEGIC MANAGEMENT

SECTION – A: INFORMATION TECHNOLOGY

Question No. 1 is compulsory.

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

Time Allowed – 1½ Hours

Maximum Marks – 50

1. Answer all the following questions in brief.
 - (i) Six Sigma
 - (ii) Decision Tree
 - (iii) Micro Architecture
 - (iv) Virtual Memory
 - (v) Multiplexer
 - (vi) HTTPS (Hyper Text Transfer Protocol Secure)
 - (vii) Transaction Processing System
 - (viii) Smart Cards
 - (ix) Access Controls
 - (x) Customer Relationship Management Software (1 x 10 = 10 Marks)
2.
 - (a) Differentiate between Asynchronous and Synchronous Transmission. (4 Marks)
 - (b) Discuss the Network Security Vulnerabilities. (4 Marks)
3.
 - (a) Discuss in brief, various Business Intelligence Tools. (4 Marks)
 - (b) What is Supply Chain Management (SCM)? Discuss its components in brief. (4 Marks)
4.
 - (a) Discuss the prime basis on which the business applications can be classified? (4 Marks)
 - (b) Differentiate between Manual Information Processing Cycle and Computerized Information Processing Cycle. (4 Marks)
5.
 - (a) Discuss Value Chain Automation, in brief. (4 Marks)
 - (b) Discuss various success factors of Business Process Reengineering (BPR). (4 Marks)
6.
 - (a) Discuss multiple types of cloud in Cloud Computing. (4 Marks)
 - (b) Discuss Information System Life Cycle in brief. (4 Marks)

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

(a) Process Management

(b) Application Software

(c) Virtual Private Network

(d) Business Intelligence

(e) Objectives of Business Process Automation (BPA)

(4 × 2 = 8 Marks)

Test Series: October, 2014

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

Question No.1 is compulsory.

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

Time Allowed – 1½ Hours

Maximum Marks – 50

1. (a) Is competition good for organisations? (3 Marks)
- (b) What do you mean by Core competencies?. (3 Marks)
- (c) Define Benchmarking. (3 Marks)
- (d) Explain why some organizations adopt turnaround strategy. (3 Marks)
- (e) What is relevance of TOWS Matrix in strategic planning process? (3 Marks)
2. (a) Explain the concept of Product Life Cycle (3 Marks)
- (b) State with reasons which of the following statements is correct/incorrect:
 - (i) Restructuring is a slow process that brings consistent changes. (2 Marks)
 - (ii) Retrenchment implies downsizing of organizational structure. (2 Marks)
3. (a) Write short notes on the following:
 - (i) Strategic groups. (2 Marks)
 - (ii) Define Competitive advantage. (2 Marks)
- (b) Discuss different characteristics exhibited by business environment. (3 Marks)
4. (a) "Strategy is partly proactive and partly reactive." Do you agree? Discuss. (3 Marks)
- (b) Explain strategic planning and discuss the difference between top-down and bottom-up approach. (4 Marks)
5. Explain the five competitive forces in an industry as enunciated by Michael Porter? (7 Marks)
6. Explain prominent areas where Human Resource Manager can play a strategic role. (7 Marks)
7. (a) What do you understand by strategic leadership? What are two approaches to leadership style? (4 Marks)
- (b) What do you understand by merger and acquisitions? . (3 Marks)

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

1. (a) **Obtaining Knowledge of the business:** The auditor needs to obtain a level of knowledge of the client's business that will enable him to identify the events, transactions and practices that, in his judgment, may have significant effect on the financial information among other things.

As per SA 315– “Identifying and Assessing the Risk of Material Misstatement Through Understanding the Entity and its Environment”, the auditor shall obtain an understanding of the following:

- (a) Relevant industry, regulatory, and other external factors including the applicable financial reporting framework
- (b) The nature of the entity, including:
 - (i) its operations;
 - (ii) its ownership and governance structures;
 - (iii) the types of investments that the entity is making and plans to make, including investments in special-purpose entities; and
 - (iv) the way that the entity is structured and how it is financed;to enable the auditor to understand the classes of transactions, account balances, and disclosures to be expected in the financial statements.
- (c) The entity's selection and application of accounting policies, including the reasons for changes thereto. The auditor shall evaluate whether the entity's accounting policies are appropriate for its business and consistent with the applicable financial reporting framework and accounting policies used in the relevant industry.
- (d) The entity's objectives and strategies, and those related business risks that may result in risks of material misstatement.
- (e) The measurement and review of the entity's financial performance.

In addition to the importance of knowledge of the client's business in establishing the overall audit plan, such knowledge helps the auditor to identify areas of special audit consideration, to evaluate the reasonableness both of accounting estimates and management representations, and to make judgement regarding the appropriateness of accounting policies and disclosures.

(b) Events or Conditions that may cast doubt about Going Concern Assumption:

As per SA 570 "Going Concern", events or conditions that may cast significant doubt on an entity's ability to continue as a going concern may include situations where such type of entity lacks funding for its continued existence or when policy decisions are made that affect the services provided by such an entity. However, the auditor should consider the risk that the going concern assumption may no longer be appropriate. The following are examples of events or conditions that, individually or collectively, may cast significant doubt about the going concern assumption. This listing is not all-inclusive nor does the existence of one or more of the items always signify that a material uncertainty exists.

Financial

- Net liability or net current liability position.
- Fixed-term borrowings approaching maturity without realistic prospects of renewal or repayment; or excessive reliance on short-term borrowings to finance long-term assets.
- Indications of withdrawal of financial support by creditors.
- Negative operating cash flows indicated by historical or prospective financial statements.
- Adverse key financial ratios.
- Substantial operating losses or significant deterioration in the value of assets used to generate cash flows.
- Arrears or discontinuance of dividends.
- Inability to pay creditors on due dates.
- Inability to comply with the terms of loan agreements.
- Change from credit to cash-on-delivery transactions with suppliers.
- Inability to obtain financing for essential new product development or other essential investments.

Operating

- Management intentions to liquidate the entity or to cease operations.
- Loss of key management without replacement.
- Loss of a major market, key customer(s), franchise, license, or principal supplier(s).
- Labour difficulties.
- Shortages of important supplies.
- Emergence of a highly successful competitor.

Other

- Non-compliance with capital or other statutory requirements.
- Pending legal or regulatory proceedings against the entity that may, if successful, result in claims that the entity is unlikely to be able to satisfy.
- Changes in law or regulation or government policy expected to adversely affect the entity.
- Uninsured or underinsured catastrophes when they occur.

The significance of such events or conditions often can be mitigated by other factors. For example, the effect of an entity being unable to make its normal debt repayments may be counter-balanced by management's plans to maintain adequate cash flows by alternative means, such as by disposing of assets, rescheduling loan repayments, or obtaining additional capital. Similarly, the loss of a principal supplier may be mitigated by the availability of a suitable alternative source of supply.

- (c) **Certificate from the management without obtaining other audit evidence:** As per SA 580 on "Written Representations", in the course of audit, an auditor comes across various matters in respect of which he is not able to obtain sufficient appropriate audit evidence. In such a situation he may rely on the submission by the management but he should seek corroborative audit evidence from sources inside or outside the entity and evaluate the representation made by management.

Management representation is not a substitute for other audit evidence. The auditor should seek and apply normal audit procedure. Mere possession of a certificate does not absolve the auditor from his liability. He should not seek or accept certificates when subject matter is such that it is capable of verification from internal and/or external evidences.

In the instant case, the stock of imported material lying with the transporter can be easily verified with purchase order, invoice, bill of entry, custom document, payment of F.C. etc.

Therefore, the auditor of AAS Ltd. has not used available evidences. He should not have rested with the certificate obtained from the management and could have evaluated other evidences. He may be held liable for negligence and professional misjudgment.

- (d) **Reliance on the results of analytical procedures:** As per SA 520 "Analytical Procedures", the application of analytical procedures is based on the expectation that relationships among data exist and continue in the absence of known conditions to the contrary. The presence of these relationships provides audit evidence as to the completeness, accuracy and validity of the data produced by the accounting system. However, reliance on the results of analytical procedures will

depend on the auditor's assessment of the risk that the analytical procedures may identify relationships as expected when, in fact, a material misstatement exists.

The extent of reliance that the auditor places on the results of analytical procedures depends on the following factors:

- (i) Materiality of the items involved, for example, when inventory balances are material, the auditor does not rely only on analytical procedures in forming conclusions. However, the auditor may rely solely on analytical procedures for certain income and expense items when they are not individually material.
 - (ii) Other audit procedures directed toward the same audit objectives, for example, other procedures performed by the auditor in reviewing the collectability of accounts receivable, such as the review of subsequent cash receipts, might confirm or dispel questions raised from the application of analytical procedures to an ageing schedule of customers' accounts.
 - (iii) Accuracy with which the expected results of analytical procedures can be predicted. For example, the auditor will ordinarily expect greater consistency in comparing gross profit margins from one period to another than in comparing discretionary expenses, such as research or advertising.
 - (iv) Assessments of inherent and control risks, for example, if internal control over sales order processing is weak and, therefore, control risk is high, more reliance on tests of details of transactions and balances than on analytical procedures in drawing conclusions on receivables may be required.
 - (v) The auditor will need to consider testing the controls, if any, over the preparation of information used in applying analytical procedures. When such controls are effective, the auditor will have greater confidence in the reliability of the information and, therefore, in the results of analytical procedures. The controls over non-financial information can often be tested in conjunction with tests of accounting-related controls. For example, an entity in establishing controls over the processing of sales invoices may include controls over the recording of unit sales. In these circumstances, the auditor could test the controls over the recording of unit sales in conjunction with tests of the controls over the processing of sales invoices.
2. (i) **Incorrect:** The above statement is not correct as it is not necessary that balances of debtors/ creditors should necessarily be verified only at the end of the year only. In fact, in order to incorporate an element of surprise, the auditor may consider different confirmation dates periodically, i.e., Dec 31 as a cut-off date in one year and June 30 in another year and so on. Therefore, the statement given is not correct.
- (ii) **Correct:** Assets acquired under Hire Purchase System should be recorded at the full cash value with corresponding liability of the same amount. In case cash value is not readily available, it should be calculated presuming an appropriate rate of

interest. Hire purchased assets are shown in the balance sheet with an appropriate narration to indicate that the enterprise does not have full ownership thereof. Thus the treatment followed by the company is correct.

- (iii) **Incorrect:** Section 227 of the Companies Act, 1956 grants powers to the auditor that every auditor has a right of access, at all times, to the books and account including all statutory records such as minute books, fixed assets register, etc. of the company for conducting the audit.
- (iv) **Incorrect:** As per SA 210, "Agreeing the Terms of Audit Engagements", it is not necessary to issue audit engagement letter each year for repetitive audit. It is enough if the same had been issued at the time of taking initial engagement. Therefore, the statement that it is necessary to issue audit engagement letter each year for repetitive audits is not correct.
- (v) **Incorrect:** As per Section 224(7) of the Companies Act, 1956, an auditor may be removed from office before the expiry of his term, by the company in a general meeting, after obtaining prior permission of Central Government as removal of auditor before expiry of his term i.e. before he has submitted his report is a serious matter and may adversely affect his independence.

On the other hand if auditor has completed his term i.e. has submitted his report and thereafter he is not re-appointed then the matter is not serious enough for central government to call for its intervention.

In view of the above, the permission of the Central Government is required when auditors are removed before expiry of their term and the same is not needed when they are not re-appointed after expiry of their term.

- (vi) **Incorrect:** Section 78 of Companies Act, 1956 deals with the application of Securities Premium. Further, Section 205 of Companies Act, 1956 also specifies the sources from which dividend can be paid and requires the same to be only paid out of past profits, general reserve or any other free reserve. Hence declaration of dividend from Securities Premium is not proper.
- (vii) **Incorrect:** Legal expenses of Rs. 5 lakhs incurred to defend the patent of a product of the pharmacy company is revenue expenditure pertaining to the asset since by this expenditure neither any endurable benefit can be obtained in future in addition to what is presently available nor the capacity of the asset would be increased.

Payment of legal fees is normally revenue expenditure irrespective of the amount involved unless same is incurred to bring any new asset into existence. Therefore, the statement given is not correct.

- (viii) **Incorrect:** SA 230 deals with "Audit Documentation" whereas SA 240 deals with "The Auditor's responsibilities Relating to Fraud in an Audit of Financial Statements".

- (ix) **Correct:** Section 226(3) of the Companies Act, 1956 evidently excludes a body corporate to be qualified for appointment as auditors of a company. Therefore, the statement that a Body Corporate is not qualified for appointment as Auditors of a Company is correct.
- (x) **Correct:** Operational Audit involves examination of all operations and activities of the entity. The objects of operational audit include the examination of the control structure and of the relation of department controls to general policies. It provides an appraisal of whether the department is operating in conformity with prescribed standards and procedures and whether standards of efficiency and economy are maintained. Therefore, the statement given is correct.
3. (a) **Accounting Estimates:** According to the SA 540, "Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosure", accounting estimate means an approximation of a monetary amount in the absence of a precise means of measurement. This term is used for an amount measured at fair value where there is estimation uncertainty, as well as for other amounts that require estimation. SA 540 addresses only accounting estimates involving measurement at fair value, the term "fair value accounting estimates" is used.

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

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

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

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

- Accounting estimates relating to the outcome of litigation.
- Fair value accounting estimates for derivative financial instruments not publicly traded.

Additional examples of accounting estimates are:

- Allowance for doubtful accounts.
- Inventory obsolescence.
- Warranty obligations.
- Depreciation method or asset useful life.
- Provision against the carrying amount of an investment where there is uncertainty regarding its recoverability.
- Outcome of long term contracts.
- Financial Obligations/Costs arising from litigation settlements and judgments.

- (b) **Factors which cause Risk:** As Per SA 200 “Overall Objectives of the Independent Auditor and the conduct of an audit in accordance with standards on auditing”, the purpose of an audit is to enhance the degree of confidence of intended users in the financial statements. This is achieved by the expression of an opinion by the auditor on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework. In the case of most general purpose frameworks, that opinion is on whether the financial statements are presented fairly, in all material respects, or give a true and fair view in accordance with the framework. An audit conducted in accordance with SAs and relevant ethical requirements enables the auditor to form that opinion.

An independent audit whether performed in terms of applicable financial reporting framework or in terms of the engagement, the auditor has to be reasonably satisfied as to whether the information contained in the underlying accounting records and other source data is reliable for the preparation of financial statements. Since the entire process of auditing is based on the assessment of judgements made by the management of the entity as well as evaluation of internal controls, the audit suffers certain inherent risks. Factors which may cause such risk in conducting an audit are discussed below:

- (i) *Exercising judgement on the part of the auditor:* The auditor’s work involves exercise of judgement, for example, in deciding the extent of audit procedures and in assessing the reasonableness of the judgements and estimates made by management in preparing the financial statements.
- (ii) *Nature of audit evidence:* Much of the evidence available to the auditor can enable him to draw only reasonable conclusions therefrom. The auditor normally relies upon persuasive evidence rather than conclusive evidence. Even in circumstances where conclusive evidence is available, the cost of obtaining such an evidence may far exceed the benefits.

- (iii) *Inherent limitations of internal control:* Internal control can provide only reasonable, but not absolute, assurance on account of several inherent limitations such as potential for human error, possibility of circumstances of control through collusion, etc.

On account of above, it is quite clear that an audit suffers from control risk on account of inherent limitations of internal control and detection risk on account of test nature of audit and judgement and estimates involved in formulating accounting policies.

- (c) (i) **Comment on Matters Contained under Section 227(1A) of the Companies Act, 1956:** Section 227(1A) of the Act deals with duties of an auditors requiring auditor to make an enquiry in respect of specified matters. The matters in respect of which the enquiry has to be made by the auditor include relating to loans and advances on the basis of security have been properly secured, transactions represented merely by book entries, investments sold at less than cost price, loans and advances shown as deposits, personal expenses charged to revenue account etc. Since the law requires the auditor to make an enquiry, the Research Committee of the Institute of Chartered Accountants of India opined that the auditor is not required to report on the matters specified in sub-section (1A) 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 Trilok Ltd. is correct in non-reporting on the matters specified in Section 227(1A) of the Act.
- (ii) **Appointment of Special Auditor:** Section 233A of the Companies Act, 1956, under the circumstances as specified in the section, empowers the Central Government that it may issue directions to the effect that a special audit of the company's accounts for the specified period shall be conducted.

Amongst others, one of the circumstances specified is in case a company is not being managed in accordance with some business principles or prudent commercial practices. Further the said section also provides that for the purpose, it may appoint a chartered accountant, whether or not the chartered accountant is in practice, or the company's auditor itself to conduct such special audit.

Therefore, the appointment of Mr. Sushil, a non-practising member of Institute of Chartered Accountants of India is within the provisions of law and, accordingly, the contention of Mr. Ajay, M.D. of MM Ltd., is not correct.

4. (a) **Sale Proceeds of Scrap Material**

- (i) Review the internal control on scrap materials, as regards its generation, storage and disposal and see whether it was properly followed at every stage.

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

(b) Trade Marks and Copyrights

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

(c) Machinery acquired under Hire-purchase system

- (i) Examine the Board's Minute Book approving the purchase on hire-purchase terms.

- (ii) Examine the hire-purchase agreement carefully and note the description of the machinery, cost of the machinery, hire purchase charges, and terms of payment and rate of purchase.
 - (iii) Assets acquired under Hire Purchase System should be recorded at the full cash value with corresponding liability of the same amount. In case cash value is not readily available, it should be calculated presuming an appropriate rate of interest.
 - (iv) Hire purchased assets are shown in the balance sheet with an appropriate narration to indicate that the enterprise does not have full ownership thereof. The interest payable along with each installments, whether separately or included therein should be debited to the interest account and not to the asset account.
- (d) **Work-in-Progress:** The audit procedures regarding work-in-progress are similar to those used for raw materials and finished goods. However, the auditor has to carefully assess the stage of completion of the work-in-progress for assessing the appropriateness of its valuation. For this purpose, the auditor may examine the production/costing records (i.e., cost sheets), hold discussions with the personnel concerned, and obtain expert opinion, where necessary. The auditor may advise his client that where possible the work-in-progress should be reduced to the minimum before the closing date. Cost sheets of work-in-progress should be verified as follows:
- (i) Ascertain that the cost sheets are duly attested by the works engineer and works manager.
 - (ii) Test the correctness of the cost as disclosed by the cost records by verification of quantities and cost of materials, wages and other charges included in the cost sheets by reference to the records maintained in respect thereof.
 - (iii) Compare the unit cost or job cost as shown by the cost sheet with the standard cost or the estimated cost expected.
 - (iv) Ensure that the allocation of overhead expenses had been made on a rational basis.
Compare the cost sheet in detail with that of the previous year. If they vary materially, investigate the cause thereof.
 - (v) Ensure that the Work-in-Progress as at Balance Sheet date has been appropriately disclosed in Balance Sheet as per the requirements of Part I of Revised Schedule VI to the Companies Act, 1956.

5 (a) Receipt of Donations

- (i) *Internal Control System*: Existence of internal control system particularly with reference to division of responsibilities in respect of authorised collection of donations, custody of receipt books and safe custody of money.
- (ii) *Custody of Receipt Books*: Existence of system regarding issue of receipt books, whether unused receipt books are returned and the same are verified physically including checking of number of receipt books and sequence of numbering therein.
- (iii) *Receipt of Cheques*: Receipt Book should have carbon copy for duplicate receipt and signed by a responsible official. All details relating to date of cheque, bank's name, date, amount, etc. should be clearly stated.
- (iv) *Bank Reconciliation*: Reconciliation of bank statements with reference to all cash deposits not only with reference to date and amount but also with reference to receipt book.
- (v) *Cash Receipts*: Register of cash donations to be vouched more extensively. If addresses are available of donors who had given cash, the same may be cross-checked by asking entity to post thank you letters mentioning amount, date and receipt number.
- (vi) *Foreign Contributions*, if any, to receive special attention to compliance with applicable laws and regulations.

Remittance of donations to different NGOs

- (i) *Mode of Sending Remittance*: All remittances are through account payee cheques. Remittances through Demand Draft would also need to be scrutinised thoroughly with reference to recipient.
- (ii) *Confirming Receipt of Remittance*: All remittances are supported by receipts and acknowledgements.
- (iii) *Identity*: Recipient NGO is a genuine entity. Verify address, 80G Registration Number, etc.
- (iv) *Direct Confirmation Procedure*: Send confirmation letters to entities to whom donations have been paid.
- (v) *Donation Utilisation*: Utilisation of donations for providing relief to Tsunami victims and not for any other purpose.
- (vi) *System of NGOs' Selection*: System for selecting NGO to whom donations have been sent.

(b) Special steps involved in audit of a Cinema Hall

- (i) Verify

- (a) that entrance to the cinema hall is only through printed tickets;
 - (b) tickets are serially numbered and bound into books;
 - (c) that the number of tickets issues for each show and class are different;
 - (d) that for advance booking a separate series of tickets is issued and
 - (e) stock of tickets is kept in proper custody.
- (ii) If tickets are issued through computer- audit the system to ensure its reliability and authenticity of data generated by it.
 - (iii) System should provide that at the end of each show a proper statement should be prepared and cash collected be tallied.
 - (iv) Cash collected is deposited in banks partly on the same day and rest on the next day – depending upon the banking facility available.
 - (v) Verify that proper record is kept for free passes issued and the same are issued under proper authority.
 - (vi) Cross check the entertainment tax deposited.
 - (vii) Verify the income from advertisements and slides showed before the show.
 - (viii) Vouch the expenditure incurred on publicity of picture, maintenance of hall, electricity expenses etc.
 - (ix) Vouch recoveries of advertisement expenses etc from film distributors.
 - (x) Vouch payment of film hire with reference to agreement with distributor or producer.
 - (xi) Verify the basis of other incomes earned like restaurant, car and scooter parking and display windows etc.
 - (xii) Confirm that depreciation on machinery and furniture has been charged at appropriate rates which are higher, as compared to those admissible in the case of other businesses, in respect of similar assets.

- 6 (a) Determination of cost in case of exchange of assets:** An enterprise may acquire an asset through exchange process. In the instant case, the company has acquired a motor car from a customer in exchange of amount due from him.

However, the motor car has not been registered in the name of the company on the date of the balance sheet. Having regard to the principle of substance over form, the auditor should see that the transaction is recorded though the car is not registered in the name of the auditee. As far as determination of the cost is concerned, AS 10 broadly lays down the following principle:

“When a fixed asset is acquired in exchange for another asset, its cost is usually determined by reference to the fair market value of the consideration given. It may

be appropriate to consider also the fair market value of the asset acquired if this is more clearly evident. An alternative accounting treatment that is sometimes used for an exchange of assets, particularly when the assets exchanged are similar, is to record the asset acquired at the net book value of the asset given up; in each case an adjustment is made for any balancing receipt or payment of cash or other consideration.”

Consequently, it shall be more appropriate to record the cost of motor car at Rs. 5 lacs since the value of asset given up is more clearly evident than the fair value of assets acquired i.e. motor car which happens to be estimation on the part of directors. Accordingly, the customer’s account should also be credited by Rs. 5 lacs.

Note: However, directors may revalue the asset and write up the value of motor car to Rs. 5.25 lacs. Then Rs. 25,000 should be transferred to Revaluation Reserve.

(b) Requirements of Internal Control System at a Service Bureau: Various requirements to establish or evaluate a system of internal control for applications processed at a service bureau are stated below:

- (i) Liaison between bureau and user should be clearly defined. Senior member of the user’s staff is appointed as liaison officer.
- (ii) Need for a system testing including all clerical procedures at the user company.
- (iii) Control over physical movement of data and in this respect whether a copy or microfilm of documents sent to the service bureau is kept.
- (iv) Planning procedure so that error is identified by documents provided by the bureau. The user must ensure that prompt correction and resubmission of rejection to meet the bureau processing schedule.
- (v) Establishing a system in the user company to ensure that all exceptional reports are received from bureau.
- (vi) Establish clerical control to verify the accuracy of computer processing.
- (vii) Normally, user has no physical control over the files, therefore, high control over the maintenance of data on master files should be established.

(c) Assertions: Auditor checks specific assertions that the items of financial statements portray and also gives his opinion in the form of overall assertion in respect of financial statements taken as a whole.

The **specific assertions** are –

- (i) *Existence* – That the asset or liability exists at a given date.
- (ii) *Rights and obligations* – The asset is a right of the entity and the liability is an obligation of the entity at a given date.

- (iii) *Occurrence* – That a transaction or event has occurred which pertains to the entity.
- (iv) *Completeness* – There are no unrecorded asset/liabilities or transactions.
- (v) *Valuation* – An asset or liability is recorded in the proper amount and recorded at appropriate carrying value.
- (vi) *Measurement* – A transaction is recorded in the proper amount and revenue or expenses is allocated to proper period.
- (vii) *Presentation* – An item is disclosed, classified and described in accordance with accounting policies and legal requirements.

The **overall assertions** opined by the auditor about the financial statements are:

- (i) The profit and loss account give a true and fair view of the results – profit or loss for the period ended on the last date of the accounting period.
- (ii) The balance sheet gives a true and fair view of the status or financial position of the entity as on the last date of the accounting period.

7 (a) Disclosure Requirements for Bank Balance:

Under the Revised Schedule VI to the Companies Act, 1956, the following disclosure requirements are mandated:

General Instructions for Current Assets under Revised Schedule VI:
<ul style="list-style-type: none"> • Cash and cash equivalents: <ol style="list-style-type: none"> 1. Cash and cash equivalents shall be classified as: <ul style="list-style-type: none"> (a) Balances with banks; (b) Cheques, drafts on hand; (c) Cash on hand; (d) Others (specify nature). 2. Earmarked balances with banks (for example, for unpaid dividend) shall be separately stated; 3. Balances with banks to the extent held as margin money or security against the borrowings, guarantees, other commitments shall be disclosed separately; 4. Repatriation restrictions, if any, in respect of cash and bank balances shall be separately stated; 5. Bank deposits with more than 12 months maturity shall be disclosed separately.

- (b) **Substantive Procedures:** These procedures are audit tests designed to obtain evidence to verify balance of an account or a specific financial statement assertion i.e. they test the validity and propriety of the accounting treatment of the transaction. They

can be classified as either test of details of transactions and balances or as analytical review procedures. They provide assurance to the auditor in respect of the following assertions:

- (i) The asset or a liability should exist at a given date.
 - (ii) The asset should be owned by the entity and the liability is an obligation of the entity at a given date.
 - (iii) There should not be any unrecorded assets, liabilities or transactions.
 - (iv) Assets or liabilities should be recorded at appropriate carrying values.
 - (v) Transaction or event that took place should pertain to the entity during the relevant period.
 - (vi) Transaction should be recorded in the proper amount and revenue or expense should be allocated to the proper period.
 - (vii) Various items should be disclosed, classified, and described in accordance with recognised accounting policies and practices and relevant statutory requirements, if any.
- (c) **Contents of Audit Note book:** Audit note book contains large variety of matters observed during the course of audit. Significant matters observed during audit which should be recorded in audit note book are normally the following:
- (i) Audit queries not cleared immediately.
 - (ii) Mistakes or irregularities observed during the course of audit.
 - (iii) Unsatisfactory book-keeping arrangements, costing method.
 - (iv) Important information about the company which is not apparent from the accounts.
 - (v) Special points requiring consideration at the time of verification of annual accounts.
 - (vi) Important matters for future reference.
- (d) **Inherent limitations of Internal Control system:** 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, 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.
- (e) **Types of audits required under law:** Audit is not legally obligatory for all types of business organisations or institutions. On this basis audits may be of two broad categories i.e., audit required under law and voluntary audits.

The organisations which require audit under law are the following:

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

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

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

(b) **Journal Entries**

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

(c) Calculation of Preferential Creditors

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

Note:

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

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

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

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

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

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

Notes to Accounts

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

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

Partners' Capital Accounts

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

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

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

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

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

Working Notes:

1. Calculation of goodwill

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

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

2 Purchase consideration Computation of Value placed on business:

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

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

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

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

Notes to Accounts

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

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

Working Notes:

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

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

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

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

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

		<i>Rs. in crores</i>	<i>Rs. in crores</i>	
(i)	Capital funds – Tier I			
	Equity share capital		750	
	Statutory reserve		150	
	Securities Premium		150	
	Capital reserve (arising out of sale of assets) (90-40)		<u>50</u>	
			1,100	
	Less: Intangible Assets		<u>(15)</u>	
			1,085	
	Capital funds – Tier II			
	Capital reserve (arising out of revaluation of assets)	40		
	Less: Discount to the extent of 55%	<u>(22)</u>	<u>18</u>	
			<u>1,103</u>	
		<i>Rs. in crores</i>	<i>% of risk weight</i>	<i>Rs. in crores</i>
(ii)	Risk Adjusted Assets			
	Funded Risk Assets			
	Cash balance with RBI	60	0	0
	Claims on banks	170	20	34
	Other investments	2,300	100	2,300
	Loans and advances:			
	(i) Guaranteed by the government	400	0	0
	(ii) Granted to staff of bank, fully covered by Super Annuation Benefits and mortgage of Flat/House	50	20	10

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

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

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

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

(b)

Journal Entries

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

5. (a)

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

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

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

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

Working Notes:

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

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

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

Note:

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

6. (a)

FORM B-RA

Name of the Insurer: Bigfish Marine Insurance Ltd.

Revenue Account for the year ended 31st March, 2014

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

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

Schedule -1

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

Schedule -2

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

Schedule -3

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

Schedule -4

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

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

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

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

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

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

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

In the given case, advertisement expenditure of Rs. 2 crores had been taken up for the marketing of a new product which may provide future economic benefits to an enterprise by having a turnover of Rs. 25 crores. Here, no intangible asset or other asset is acquired or created that can be recognised. Therefore, the accounting treatment by the company of debiting the entire advertising expenditure of Rs. 2 crores to the Profit and Loss account of the year is correct.

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

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

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

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

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

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

No. of equity shares resulting from conversion of debentures

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

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

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

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

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

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

In the given case, company should make the provision for doubtful debts, as legal suit has been filed on 31st March, 2012 and the chances of recovery from the suit are not good. Though, the actual result of legal suit will be known in future yet situation of non-recovery from the debtors exists before finalisation of financial statements. Therefore, provision for doubtful debts should be made for the year ended on 31st March, 2012.

(e) As per para 21 of AS 12, 'Accounting for Government Grants', amount refundable in respect of a grant related to revenue should be applied first against any unamortized deferred credit remaining in respect of the grant. To the extent the amount refundable exceeds any such deferred credit, the amount should be charged to the Statement of Profit and Loss.

(i) In this case, the grant refunded is Rs. 300 lakhs and balance in deferred income is Rs. 210 lakhs. Therefore, Rs. 90 lakhs shall be charged to the Statement of Profit and Loss for the year 2012-13. There will be no effect on the cost of the fixed asset and depreciation charged will be same as charged

in the earlier years.

- (ii) As per para 21 of AS 12, the amount refundable in respect of grant which was related to specific fixed assets should be recorded by increasing the book value of the assets by the amount refundable. Where the book value of the asset is increased, depreciation on the revised book value should be provided prospectively over the residual useful life of the asset. Therefore, in this case the book value of the plant shall be increased by Rs. 300 lakhs. The increased cost of Rs. 300 lakhs of the plant should be amortised over 7 years (remaining useful life). Depreciation charged during the year 2012-13 shall be $1200/10 + 300/7 = 162.86$ lakhs.

Test Series: October, 2014

MOCK TEST PAPER – 2

INTERMEDIATE (IPC): GROUP – II

PAPER – 7: INFORMATION TECHNOLOGY AND STRATEGIC MANAGEMENT

SECTION – A: INFORMATION TECHNOLOGY

SUGGESTED ANSWERS/HINTS

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

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

- (viii) **Smart Cards:** Smart cards have an embedded microchip instead of magnetic strip. The chip contains all the information a magnetic strip contains but offers the possibility of manipulating the data and executing applications on the card. **Contact Cards, Contactless Cards and Combi/Hybrid Cards** are three types of smart cards.
- (ix) **Access Controls:** Access controls are implemented with an access control mechanism and links the authentic users to the authorized resources they are permitted to access. Cryptography, Passwords, Personal Identification Numbers (PIN) and Identification Cards are some of the examples of access controls.
- (x) **Customer Relationship Management Software:** These are specialized applications catering to the need of organizations largely in **FMCG (Fast-Moving Consumer Goods)** categories. These entities need to interact with their customers and respond to them. The response may be in the form of service support or may lead to product innovation. These are sought by entities, which deal directly with consumers.

2. (a)

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

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

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

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

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

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

Components of SCM

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

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

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

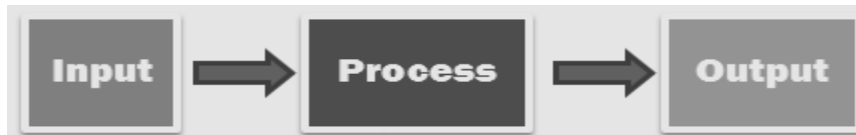
- ◆ **Nature of processing:** This is the way an application updates data, say in batch processing, there is a time delay in occurrence and recording of transaction. On the other hand in online processing, the transactions are recorded at the moment they occur. An application that allows query handling/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

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

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

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

information, incomplete information and low levels of detail.

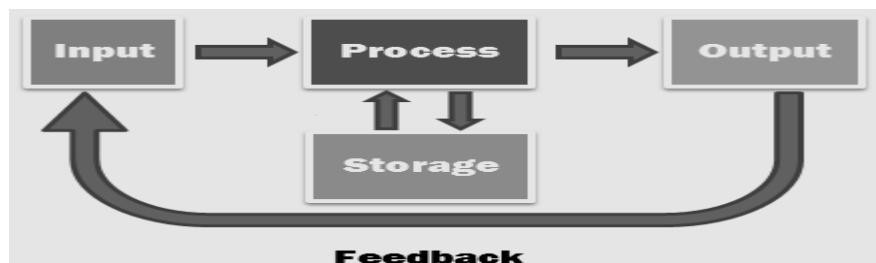


Manual Processing Cycle

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

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

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



Computerized Processing Cycle

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

(e) Objectives of Business Process Automation (BPA)

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

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

MOCK TEST PAPER – 2

INTERMEDIATE (IPC): GROUP – II

PAPER –7: INFORMATION TECHNOLOGY AND STRATEGIC MANAGEMENT

SECTION – B: STRATEGIC MANAGEMENT

SUGGESTED ANSWERS/HINTS

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

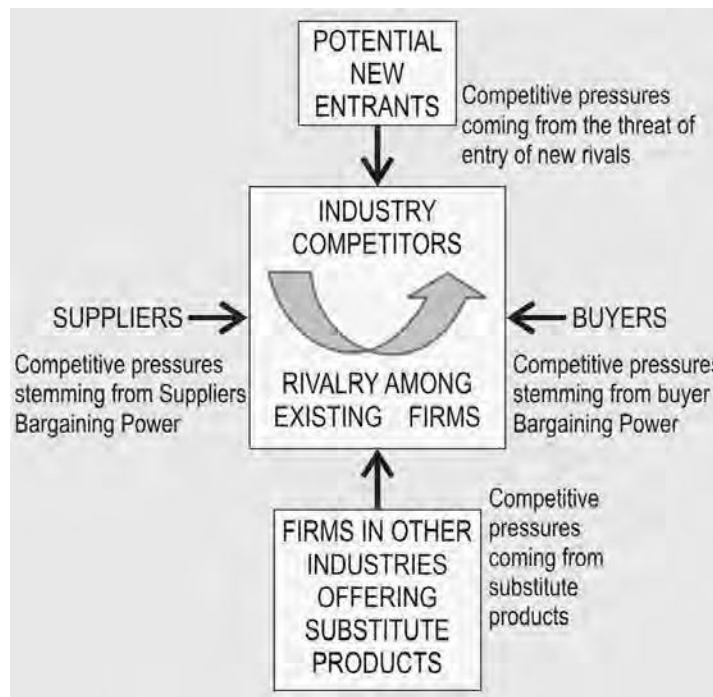
Top down strategic planning describes a centralized approach to strategy formulation in which the corporate centre or head office determines mission, strategic intent, objectives and strategies for the organization as a whole and for all parts. Unit managers are seen as implementers of pre-specified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

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

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

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

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



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

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

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

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

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

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

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

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

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