

Test Series: October, 2015

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) "One of the characteristics of financial statements is neutrality"- Do you agree with this statement?
- (b) Mohan bought a forward contract for three months of US \$ 2,00,000 on 1st December 2014 at 1 US \$ = Rs. 44.10 when the exchange rate was 1 US \$ = Rs. 43.90. On 31-12-2014, when he closed his books, exchange rate was 1 US \$ = Rs. 44.20. On 31st January, 2015 he decided to sell the contract at Rs. 44.30 per Dollar. Show how the profits from the contract will be recognized in the books of Mohan.
- (c) State with reasons, how the following events would be dealt with in the financial statements of Omega Ltd. for the year ended 31st March, 2015:
- (i) An agreement to sell a land for Rs. 30 lakh to another company was entered into on 1st March, 2015. The value of land is shown at Rs. 20 lakh in the Balance Sheet as on 31st March, 2014. However, the Sale Deed was registered on 15th April, 2015.
- (ii) The negotiation with another company for acquisition of its business was started on 2nd February, 2015. Omega Ltd. invested Rs. 40 lakh on 12th April, 2015.
- (d) A Company had issued 20,000, 13% Convertible debentures of Rs. 100 each on 1st April, 2011. The debentures are due for redemption on 1st July, 2013. The terms of issue of debentures provided that they were redeemable at a premium of 5% and also conferred option to the debenture holders to convert 20% of their holding into equity shares (Nominal value Rs. 10) at a price of Rs. 15 per share. Debenture holders holding 2,500 debentures did not exercise the option. Calculate the number of equity shares to be allotted to the Debenture holders exercising the option to the maximum. (4 x 5 = 20 Marks)

2. A, B and C give you the following Balance Sheet as on 31st March, 2015.

Liabilities	Rs.	Assets	Rs.
A's Loan	15,000	Plant and Machinery at cost	30,000
Capital Accounts:		Fixtures and Fittings	2,000
A 30,000		Stock	10,400
B 10,000		Debtors 18,400	
C <u>2,000</u>	42,000	Less: Provision <u>(400)</u>	18,000
Sundry Creditors	17,800	Joint Life Policy	15,000
Loan on Hypothecation of Stock	6,200	Patents and Trademarks	10,000
Joint Life Policy Reserve	12,400	Cash at Bank	8,000
	93,400		93,400

The partners shared profits and losses in the ratio of A 4/9, B 2/9 and C 1/3. Firm was dissolved on 31st March, 2015 and you are given the following information:

- (a) C had taken a loan from insurers for Rs. 5,000 on the security of Joint Life Policy. The policy was surrendered and Insurers paid a sum of Rs. 10,200 after deducting Rs. 5,000 for. C's loan and Rs. 300 as interest thereon.
- (b) One of the creditors took some of the patents whose book value was Rs. 6,000 at a valuation of Rs. 4,500. The balance to that creditor was paid in cash.
- (c) The firm had previously purchased some shares in a joint stock company and had written them off on finding them useless. The shares were now found to be worth Rs. 3,000 and the loan creditor agreed to accept the shares at this value.
- (d) The remaining assets realized the following amount:
- | | |
|---------------------------------|--------|
| | Rs. |
| Plant and Machinery | 17,000 |
| Fixtures and Fittings | 1,000 |
| Stock | 9,000 |
| Debtors | 16,500 |
| Patents 50% of their book value | |
- (e) The liabilities were paid and a total discount of Rs. 500 was allowed by the creditors.
- (f) The expenses of realization amounted to Rs. 2,300.

Prepare the Realisation Account, Bank Account and Partners Capital Accounts in columnar form. (16 Marks)

3. Alpha Ltd. furnishes the following summarized Balance Sheet as at 31st March, 2015:

	Rs. in '000	Rs. in '000
Equity & Liabilities		
Share Capital:		
Authorized Capital:		5,000
Issued and Subscribed Capital :		
3,00,000 Equity shares of Rs. 10 each fully paid up	3,000	
20,000 9% Preference Shares of 100 each (issued two months back for the purpose of buy back)	2,000	5,000
Reserve and Surplus:		
Capital reserve	10	
Revenue reserve	4,000	
Securities premium	500	
Profit and Loss account	1,800	6,310
Non-current liabilities - 10% Debentures		400
Current liabilities and provisions		40
		11,750
Assets		
Fixed Assets: Cost	3,000	
Less: Provision for depreciation	250	2,750
Non-current investments at cost		5,000
Current assets, loans and advances (including cash and bank balances)		4,000
		11,750

- (1) The company passed a resolution to buy back 20% of its equity capital @ Rs. 15 per share. For this purpose, it sold its investments of Rs. 30 lakhs for Rs. 25 lakhs.
- (2) The company redeemed the preference shares at a premium of 10% on 1st April, 2015.
- (3) Included in its investments were 'Investments in own debentures' costing Rs. 3 lakhs (face value Rs. 3.30 lakhs). These debentures were cancelled on 1st April, 2015.

You are required to pass necessary Journal entries and prepare the Balance Sheet on 01.04.2015. (16 Marks)

4. Following is the Balance Sheet of Aditya Ltd. as at 31st March, 2015 :

Liabilities	Rs.	Assets	Rs.
15,000, 10% Preference shares of Rs. 100 each	15,00,000	Goodwill	3,50,000
35,000 Equity shares of Rs. 100 each	35,00,000	Land & Buildings	15,00,000
Securities Premium account	1,00,000	Plant & Machinery	10,00,000
7% Debentures of Rs. 100 each	5,00,000	Inventory	6,00,000
Trade payables	12,50,000	Trade receivables	15,00,000
Loan from Director	1,50,000	Cash at bank	1,00,000
		Profit & Loss A/c	<u>19,50,000</u>
	<u>70,00,000</u>		<u>70,00,000</u>

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

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

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

Shares were fully taken up.

(viii) The total expenses incurred by the company in connection with the scheme excluding underwriting commission amounted to Rs. 15,000.

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

5. (a) Krishna Ltd. has two departments X and Y. From the following particulars prepare departmental trading accounts and general profits and loss account for the year ending 31st March, 2015:

	Department X	Department Y
	Rs.	Rs.
Opening stock (at cost)	80,000	48,000
Purchases	3,68,000	2,72,000
Carriage inward	8,000	8,000
Wages	48,000	32,000
Sales	5,60,000	4,48,000
Purchased goods transferred		
By department Y to X	40,000	-
By department X to Y	-	32,000
Finished goods transferred		
By department Y to X	1,40,000	-
By department X to Y	-	1,60,000
Return of finished goods		
By department Y to X	40,000	-
By department X to Y	-	28,000
Closing stock		
Purchased goods	18,000	24,000
Finished goods	96,000	56,000

Purchased goods have been transferred mutually at their respective departmental purchase cost and finished goods at departmental market price and that 25% of the closing finished stock with each department represents finished goods received from the other department.

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

Following details are furnished for the year ended 31st March, 2015 :

	Head Office (Rs.)	Branch (Rs.)
Opening stock (as on 1.4.2014)	2,25,000	-
Purchases	25,50,000	-
Goods sent to branch (Cost to H.O. plus 80%)	9,54,000	-
Sales	27,81,000	9,50,000
Office expenses	90,000	8,500
Selling expenses	72,000	6,300
Staff salary	65,000	12,000

You are required to prepare Trading and Profit and Loss Account of the head office and branch for the year ended 31st March, 2015 . (8 + 8 = 16 Marks)

6. (a) A Commercial Bank has the following capital funds and assets. Segregate the capital funds into Tier I and Tier II capitals. Find out the risk adjusted asset and risk weighted assets ratio.

	(Rs. in crores)
Equity share capital	500.00
Statutory reserve	270.00
Capital reserve (of which Rs. 16 crores were due to revaluation of assets and the balance due to sale of capital asset)	78.00
Assets:	
Cash balance with RBI	10.00
Balance with other banks	18.00
Other investments	36.00
Loans and advances:	
(i) Guaranteed by the Government	16.50
(ii) Others	5,675.00
Premises, furniture and fixtures	78.00
Off-Balance Sheet items:	
(i) Guarantee and other obligations	800.00
(ii) Acceptances, endorsements and letter of credit	4,800.00

(b) From the following information furnished to you by Vridhi Insurance Co. Ltd., you are required to pass Journal entries relating to unexpired risk reserve and show in columnar form "Unexpired Risks Reserve Account" for 2015.

- (i) On 31.12.2014, it had reserve for unexpired risks amounting to Rs. 40 crores. It comprised of Rs. 15 crores in respect of marine insurance business, Rs. 20 crores in respect of fire insurance business and Rs. 5 crores in respect of miscellaneous insurance business.
- (ii) Vridhi Insurance Co. Ltd. creates reserves at 100% of net premium income in respect of marine insurance policies and at 50% of net premium income in respect of fire and miscellaneous income policies.
- (iii) During 2015, the following business was conducted:

	Marine	(Rs. in crores)	
		Fire	Miscellaneous
Premium collected from:			
(a) Insured in respect of policies issued	18.00	43.00	12.00
(b) Other insurance companies in respect of risks undertaken	7.00	5.00	4.00
Premium paid/payable to other insurance companies on business ceded	6.70	4.30	7.00

(8 + 8 = 16 Marks)

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

- (a) Why goods are marked on invoice price by the head office while sending goods to the branch?
- (b) When capitalisation of borrowing cost should cease as per Accounting Standard 16?
- (c) Annual lease rent = Rs. 40,000 at the end of each year

Lease period = 5 years

Guaranteed residual value = Rs. 14,000

Fair value at the inception (beginning) of lease = Rs. 1,50,000

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

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

- (d) From the following information relating to Y Ltd. Calculate Earnings Per Share (EPS):

	<i>Rs. in crores</i>
<i>Profit before V.R.S. payments but after depreciation</i>	<i>75.00</i>
<i>Depreciation</i>	<i>10.00</i>
<i>VRS payments</i>	<i>32.10</i>
<i>Provision for taxation</i>	<i>10.00</i>
<i>Fringe benefit tax</i>	<i>5.00</i>
<i>Paid up share capital (shares of Rs. 10 each fully paid)</i>	<i>93.00</i>

- (e) What are the costs that are to be included in Research and Development costs as per AS 26. (4 x 4 = 16 Marks)

Test Series: October, 2015

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

Question No. 1 is compulsory.

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

Time Allowed – 3 Hours

Maximum Marks – 100

1. (a) Discuss the factors governing modes of communication of auditor with those charged with governance. *(5 Marks)*
- (b) Dabloo Ltd. received grant of Rs. 50 lacs from Haryana Government towards the part cost of a specific machinery. The company credited the above sum of Rs. 50 lacs as income in its Statement of Profit and Loss for the year. What are your views on the accounting treatment of the above receipt of Rs. 50 lacs made by Dabloo Ltd.? *(5 Marks)*
- (c) Explain the assertions need to be considered about the classes of transactions and events for the period under audit. *(5 Marks)*
- (d) Mention the areas in which different accounting policies may be encountered and the manner in which these would be disclosed. *(5 Marks)*
2. State with reason (in short) whether the following statements are correct or incorrect (Answer any eight):
 - (i) The overall objective of audit does not change in Computer Information System (CIS) environment.
 - (ii) The primary objective of an audit is to detect fraud and errors in Financial Statements.
 - (iii) An Auditor's external expert is not subjected to quality control policies and procedures of an audit firm.
 - (iv) "Examination in depth" implies that the auditor vouches almost all transactions in a manner that the chances of not checking any transaction are left at minimum.
 - (v) A casual vacancy caused by resignation of the auditor can be filled by the Board of Directors.
 - (vi) SA 230 deals with auditor's responsibilities relating to fraud in an audit of financial statement.
 - (vii) If there is difference of opinion among the joint auditors with regard to any matter, majority joint auditors opinion will prevail while reporting.

- (viii) Procedural error arises as a result of transactions having been recorded in a fundamentally incorrect manner.
- (ix) Comptroller and Auditor General of India can be removed by the Prime Minister of India on the recommendation of his Council of Ministers.
- (x) Taking management representation is a convenient, economical and equally acceptable auditing method even where the direct access by auditor to audit evidence is possible. *(2 x 8 = 16 Marks)*
3. How will you vouch/verify the following:
- (a) Bad Debts.
- (b) Bank Overdraft.
- (c) Patterns, Dies, Loose Tools, etc.
- (d) Wages Paid to Seasonal Labourers. *(4 x 4 = 16 Marks)*
4. (a) The auditor is required to plan the nature, timing and extent of the direction and supervision of engagement team members and review of their work. However, this varies depending on many factors. Mention such factors in accordance with SA 300. *(4 Marks)*
- (b) The auditors should consider the effect of subsequent events on the financial statements and on auditor's report. Discuss with reference to SA 560. *(6 Marks)*
- (c) With reference to SA 250, give some examples of the policies and procedures that an entity may implement to assist in the prevention and detection of non-compliance with laws and regulations. *(6 Marks)*
5. (a) ABC Pvt. Ltd. reports the following position as on 31st March, 2015:

Paid up Capital	Rs. 30 Lacs
Revaluation Reserve	Rs. 10 Lacs
Capital Reserve	Rs. 11 Lacs
Profit & Loss (Dr.) Balance	Rs. 2 Lacs

The Management of the Company contends that CARO, 2015 is not applicable to it. Comment. *(4 Marks)*

- (b) The Balance Sheet of XYZ Ltd., an unlisted public company, shows paid up share capital of Rs. 5 crore and public deposits of Rs. 100 crore. The company appointed CA. Ananya as the statutory auditor in its annual general meeting held at the end of September, 2015 for 6 years.

Comment upon the facts of the case with respect to applicability of provisions related to rotation of auditors and cooling off period as per the section 139(2) of the Companies Act, 2013. *(6 Marks)*

- (c) Mention any eight special audit points to be considered by the auditor during the audit of a Hospital? *(6 Marks)*
6. (a) State the circumstances where "Auditing through the computer" approach must be used. *(4 Marks)*
- (b) The closing stock of Lemon (P) Ltd. as on 31.3.2014 amounting to Rs. 58 lacs continued as it is as on 31.3.2015. The management contends that the inventory has not undergone any change and therefore, the auditor proposes to exclude from their audit programme the audit of closing stock as it pertains to the preceding year which was already audited by another auditor. Comment. *(6 Marks)*
- (c) Discuss the procedure to be adopted by an auditor while auditing leasing transactions entered into by the leasing company. *(6 Marks)*
7. Write short notes on any **four** of the following:
- (a) Surprise checks.
- (b) Self-revealing errors.
- (c) Disadvantages of the use of an audit programme.
- (d) Verification of Issue of shares for consideration other than cash.
- (e) Matters to be enquired by the auditor under section 143(1) of the Companies Act, 2013.
- (4 x 4 = 16 Marks)*

Test Series: October, 2015

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) What do you understand by the term 'Process'?
 - (ii) Differentiate between Connection Oriented and Connectionless Networks.
 - (iii) What are the major functions and services performed by the Physical Layer of OSI Model?
 - (iv) Name all the components of an Information System.
 - (v) Discuss some of the disadvantages of Cloud Computing? *(2 x 5 = 10 Marks)*
2.
 - (a) Discuss the 'Privacy' aspect under Network Security. *(4 Marks)*
 - (b) Discuss some steps that may be included in a Security Program in order to ensure safeguarding of assets and maintenance of data integrity? *(4 Marks)*
3.
 - (a) Discuss some of the key modules of Human Resource Management Systems (HRMS). *(4 Marks)*
 - (b) Discuss Knowledge Management System (KMS) in brief. *(4 Marks)*
4.
 - (a) Discuss some of the applications that help entity to achieve Business Process Automation (BPA). *(5 Marks)*
 - (b) Discuss Programming Management Controls under Managerial Controls *(3 Marks)*
5.
 - (a) Discuss the general objectives of Auditing in a computerized environment. *(4 Marks)*
 - (b) Discuss some business applications of Mobile Computing. *(4 Marks)*
6.
 - (a) Discuss the 'Order to Cash Process Flow' Cycle of a Sales Transaction. *(5Marks)*
 - (b) Discuss the key factors to be considered in implementing Business Process Management (BPM). *(5 Marks)*

7. Write short notes on any **four** of the following.
- (a) Data Flow in Data Flow Diagram (DFD)
 - (b) Registers in CPU
 - (c) Secure Socket Layer (SSL)
 - (d) 'Authorization' during Credit Card processing
 - (e) Platform as a Service (PaaS)

(4 × 2 = 8 Marks)

Test Series: October, 2015

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) “Competition adversely hits the organizational growth.” Elucidate. (3 Marks)
(b) Discuss profit as business objective as per Peter F Drucker. (3 Marks)
(c) “The thrust of operational control is on individual tasks or transactions.” Elucidate. (3 Marks)
(d) Explain augmented marketing. (3 Marks)
(e) What is strategic decision making? (3 Marks)
2. (a) State with reasons which of the following statements is correct/incorrect:
(i) Changes in strategy may lead to changes in organizational structure.
(ii) Vertical diversification integrates firms forward or backward in the product chain. (2 × 2 = 4 Marks)
(b) Explain the meaning of the following concepts:
(i) Competitive advantage
(ii) Strategic vision.
(iii) Portfolio analysis (3 × 1 = 3 Marks)
3. Write short notes on the following:
(a) Socio-cultural environment (2 Marks)
(b) Benchmarking (2 Marks)
(c) Concept of strategic Intent (3 Marks)
4. Explain GE model. How is it useful in making strategic choices? (7 Marks)
5. A company is planning to introduce changes in its structure, technology and people. Explain how Kurt Lewin’s change process can help this organisation. (7 Marks)
6. Devise an ideal work plan for implementing a turnaround strategy in an organization? (7 Marks)
7. Explain in brief the themes of Six Sigma. (7 Marks)

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

1. (a) Yes, one of the characteristics of financial statements is neutrality. To be reliable, the information contained in financial statement must be neutral, that is free from bias. Financial Statements are not neutral if by the selection or presentation of information, the focus of analysis could shift from one area of business to another thereby arriving at a totally different conclusion on the business results. For example if the assets of a company primarily consist of debtors and insurance claims and the financial statements do not specify that the insurance claims have been lying unrealized for a number of years or that a few key debtors have not given balance confirmation certificates, an erroneous conclusion may be drawn on the liquidity of the company. Financial statements are said to depict the true and fair view of the business of the organization by virtue of neutrality.
- (b) As per para 39 of AS 11 'Changes in Foreign Exchange Rates', in recording a forward exchange contract intended for trading or speculation purpose, the premium or discount on the contract is ignored and at each balance sheet date, the value of contract is marked to its current market value and the gain or loss on the contract is recognised. Since the forward contract was for speculation purposes the premium on forward contract i.e. the difference between the spot rate and the forward contract rate will not be recorded in the books. Only when the forward contract is sold the difference between the forward contract rate and sale rate will be recorded in the Profit & Loss Account.

	Rs.
Sale rate	44.30
Less: Contract rate	<u>(44.10)</u>
Profit on sale of contract per US\$	<u>00.20</u>

Contract Amount US \$ 2,00,000

Total profit (2,00,000 x 0.20) Rs. 40,000

- (c) (i) According to 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, sale of immovable property was carried out before the closure of the books of accounts. This is clearly an event occurring after the balance sheet date but agreement to sell was effected on 1st March, 2015 i.e. before the balance sheet date. Registration of the sale deed on 15th April, 2015, simply provides additional information relating to the conditions existing at the balance sheet date. Therefore, adjustment to assets for sale of land is necessary in the financial statements of Omega Ltd. for the year ended 31st March, 2015.

- (ii) AS 4 (Revised) defines "Events occurring after the balance sheet date" as those significant events, both favorable and unfavorable, that occur between the balance sheet date and the date on which the financial statements are approved by the Board of Directors in the case of a company. Accordingly, the acquisition of another company is an event occurring after the balance sheet date. However, no adjustment to assets and liabilities is required as the event does not affect the determination and the condition of the amounts stated in the financial statements for the year ended 31st March, 2015.

Applying provisions of the standard which clearly state that/disclosure should be made in the report of the approving authority of those events occurring after the balance sheet date that represent material changes and commitments affecting the financial position of the enterprise, the investment of Rs. 40 lakhs in April, 2015 in the acquisition of another company should be disclosed in the report of the Board of Directors to enable users of financial statements to make proper evaluations and decisions.

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

	<i>Number of debentures</i>
Total number of debentures	20,000
Less: Debenture holders not opted for conversion	<u>(2,500)</u>
Debenture holders opted for conversion	<u>17,500</u>
Option for conversion	20%
Number of debentures to be converted (20% of 17,500)	3,500
Redemption value of 3,500 debentures at a premium of 5% [3,500 x (100+5)]	Rs. 3,67,500
Equity shares of Rs. 10 each issued on conversion [Rs. 3,67,500/ Rs. 15]	24,500 shares

2.

Realisation Account

	<i>Rs.</i>		<i>Rs.</i>
To Plant and machinery	30,000	By Provision for doubtful debts	400
To Fixtures and fittings	2,000	By Loan on hypothecation of stock (W.N.3)	3,000
To Stock	10,400	By Creditors (W.N.2)	500
To Debtors	18,400	By Joint Life Policy A/c (W.N.4)	12,900
To Patents and Trademarks (W.N.5)	5,500	By Bank	
To Bank	2,300	Plant and machinery	17,000
		Fixtures and fittings	1,000
		Stock	9,000
		Debtors	16,500
		Patents and Trademarks	<u>2,000</u>
		By Partners' Capital Accounts	
		A	2,800
		B	1,400
		C	<u>2,100</u>
	<u>68,600</u>		<u>68,600</u>

Bank Account

	<i>Rs.</i>		<i>Rs.</i>
To Balance b/d	8,000	By C's Capital A/c- drawings	5,300
To Joint Life Policy	15,500	By Loan on hypothecation of stock	3,200
To Realisation A/c	45,500	By Creditors	12,800
To C's Capital A/c	5,400	By Realisation A/c (expenses)	2,300
		By A's Loan A/c	15,000
		By A's Capital A/c	27,200
		By B's Capital A/c	<u>8,600</u>
	<u>74,400</u>		<u>74,400</u>

Partners' Capital Accounts

	A	B	C		A	B	C
	<i>Rs.</i>	<i>Rs.</i>	<i>Rs.</i>		<i>Rs.</i>	<i>Rs.</i>	<i>Rs.</i>
To Bank			5,300	By Balance	30,000	10,000	2,000

To Realisation A/c	2,800	1,400	2,100	b/d			
To Bank (Bal. Fig.)				By Bank A/c (bal.fig.)			5,400
	<u>27,200</u>	<u>8,600</u>	<u> </u>		<u> </u>	<u> </u>	<u> </u>
	<u>30,000</u>	<u>10,000</u>	<u>7,400</u>		<u>30,000</u>	<u>10,000</u>	<u>7,400</u>

Working Notes:

1. A's Loan Account

	Rs.		Rs.
To Bank A/c	<u>15,000</u>	By Balance b/d	<u>15,000</u>
	<u>15,000</u>		<u>15,000</u>

2. Sundry Creditors Account

	Rs.		Rs.
To Patents and Trademarks A/c	4,500	By Balance b/d	17,800
To Realisation A/c	500		
To Bank A/c	<u>12,800</u>		<u> </u>
	<u>17,800</u>		<u>17,800</u>

3. Loan on Hypothecation of Stock Account

	Rs.		Rs.
To Realisation A/c	3,000	By Balance b/d	6,200
To Bank A/c	3,200		
	6,200		6,200

4. Joint Life Policy Account

	Rs.		Rs.
To Balance b/d	15,000	By Joint Life Policy Reserve A/c	12,400
To Realisation A/c	12,900	By Bank A/c (10,200 + 5,300)	15,500
	<u>27,900</u>		<u>27,900</u>

5. Patents and Trademarks Account

	Rs.		Rs.
To Balance b/d	10,000	By Creditors A/c	4,500
		By Realisation A/c	1,500

	<u>10,000</u>	By Realisation A/c (bal.fig.)	<u>4,000*</u>
			<u>10,000</u>

3. Journal Entries in the books of Alpha Ltd.

		<i>Dr.</i>	<i>Cr.</i>
		Rs. in '000	Rs. in '000
1	Bank A/c Profit and Loss A/c To Investment A/c (Being investment sold for the purpose of buy-back of Equity Shares)	Dr. Dr. 	2,500 500 3,000
2	Preference share capital A/c Premium on redemption of Preference Shares A/c To Preference shareholders A/c (Being redemption of preference share capital at premium of 10%)	Dr. Dr. 	2,000 200 2,200
3	Preference shareholders A/c To Bank A/c (Being payment made to preference shareholders)	Dr. 	2,200 2,200
4	Equity share capital A/c Securities Premium A/c (Premium payable on buy-back) To Equity shares buy-back A/c (Being the amount due on buy-back of equity shares)	Dr. Dr. 	600 300 900
5	Equity shares buy-back A/c To Bank A/c (Being payment made for buy-back of equity shares)	Dr. 	900 900
6	10% Debentures A/c To Own debentures A/c To Capital reserve A/c (Profit on cancellation) (Being own debentures cancelled at profit)	Dr. 	330 300 30
7	Securities Premium A/c	Dr.	200

	To Premium on redemption of preference shares A/c (Being premium on redemption of preference shares adjusted through securities premium)		200
8	Revenue Reserve A/c To Capital redemption reserve A/c (Refer Note) (Being creation of capital redemption reserve to the extent of nominal value of preference shares redeemed)	Dr.	2,000
			2,000

Balance Sheet of the Alpha Ltd. as on 1st April, 2015

		Notes No.	Rs. in '000
Equity and Liabilities			
1	Shareholders funds		
	Share capital	1	2,400
	Reserves and Surplus	2	5,340
2	Non-current liabilities		
	Long term borrowings	3	70
3	Current liabilities		<u>40</u>
	Total		<u>7,850</u>
Assets			
1	Non-current assets		
	(a) Fixed assets		2,750
	(b) Non-current investments	4	1,700
2	Current assets	5	<u>3,400</u>
	Total		<u>7,850</u>

Notes to Accounts

		Rs. in '000	Rs. in '000
1.	Share Capital		
	Authorized share capital:		<u>5,000</u>
	Issued, subscribed and fully paid up share capital:		
	2,40,000 Equity shares of Rs. 10 each, fully paid up		2,400

	(60,000 equity shares had been bought back and cancelled during the year)			
2.	Reserves and Surplus			
	Capital Reserves	10		
	<i>Add:</i> Profit on cancellation of debentures	<u>30</u>	40	
	Securities Premium	500		
	<i>Less:</i> Premium on redemption of preference shares	(200)		
	Premium on buy-back of equity shares	<u>(300)</u>	-	
	Revenue Reserve	4,000		
	<i>Less:</i> Transfer to Capital Redemption Reserve	<u>(2,000)</u>	2,000	
	Capital Redemption reserve		2,000	
	Surplus (Profit & Loss Account)	1,800		
	<i>Less:</i> Loss on sale of investment	<u>(500)</u>	<u>1,300</u>	5,340
3.	Long term borrowings			
	10% Debentures (400 - 330)			70
4.	Non-current investments			
	Balance as on 31.03. 2015		5,000	
	<i>Less:</i> Investment sold		(3,000)	
	Own debentures cancelled		<u>(300)</u>	1,700
5	Current assets			
	Balance as on 31.03.2015		4,000	
	<i>Add:</i> Cash received on sale of investment		2,500	
	<i>Less:</i> Payment made to equity shareholders for buy back of shares		(900)	
	Payment made to preference shareholders		<u>(2,200)</u>	<u>3,400</u>

Note: In the given solution, it is assumed that buy-back of shares has been done out of the proceeds of issue of preference shares, therefore, no amount is transferred to capital redemption reserve for buy-back. However, if it is assumed that buy-back is from sale of investments and not from the proceeds of issue of preference shares, then, amount of revenue reserves transferred to capital redemption reserve will be Rs. 2,600 instead of Rs. 2,000.

4.

In the books of Aditya Ltd.

Journal Entries

	<i>Particulars</i>		<i>Dr. Amount (Rs.)</i>	<i>Cr. Amount (Rs.)</i>
1.	Equity Share Capital (Rs. 100) A/c To Equity Share Capital (Rs. 25) A/c To Capital Reduction A/c (Being Equity shares of Rs. 100 each reduced to Rs. 25 each and balance transferred to Capital Reduction A/c)	Dr.	35,00,000	8,75,000 26,25,000
2.	10% Preference Share Capital (Rs. 100) A/c To 10% Preference Share Capital (Rs. 75) A/c To Capital Reduction A/c (Being Preference shares of Rs. 100 each reduced to Rs. 75 each and balance transferred to Capital Reduction A/c. Total Pref Shares = 15,000)	Dr.	15,00,000	11,25,000 3,75,000
3.	10% Preference Share Capital (Rs. 75) A/c To 13% Preference Share Capital (Rs. 50) A/c To Equity Share Capital A/c (Being one new 13% Preference share of Rs. 50 each and one equity share of Rs. 25 each issued against 10% Preference Share of Rs. 75 each. Total Pref Shares = 15,000)	Dr.	11,25,000	7,50,000 3,75,000
4.	Capital Reduction A/c To Preference share dividend payable A/c (Being arrear of Preference share dividend payable for one year)	Dr.	1,50,000	1,50,000
5.	Preference share dividend payable A/c To Equity Share Capital A/c (Being Equity Shares of Rs. 25 each issued for arrears of Preference Share dividend)	Dr.	1,50,000	1,50,000
6.	7% Debentures A/c	Dr.	5,00,000	

	To Debenture holders A/c (Being balance of 7% Debentures transferred to Debenture holders A/c)			5,00,000
7.	Debenture holders A/c	Dr.	5,00,000	
	To 13% Preference Share Capital A/c			2,50,000
	To Bank A/c			2,25,000
	To Capital Reduction A/c			25,000
	(Being 50% of Debenture holders opted to take 13% Preference shares at par and remaining took 90% cash payment for their claims)			
8.	Loan from Director A/c	Dr.	1,50,000	
	To Provision for Contingent Liability A/c			1,50,000
	(Being provision for contingent liability of Rs. 1,50,000 as it is payable and the same is adjusted against Loan from director A/c)			
9.	Bank A/c	Dr.	10,00,000	
	To Equity Share Application & Allotment A/c			10,00,000
	(Being application money received on 40,000 Equity shares @ Rs. 25 each)			
10.	Equity Share Application & Allotment A/c	Dr.	10,00,000	
	To Equity Share Capital A/c			10,00,000
	(Being application money transferred to capital A/c, on allotment)			
11.	Underwriting Commission A/c	Dr.	40,000	
	To Bank A/c			40,000
	(Being underwriting commission paid)			
12.	Land & Buildings A/c	Dr.	3,00,000	
	To Capital Reduction A/c			3,00,000
	(Being value of Land & Buildings appreciated)			
13.	Expenses on Reconstruction A/c	Dr.	15,000	
	To Bank A/c			15,000
	(Being payment of expenses on reconstruction)			
14.	Capital Reduction A/c	Dr.	31,75,000	

To Goodwill A/c	3,50,000
To Plant & Machinery A/c	4,00,000
To Inventory A/c	1,00,000
To Trade receivables A/c	1,50,000
To Profit & Loss A/c	19,50,000
To Expenses on Reconstruction A/c	15,000
To Underwriting Commission A/c	40,000
To Capital Reserve A/c (bal fig)	1,70,000
(Being various losses written off and balance of Capital Reduction A/c transferred to Capital Reserve A/c)	

Note: Capital Reduction Account is inter changeable with Internal Reconstruction Account or Reconstruction Account. Any Account form may be used in answering the question.

5. (a) **Departmental Trading Account in the books of Krishna Ltd.**
for the year ended 31st March 2015

Particulars	Department X	Department Y	Particulars	Department X	Department Y
	Rs.	Rs.		Rs.	Rs.
To Opening stock	80,000	48,000	By Sales	5,60,000	4,48,000
To Purchases	3,68,000	2,72,000	By Transfers:		
To Carriage inward	8,000	8,000	Purchased goods	32,000	40,000
To Wages	48,000	32,000	Finished goods	1,20,000*	1,12,000*
To Transfers:			By Closing stock:		
Purchased goods	40,000	32,000	Purchased goods	18,000	24,000
Finished goods	1,12,000	1,20,000	Finished goods	96,000	56,000
To Gross profit c/d	<u>1,70,000</u>	<u>1,68,000</u>			
	<u>8,26,000</u>	<u>6,80,000</u>		<u>8,26,000</u>	<u>6,80,000</u>

* Net transfers of finished goods by

Department X to Y = Rs. 1,60,000 – Rs. 40,000 = Rs. 1,20,000

Department Y to X = Rs. 1,40,000 – Rs. 28,000 = Rs. 1,12,000

Profit and Loss A/c
for the year ended 31st March, 2015

<i>Particulars</i>	Rs.	<i>Particulars</i>	Rs.
To Provision for unrealized profit included in closing stock		By Gross profit b/d	
Department X (W.N. 3)	7,200	Department X	1,70,000
Department Y (W.N. 3)	3,500	Department Y	1,68,000
To Net profit	<u>3,27,300</u>		<u> </u>
	<u>3,38,000</u>		<u>3,38,000</u>

Working Notes:

1. Calculation of rates of gross profit margin on sales

	<i>Department X</i>	<i>Department Y</i>
	Rs.	Rs.
Sales	5,60,000	4,48,000
Add: Transfer of finished goods	<u>1,60,000</u>	<u>1,40,000</u>
	7,20,000	5,88,000
Less: Return of finished goods	<u>(40,000)</u>	<u>(28,000)</u>
	<u>6,80,000</u>	<u>5,60,000</u>
Gross Profit	1,70,000	1,68,000
Gross profit margin =	$\frac{1,70,000}{6,80,000} \times 100 = 25\%$	$\frac{1,68,000}{5,60,000} \times 100 = 30\%$

2. Finished goods from other department included in the closing stock

	<i>Department X</i>	<i>Department Y</i>
	Rs.	Rs.
Stock of finished goods	96,000	56,000
Stock related to other department (25% of finished goods)	24,000	14,000

3. Unrealized profit included in the closing stock

Department X = 30% of Rs. 24,000 = Rs. 7,200

Department Y = 25% of Rs. 14,000 = Rs. 3,500

(b)

Trading and Profit and Loss A/c
For the year ended 31st March 2015

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

Working Notes:

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

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

6. (a)

		<i>Rs. in crores</i>	<i>Rs. in crores</i>
(i)	Capital funds – Tier I		
	Equity share capital		500
	Statutory reserve		270
	Capital reserve (arising out of sale of assets) (78-16)		<u>62</u>
			832
	Capital funds – Tier II		
	Capital reserve (arising out of revaluation of assets)	16	
	Less: Discount to the extent of 55%	<u>(8.8)</u>	<u>7.2</u>
			<u>839.2</u>

		<i>Rs. in crores</i>	<i>% of weight</i>	<i>Rs. in crores</i>
(ii)	Risk Adjusted Assets			
	Funded Risk Assets			
	Cash balance with RBI	10	0	0
	Balance with other banks	18	20	3.60
	Other investments	36	102.5	36.90
	Loans and advances:			
	(i) Guaranteed by the government	16.5	0	0
	(ii) Others	5,675	100	5,675
	Premises, furniture and fixtures	78	100	<u>78</u>
				5,793.50
		<i>Rs. in crores</i>	<i>Credit conversion factor</i>	
	Off-Balance Sheet items:			
	Guarantees and other obligations	800	100	800
	Acceptances, endorsements and letters of credit	4,800	100	<u>4,800</u>
				<u>11,393.50</u>

Risk Weighted Assets Ratio:

$$\frac{\text{Capital fund} \times 100}{\text{Risk adjusted assets}}$$

$$(839.2 / 11,393.50) \times 100 = 7.37\%$$

At present, capital adequacy ratio as per RBI norms is 9%. Therefore, Bank has to improve the ratio by introducing further Tier I capital.

Note: As per RBI Master Guidelines dated 1st July 2013, Revaluation Reserves have been advised to be discounted by 55%

(b) In the books of Vridhi Insurance Co. Ltd.**Journal Entries**

Date	Particulars	(Rs. in crores)		
		Dr.	Cr.	
1.1.2015	Unexpired Risk Reserve (Fire) A/c	Dr.	20.00	
	Unexpired Risk Reserve (Marine) A/c	Dr.	15.00	
	Unexpired Risk Reserve (Miscellaneous) A/c	Dr.	5.00	
	To Fire Revenue Account			20.00
	To Marine Revenue Account			15.00
	To Miscellaneous Revenue Account			5.00
	(Being unexpired risk reserve brought forward from last year)			
31.12.2015	Marine Revenue A/c	Dr.	18.30	
	To Unexpired Risk Reserve A/c			18.30
	(Being closing reserve for unexpired risk created at 100% of net premium income amounting to Rs.18.3 crores i.e.18+7-6.70)			
	Fire Revenue A/c	Dr.	21.85	
To Unexpired Risk Reserve A/c			21.85	
(Being closing reserve for unexpired risk created at 50% of net premium income of Rs. 43.7 crores i.e.43+5-4.30)				
Miscellaneous Revenue A/c	Dr.	4.50		
To Unexpired Risk Reserve A/c			4.50	
(Being closing reserve for unexpired risk created at 50% net premium income of Rs. 9 crores i.e. 12+4-7)				

Unexpired Risk Reserve Account

Date	Particulars	Marine (Rs.)	Fire (Rs.)	Misc. (Rs.)	Date	Particulars	Marine (Rs.)	Fire (Rs.)	Misc. (Rs.)
1.1.15	To Revenue A/c	15.00	20.00	5.00	1.1.15	By Balance b/d	15.00	20.00	5.00
31.12.15	To Balance c/d	<u>18.30</u>	<u>21.85</u>	<u>4.50</u>	31.12.15	By Revenue A/c	<u>18.30</u>	<u>21.85</u>	<u>4.50</u>
		<u>33.30</u>	<u>41.85</u>	<u>9.50</u>			<u>33.30</u>	<u>41.85</u>	<u>9.50</u>

7. (a) Goods are marked on invoice price to achieve the following objectives:
- (i) To keep secret from the branch manager, the cost price of the goods and profit made, so that the branch manager may not start a rival and competitive business with the concern; and
 - (ii) To have effective control on stock i.e stock at any time must be equal to opening stock plus goods received from head office minus sales made at branch.
 - (iii) To dictate pricing policy to its branches, as well as save work at branch because prices have already been decided.

- (b) Capitalisation of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete.

An asset is normally ready for its intended use or sale when its physical construction or production is complete even though routine administrative work might still continue. If minor modifications such as the decoration of a property to the user's specification, are all that are outstanding, this indicates that substantially all the activities are complete.

When the construction of a qualifying asset is completed in parts and a completed part is capable of being used while construction continues for the other parts, capitalisation of borrowing costs in relation to a part should cease when substantially all the activities necessary to prepare that part for its intended use or sale are complete.

- (c) **Journal entry in the books of Lessee**

	Rs.	Rs.
Asset A/c	Dr.	1,49,888
To Lessor		1,49,888
(Being recognition of finance lease as an asset and a liability)		

Working Note:

Year	Lease Payments Rs.	Discounting Factor (12.6%)	Present Value Rs.
1	40,000	0.89	35,600
2	40,000	0.79	31,600
3	40,000	0.70	28,000
4	40,000	0.622	24,880
5	40,000	0.552	22,080
5	14,000 (GRV)	0.552	7,728
			1,49,888

(d)

		Rs. in crores
Profit after depreciation but before VRS Payment		75.00
Less: Depreciation – No. adjustment required	-	
VRS payments	32.10	
Provision for taxation	10.00	
Fringe benefit tax	<u>5.00</u>	<u>(47.10)</u>
Net Profit		<u>27.90</u>
No. of shares		9.30 crores

$$\text{EPS} = \frac{\text{Net profit}}{\text{No. of shares}} = \frac{27.90}{9.30} = \text{Rs. 3 per share.}$$

(e) According to paras 41 and 43 of AS 26, “No intangible asset arising from research (or from the research phase of an internal project) should be recognized in the research phase. Expenditure on research (or on the research phase of an internal project) should be recognized as an expense when it is incurred.

Examples of research costs are:

- Costs of activities aimed at obtaining new knowledge;
- Costs of the search for, evaluation and final selection of, applications of research findings or other knowledge;
- Costs of the search for alternatives for materials, devices, products, processes, systems or services; and

- Costs of the activities involved in formulation, design, evaluation and final selection of possible alternatives for new or improved materials, devices, products, processes systems or services.”

According to paras 45 and 46 of AS 26, “In the development phase of a project, an enterprise can, in some instances, identify an intangible asset and demonstrate that future economic benefits from the asset are probable. This is because the development phase of a project is further advanced than the research phase.

Examples of development activities/costs are:

- Costs of the design, construction and testing of pre-production or pre-use prototypes and models;
- Costs of the design of tools, jigs, moulds and dies involving new technology;
- Costs of the design, construction and operation of a pilot plant that is not of a scale economically feasible for commercial production; and
- Costs of the design, construction and testing of a chosen alternative for new or improved materials, devices, products, processes, systems or services.”

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

1. (a) **Factors Governing Modes of Communication of Auditor with Those Charged with Governance:** As per SA 260, "Communication with Those Charged with Governance" the auditor may decide whether to communicate orally or in writing. Effective communication may involve structured presentations and written reports as well as less structured communications, including discussions. The form of communication may be affected by such factors as-
- (i) Whether the matter has been satisfactorily resolved.
 - (ii) Whether management has previously communicated the matter.
 - (iii) The size, operating structure, control environment, and legal structure of the entity.
 - (iv) In the case of an audit of special purpose financial statements, whether the auditor also audits the entity's general purpose financial statements.
 - (v) Legal requirements. In some jurisdictions, a written communication with those charged with governance is required in a prescribed form by local law.
 - (vi) The expectations of those charged with governance, including arrangements made for periodic meetings or communications with the auditor.
 - (vii) The amount of ongoing contact and dialogue the auditor has with those charged with governance.
 - (viii) Whether there have been significant changes in the membership of a governing body.
- (b) **Accounting Treatment of Government Grants:** As per AS 12 "Accounting for Government Grants", accounting treatment of any grants or subsidy depends on nature of grants or receipts. Grants related to specific fixed assets are government grants whose primary condition is that an enterprise qualifying for them should purchase, construct or otherwise acquire such assets. There are two method of accounting. Under one method, the grant is shown as a deduction from the gross value of the assets concerned in arriving at its book value. Depreciation is charged on reduced value of fixed assets. Under other method, grants related to depreciable assets are treated as deferred income which is recognized in the Statement of Profit and Loss on a systematic and rational basis over the useful life of the assets.

In the given question, accounting treatment of grant received towards part cost of machinery is not correct. The auditor should advise company to correct the above accounting treatments of grant; otherwise it is the duty of the auditor to qualify his report.

- (c) **Assertions:** According to SA 315 “Identifying and Assessing the Risk of Material Misstatement Through Understanding the Entity and its Environment”, following are the assertions need to be considered about the classes of transactions and events for the period under audit-
- (i) **Occurrence** - transactions and events that have been recorded have occurred and pertain to the entity.
 - (ii) **Completeness** - all transactions and events that should have been recorded have been recorded.
 - (iii) **Accuracy** - amounts and other data relating to recorded transactions and events have been recorded appropriately.
 - (iv) **Cut-off** - transactions and events have been recorded in the correct accounting period.
 - (v) **Classification** - transactions and events have been recorded in the proper accounts.
- (d) **Areas in which Different Accounting Policies may be Encountered are:**
- (i) Method of depreciation, depletion and amortization-Straight Line Method, Written Down Value method.
 - (ii) Valuation of inventories – FIFO, LIFO, weighted average etc.
 - (iii) Treatment of goodwill – write off, retain.
 - (iv) Valuation of investment – at cost, market or net realizable value etc.
 - (v) Treatment of retirement benefits – Actuarial, funded through trust, insurance policy etc.
 - (vi) Valuation of fixed assets – historical cost, revaluation price, exchange fluctuation etc.

Note: The above list is not exhaustive. There may be other examples as well.

Disclosure of Accounting Policies: The purpose of AS-1 is to promote better understanding of financial statements by establishing through an accounting standard the disclosure of significant accounting policies and the manner in which accounting policies are disclosed in the financial statements. Such disclosure would also facilitate a more meaningful comparison between financial statements of different enterprises.

All significant accounting policies adopted in the preparation and presentation of financial statements should be disclosed. Such disclosure should form part of the financial statements.

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

Any change in an accounting policy which has a material effect should be disclosed. The amount by which any item in the financial statements is affected by such change should also be disclosed to the extent ascertainable. Where such amount is not ascertainable, wholly or in part, the fact should be indicated. If a change is made in the accounting policies which has no material effect on the financial statements for the current period but which is reasonably expected to have a material effect in later periods, the fact of such change should be appropriately disclosed in the period in which the change is adopted.

2. (i) **Correct:** Overall objective of audit does not change in Computer Information System (CIS) environment. But the use of computer changes the processing and storage, retrieval and communication of financial information.
- (ii) **Incorrect:** Detection of fraud and errors in the financial statements is not the primary objective of audit. The primary objective of an audit is to obtain reasonable assurance about whether the financial statements are free from material misstatements thereby enabling the auditor to express an opinion on the financial statements.
- (iii) **Correct:** As per SA 620 "Using the Work of an Auditor's Expert", an auditor's external expert is not a member of the engagement team and is not, therefore, subject to quality control policies and procedures of the audit firm.
- (iv) **Incorrect:** Examination in depth implies examination of a few selected transactions from the beginning to the end through the entire flow of the transaction. This examination consists of studying the recording of transactions at the various stages through which they have passed. At each stage, relevant records and authorities are examined; it is also judged whether the person who has exercised the authority in relation to the transactions is fit to do so in terms of the prescribed procedure.
- (v) **Incorrect:** As per section 139(8) of the Companies Act, 2013, any casual vacancy in the office of an auditor shall be filled by the Board of Directors within 30 days. However, if such casual vacancy is as a result of the resignation of an auditor, such appointment shall also be approved by the company at a general meeting convened within 3 months of the recommendation of the Board and he shall hold the office till the conclusion of the next annual general meeting.
- (vi) **Incorrect:** SA 230 deals with "Audit Documentation" whereas SA 240 deals with "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statement".

- (vii) **Incorrect:** As per SA 299 “Responsibility of Joint Auditors”, where the joint auditors are in disagreement with regard to any matter to be covered by the audit report, each one of them should express his own opinion through a separate report.
- (viii) **Incorrect:** Procedural error arises when there is error in implementation of the procedure. If transaction has been recorded in a fundamentally incorrect manner it will result in error of principle.
- (ix) **Incorrect:** The Comptroller and Auditor General of India cannot be removed by the Prime Minister of India on the recommendation of his Council of Ministers. He can be removed on the ground of proven misbehaviour or incapacity, when each House of Parliament decides to do so by majority of not less than 2/3 of the members of the house present and voting.
- (x) **Incorrect:** Where it is possible for auditor to check the transaction by himself through direct access, it is not fair for him to merely rely the management representation as prime audit evidence.

3. (a) Bad Debts

- (i) The amount of bad debts should be traced to the schedule of bad debts written off during the year.
- (ii) Major amount of bad debts in the schedule be taken for scrutiny.
- (iii) Check that the amount considered in write off had been overdue for long and scrutinize the correspondence files.
- (iv) Check the authority for write off and the level of authority is sufficient higher than the executive involved in collection.
- (v) The bad debts should be properly disclosed in Statement of Profit and Loss according to its materiality.
- (vi) If provision had already been created for bad debts, see that to the extent of actual bad debts written off, the provision is released.

(b) Bank Overdraft

- (i) The auditor should ensure that the facility of overdraft is authorised by the Board’s resolution / partner’s resolution.
- (ii) Pursue the agreement with the bank and see whether the overdraft is clean or against hypothecation or pledge of company’s property.
- (iii) Verify the register of charges and ensure that the charge has been registered with Registrar of Companies.
- (iv) Verify the rate of interest and other terms and conditions from the agreement.
- (v) Verify the amount of overdraft from the books of accounts and compare it with the passbook.

- (vi) If the overdraft is against hypothecation of assets like inventories, a certificate from the bank should be obtained.
 - (vii) If the overdraft is against hypothecation of assets or pledge of company's property, see that overdraft is properly shown under 'secured loans' and nature of security has been properly disclosed.
- (c) **Patterns, Dies, Loose Tools, etc.:** Several entities have large investments in such assets which have a relatively short useful life and low unit cost. Evidently, it is a difficult matter, under the circumstances, to prepare a separate account for each such asset although a careful control over such property is necessary.

On these considerations, some entities charge off small tools and other similar items to Production Account as and when they are purchased and do not place any value on the unused inventory on the Balance Sheet. Nevertheless, a record of issues and receipts of tools to workmen is kept, as a check on the same being pilfered and a memorandum inventory account of dies and patterns is also maintained. In other concerns, the cost of tools, dies, etc. purchased is debited to appropriate assets account, and an inventory of the unused items at the end of the year is prepared and valued; the sum total of opening balance and purchase reduced by the value of closing inventory, as disclosed by the inventory, is charged off to Production Account in respect of such assets. On the other hand, some concerns carry such assets at their book values at the end of the first year and charge off the cost of all the purchases in the subsequent year to the Production Account on the plea that they represent cost of replacement.

The most satisfactory method, however, is that of preparing an inventory of serviceable articles, at the close of each year, and revaluing the assets on this basis, the various articles included in the inventory being valued at cost. It should be seen that the inventory does not include any worn out or defective articles the life of which has already run out.

(d) **Wages Paid to Seasonal Labourers**

- (i) Ascertain and evaluate the internal control system for recruitment and usage of seasonal labourers.
- (ii) Examine that these labourers are hired on proper authority and the rates of pay are authorized at appropriate levels.
- (iii) Ensure that the attendance is properly checked by the Time Keeping Department.
- (iv) Check that the certificate regarding work done by the labourers has been given by the proper person, in case the labourers have been appointed on a per piece basis.

- (v) Check the computation of wages payable to the labourers, after taking into account the deductions.
- (vi) Confirm that all the payments to the labourers have been acknowledged.
- (vii) See the time and job records, to ensure that the labourers have been paid for time worked. See the treatment of abnormal idle time.
- (viii) Reconcile the number of seasonal labourers on payroll as per the Personnel Department's records vis-à-vis the number of labourers to whom the wages have been paid, to ensure that there are no ghost workers. This assumes greater importance, if the seasonal labourers are hired on temporary basis, and not on permanent payroll.

4. (a) Factors affecting the Nature, Timing and Extent of the Direction and Supervision:

According to SA 300 "Planning an Audit of Financial Statements", the nature, timing and extent of the direction and supervision of engagement team members and review of their work vary depending on many factors, including-

- (i) The size and complexity of the entity.
- (ii) The area of the audit.
- (iii) The assessed risks of material misstatement (for example, an increase in the assessed risk of material misstatement for a given area of the audit ordinarily requires a corresponding increase in the extent and timeliness of direction and supervision of engagement team members, and a more detailed review of their work).
- (iv) The capabilities and competence of the individual team members performing the audit work.

(b) Effect of Subsequent Events: SA 560 "Subsequent Events", establishes standards on the auditor's responsibility regarding subsequent events.

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

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

- (i) obtain an understanding of any procedures management has established to ensure that subsequent events are identified.
- (ii) inquire of management and, where appropriate, those charged with governance as to whether any subsequent events have occurred which might affect the financial statements.

Examples of inquiries of management on specific matters are:

- Whether new commitments, borrowings or guarantees have been entered into.
 - Whether sales or acquisitions of assets have occurred or are planned.
 - Whether there have been increases in capital or issuance of debt instruments, such as the issue of new shares or debentures, or an agreement to merge or liquidate has been made or is planned.
 - Whether there have been any developments regarding contingencies.
 - Whether there have been any developments regarding risk areas and contingencies.
 - Whether any unusual accounting adjustments have been made or are contemplated.
 - Whether any events have occurred or are likely to occur which will bring into question the appropriateness of accounting policies used in the financial statements as would be the case, for example, if such events call into question the validity of the going concern assumption.
 - Whether any events have occurred that are relevant to the measurement of estimates or provisions made in the financial statements.
 - Whether any events have occurred that are relevant to the recoverability of assets.
- (iii) Read minutes, if any, of the meetings, of the entity's owners, management and those charged with governance, that have been held after the date of the financial statements and inquiring about matters discussed at any such meetings for which minutes are not yet available.
- (iv) Read the entity's latest subsequent interim financial statements, if any.
- (v) Read the entity's latest available budgets, cash flow forecasts and other related management reports for periods after the date of the financial statements.
- (vi) Inquire, or extend previous oral or written inquiries, of the entity's legal counsel concerning litigation and claims.
- (vii) Consider whether written representations covering particular subsequent events may be necessary to support other audit evidence and thereby obtain sufficient appropriate audit evidence.

When the auditor identifies events that require adjustment of, or disclosure in, the financial statements, the auditor shall determine whether each such event is appropriately reflected in those financial statements. If such events have not been

considered by the management and which in the opinion of the auditor are material, the auditor shall modify his report accordingly.

(c) Prevention and Detection of Non-Compliance with Laws and Regulations: As per SA 250 "Consideration of Laws and Regulations in an Audit of Financial Statements", following are the examples of the types of policies and procedures an entity may implement to assist in the prevention and detection of non-compliance with laws and regulations-

- (i) Monitoring legal requirements and ensuring that operating procedures are designed to meet these requirements.
- (ii) Instituting and operating appropriate systems of internal control.
- (iii) Developing, publicising and following a code of conduct.
- (iv) Ensuring employees are properly trained and understand the code of conduct.
- (v) Monitoring compliance with the code of conduct and acting appropriately to discipline employees who fail to comply with it.
- (vi) Engaging legal advisors to assist in monitoring legal requirements.
- (vii) Maintaining a register of significant laws and regulations with which the entity has to comply within its particular industry and a record of complaints.

5. (a) Applicability of CARO, 2015: The CARO, 2015 specifically exempts a private limited company with a paid up capital and reserves not more than Rs. 50 lakh and which does not have loan outstanding exceeding Rs. 25 lakh from any bank or financial institution and does not have a turnover exceeding Rs. 5 crore at any point of time during the financial year.

For determining the applicability of the CARO to a private limited company, both capital as well as the revenue reserves shall be taken into consideration while computing the limit of Rs. 50 lakh prescribed for paid up capital and reserves. Revaluation reserve, if any, should also be taken into consideration while determining the figure of reserves for the limited purpose of determining the applicability of the Order. The credit balance in the profit and loss account should also be considered as a part of reserve since the balance in the profit and loss account is available for general purposes like declaration of dividend. The debit balance in the profit and loss account, if any, should be reduced from the figure of revenue reserves only. If the company does not have revenue reserves, debit balance of profit and loss account cannot be reduced from the figures of paid up capital, capital reserve and revaluation reserve.

Accordingly the profit and loss account (Dr. balance) of Rs. 2 lakh cannot be deducted. Therefore, the sum total of paid up capital and reserves shall be Rs. 51 lakh and hence CARO, 2015 shall be applicable to the Company.

(b) Rotation of Auditor: The provisions related to rotation of auditors are applicable to those companies which are prescribed in Companies (Audit and Auditors) Rules, 2014, which prescribes the following classes of companies excluding one person companies and small companies, namely:-

- (i) all unlisted public companies having paid up share capital of Rs. 10 crore or more;
- (ii) all private limited companies having paid up share capital of Rs. 20 crore or more;
- (iii) all companies having paid up share capital of below threshold limit mentioned above, but having public borrowings from financial institutions, banks or public deposits of Rs. 50 crores or more.

As per section 139(2) of the Companies Act, 2013, no listed company or a company belonging to such class or classes of companies as mentioned above, shall appoint or re-appoint an individual as auditor for more than one term of five consecutive years.

In the given case, XYZ Ltd. is an unlisted public company having paid up share capital of Rs. 5 crore and public deposits of Rs. 100 crore. The company appointed CA. Ananya as the statutory auditor in its AGM held at the end of September, 2015 for 6 years.

The provisions relating to rotation of auditor will be applicable as the public deposits exceeds Rs. 50 crore. Therefore, XYZ Ltd. can appoint CA. Ananya as an auditor of the company for not more than one term of five consecutive years and CA. Ananya will hold office of auditor from the conclusion of this meeting upto conclusion of sixth AGM i.e. AGM to be held in the year 2020. As a result, the appointment of CA. Ananya made by XYZ Ltd. for 6 years is void.

Cooling-Off Period: As per the proviso to section 139(2) of the Companies Act, 2013 an individual auditor who has completed his respective term shall not be eligible for re-appointment as auditor in the same company for five years from the completion of his term.

Therefore, CA. Ananya shall not be re-appointed as auditor in XYZ Ltd. for further term of five years i.e. she cannot be appointed as auditor upto year 2025.

(c) Audit of Hospital: The audit points to be considered by the auditor during the audit of a Hospital are stated below-

- (i) **Income from Services:** Vouch the Register of patients with copies of bills issued to them. Verify bills for a selected period with the patients' attendance record to see that the bills have been correctly prepared. Also see that bills have been issued to all patients from whom an amount was recoverable according to the rules of the hospital.

- (ii) **Collection of Cash:** Check cash collections as entered in the Cash Book with the receipts, counterfoils and other evidence for example, copies of patients bills, counterfoils of dividend and other interest warrants, copies of rent bills, etc.
- (iii) **Income from Investments:** See by reference to the property and Investment Register that all income that should have been received by way of rent on properties, dividends, and interest on securities settled on the hospital, has been collected.
- (iv) **Legacies and Donations:** Ascertain that legacies and donations received for a specific purpose have been applied in the manner agreed upon.
- (v) **Reconciliation of Subscriptions:** Trace all collections of subscription and donations from the Cash Book to the respective Registers. Reconcile the total subscriptions due (as shown by the Subscription Register and the amount collected and that still outstanding).
- (vi) **Authorisation and Sanctions:** Vouch all purchases and expenses and verify that the capital expenditure was incurred only with the prior sanction of the Trustees or the Managing Committee and that appointments and increments to staff have been duly authorised.
- (vii) **Grants and TDS:** Verify that grants, if any, received from Government or local authority has been duly accounted for. Also, that refund in respect of taxes deducted at source has been claimed.
- (viii) **Budgets:** Compare the totals of various items of expenditure and income with the amount budgeted for them and report to the Trustees or the Managing Committee significant variations which have taken place.
- (ix) **Internal Check:** Examine the internal check as regards the receipt and issue of stores; medicines, linen, apparatus, clothing, instruments, etc. so as to ensure that purchases have been properly recorded in the Inventory Register and that issues have been made only against proper authorisation.
- (x) **Depreciation:** See that depreciation has been written off against all the assets at the appropriate rates.
- (xi) **Registers:** Inspect the bonds, share scrips, title deeds of properties and compare their particulars with those entered in the property and Investment Registers.
- (xii) **Inventories:** Obtain inventories, especially of stocks and stores as at the end of the year and check a percentage of the items physically; also compare their total values with respective ledger balances.
- (xiii) **Management Representation and Certificate:** Get proper Management Representation and Certificate with respect to various aspects covered during the course of audit.

6. (a) **Auditing Through the Computer Approach:** The auditor can use the computer to test-
- (1) The logic and controls existing within the system.
 - (2) The records produced by the system.

Depending upon the complexity of the application system being audited, the approach may be fairly simple or require extensive technical competence on the part of the auditor.

Following are several circumstances where auditing through the computer approach must be used:

- (i) The application system processes large volumes of input and produces large volumes of output that make extensive direct examination of the validity of input and output difficult.
 - (ii) Significant parts of the internal control system are embodied in the computer system. For example, in an online banking system a computer program may batch transactions for individual tellers to provide control totals for reconciliation at the end of the day's processing.
 - (iii) The logic of the system is complex and there are large portions that facilitate use of the system for efficient processing.
 - (iv) Because of cost-benefit considerations, there are substantial gaps in the visible audit trail.
- (b) **Verification of Inventory:** As per SA 510 "Initial Audit Engagements – Opening Balances", in conducting an initial audit engagement, the objective of the auditor with respect to opening balances is to obtain sufficient appropriate audit evidence about whether-
- (i) Opening balances contain misstatements that materially affect the current period's financial statements; and
 - (ii) Appropriate accounting policies reflected in the opening balances have been consistently applied in the current period's financial statements, or changes thereto are properly accounted for and adequately presented and disclosed in accordance with the applicable financial reporting framework.

When the financial statements for the preceding period were audited by predecessor auditor, the current auditor may be able to obtain sufficient appropriate audit evidence regarding opening balances by perusing the copies of the audited financial statements including the other relevant documents relating to the prior period financial statements such as supporting schedules to the audited financial statements. Ordinarily, the current auditor can place reliance on the closing balances contained in the financial statements for the preceding period, except

when during the performance of audit procedures for the current period the possibility of misstatements in opening balances is indicated.

General principles governing verification of assets require that the auditor should confirm that assets have been correctly valued as on the balance sheet date. The contention of the management that the inventory has not undergone any change cannot be accepted, it forms part of normal duties of auditor to ensure that the figures on which he is expressing opinion are correct and properly valued. Moreover, it is also quite likely that the inventory lying as it is might have deteriorated and the same need to be examined. The auditor is advised not to exclude the audit of closing inventory from his audit programme.

The auditor is also required to comment under clause (i) of Para 3 of CARO, 2015 whether physical verification of inventory has been conducted at reasonable intervals by the management.

(c) Audit of Leasing Transactions: In respect of leasing transaction entered into by the leasing company, the following procedures may be adopted by the auditor-

- (i) The object clause of leasing company to see that the goods like capital goods, consumer durables etc. in respect of which the company can undertake such activities. Further, to ensure that whether company can undertake financing activities or not.
- (ii) Whether there exists a procedure to ascertain the credit analysis of lessee like lessee's ability to meet the commitment under lease, past credit record, capital strength, availability of collateral security, etc.
- (iii) The lease agreement should be examined and the following points may be noted:
 - (1) the description of the lessor, the lessee, the equipment and the location where the equipment is to be installed. (The stipulation that the equipment shall not be removed from the described location except for repairs. For the sake of identification, the lessor may also require plates or markings to be attached to the equipment).
 - (2) the amount of tenure of lease, dates of payment, late charges, deposits or advances etc. should be noted.
 - (3) whether the equipment shall be returned to the lessor on termination of the agreement and the cost shall be borne by the lessee.
 - (4) whether the agreement prohibits the lessee from assigning the subletting the equipment and authorises the lessor to do so.
- (iv) Examine the lease proposal form submitted by the lessee requesting the lessor to provide him the equipment on lease.

- (v) Ensure that the invoice is retained safely as the lease is a long-term contract.
- (vi) Examine the acceptance letter obtained from the lessee indicating that the equipment has been received in order and is acceptable to the lessee.
- (vii) See the Board resolution authorising a particular director to execute the lease agreement has been passed by the lessee.
- (viii) See that the copies of the insurance policies have been obtained by the lessor for his records.

7. (a) **Surprise Checks:** Surprise checks are a part of normal audit procedures. An element of surprise can significantly improve the audit effectiveness. Wherever practical, an element of surprise should be incorporated in the audit procedures.

The element of surprise in an audit may be, both in regard to the time of audit, i.e. selection of date, when the auditor will visit the client's office for audit and selection of areas of audit.

Surprise checks are mainly intended to ascertain whether the internal control system is working effectively and whether the accounting and other records are kept up to date as per the statutory regulations. Surprise checks can exercise good moral check on the client's staff. It helps in determining whether errors or frauds exist and if they exist, brings the matter promptly to the management's attention, so that corrective action can be taken at the earliest. Surprise checks are very effective in verification of cash and investments, test checking of inventory, verification of accounting records, statutory registers and internal control system. The frequency of surprise checks may be determined by the auditor in the circumstances of each audit but should normally be at least once in the course of an audit.

(b) **Self-revealing Errors:** These are such errors the existence of which becomes apparent in the process of compilation of accounts.

A few illustrations of such errors are given hereunder, showing how they become apparent-

(i)	Omission to post a part of a journal entry to the ledger.	Trial balance is thrown out of agreement.
(ii)	Wrong totaling of the Purchase Register.	Control Account (e.g., the Sundry Creditors Account) balances and the aggregate of the balances in the personal ledger will disagree.
(iii)	A failure to record in the cash book amounts paid into or withdrawn from the bank.	Bank reconciliation statement will show up error.
(iv)	A mistake in recording amount received from X in the account of Y.	Statements of account of parties will reveal mistake.

From the above, it is clear that certain apparent errors balance almost automatically by double entry accounting procedure and by following established practices that lie within the accounting system but not being generally considered to be a part of it, like bank reconciliation or sending monthly statements of account for confirmation.

(c) Disadvantages of the Use of an Audit Programme: There are some disadvantages in the use of audit programmes but most of these can be removed by taking some steps. It may be noted that the disadvantages are-

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

(d) Verification of Issue of Shares for Consideration Other Than Cash

- (i) Study of the contract pursuant to which the issue is made to determine how many shares are agreed to be issued and for what value and the nature and other details of the consideration.
- (ii) Examination of the prospectus to see the substance of the contract and the relevant terms of the issue including the mode of payment of the purchase consideration in case of an issue to a vendor of the business or pay-ability of commission to the underwriters or pay-ability of the preliminary expenses.
- (iii) Examination of the Board's minutes to see the adoption of the relevant contract, the decision to issue shares for a consideration other than cash and the actual allotment of shares.
- (iv) Ensuring that proper accounting entry has been passed to record the acquisition of the assets or the business or payment of the expenses (any of these may constitute the consideration) on the one hand and the issue of shares on the other. Incidentally, if any premium or discount is involved, ensure that appropriate adjustment entry has been passed therefore.

Sometimes, in view of the nature of transaction, it may be difficult to know whether an allotment is for cash or for a consideration other than cash, for instance, allotment of shares in adjustment of a debt owed by the company. In such a case, if the allotment is made in adjustment of a *bonafide* debt payable in money at once, the allotment should be considered as against cash.

This position should be kept in view when inquiring into matters stated in section 143(1) of the Companies Act, 2013. Again if the shares are allotted on a cash basis, though the amount is actually paid later, it should constitute an allotment against cash.

- (e) **Audit Enquiry under Section 143(1) of the Companies Act, 2013:** Auditor is required to make an enquiry and report under section 143(1) of the Companies Act, 2013, if he is not satisfied in respect of the following matters-
- (i) whether loans and advances made by the company on the basis of security have been properly secured and whether the terms on which they have been made are prejudicial to the interests of the company or its members;
 - (ii) whether transactions of the company which are represented merely by book entries are prejudicial to the interests of the company;
 - (iii) where the company not being an investment company or a banking company, whether so much of the assets of the company as consist of shares, debentures and other securities have been sold at a price less than that at which they were purchased by the company;
 - (iv) whether loans and advances made by the company have been shown as deposits;
 - (v) whether personal expenses have been charged to revenue account;
 - (vi) where it is stated in the books and documents of the company that any shares have been allotted for cash, whether cash has actually been received in respect of such allotment, and if no cash has actually been so received, whether the position as stated in the account books and the Balance Sheet is correct, regular and not misleading.

MOCK TEST PAPER – 2

INTERMEDIATE (IPC): GROUP – II

PAPER – 7: INFORMATION TECHNOLOGY AND STRATEGIC MANAGEMENT

SECTION – A: INFORMATION TECHNOLOGY

SUGGESTED ANSWERS/HINTS

1. (i) **Process:** In the systems engineering arena, a **Process** is defined as a sequence of events that uses inputs to produce outputs. This is a broad definition and can include sequences as mechanical as reading a file and transforming the file to a desired output format; to taking a customer order, filling that order, and issuing the customer invoice.

From a business perspective, a **Process** is a coordinated and standardized flow of activities performed by people or machines, which can traverse functional or departmental boundaries to achieve a business objective and creates value for internal or external customers.

- (ii) **Connection Oriented networks:** Wherein a connection is first established and then data is exchanged like it happens in case of telephone networks.

Connectionless Networks: Where no prior connection is made before data exchanges. Data which is being exchanged in fact has a complete contact information of recipient and at each intermediate destination, it is decided how to proceed further like it happens in case of postal networks.

- (iii) The major functions and services performed by the Physical Layer of OSI model are as follows:

- Establishment and termination of a connection to a communications medium.
- Participation in the process whereby the communication resources are effectively shared among multiple users. For example, contention resolution and flow control.
- Modulation or conversion between the representation of digital data in user equipment and the corresponding signals transmitted over a communications channel. These are signals operating over the physical cabling (such as copper and optical fiber) or over a radio link.

- (iv) **Information System:** Information System (IS) is a combination of people, hardware, software, communication devices, network and data resources that processes (can be storing, retrieving, transforming information) data and information for a specific purpose. The system needs inputs from user (key in instructions and commands, typing, scanning) which will then be processed (calculating, reporting)

using technology devices such as computers, and produce output (printing reports, displaying results) that will be sent to another user or other system via a network and a feedback method that controls the operation.

(v) Disadvantages of Cloud Computing are as follows:

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

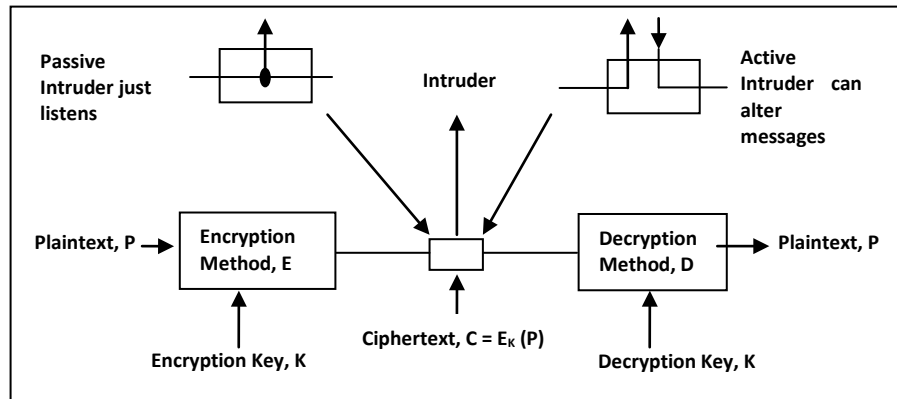
2. (a) **Privacy:** In terms of Network security, this means that the sender and the receiver expect confidentiality. The transmitted message should make sense to only the intended receiver and the message should be unintelligible to unauthorized users. This is achieved by cryptography and encryption techniques so that the data is secured and can only be decrypted with a special algorithm, logical key, mathematical formula and/or a combination of all of them.

Cryptography: Cryptography is the practice and study of techniques for secure communication in the presence of third parties (called Adversaries). More generally, it is about constructing and analyzing protocols that overcome the influence of adversaries and which are related to various aspects in information security such as data confidentiality, integrity, authentication, and non-repudiation.

➤ **Encryption:** In Cryptography, encryption is the process of encoding messages (or information) in such a way that eavesdroppers or hackers cannot read it, but only authorized parties can. Decryption is defined as the recovery of the original message from the encrypted data.

- ◆ **Plaintext** - It is the message that is to be encrypted. It is transformed by a function that is parameterized by a key.
- ◆ **CipherText** - It is the output of the encryption process that is transmitted often by a messenger or radio.
- ◆ **Encryption Model** - The intruder may hear and accurately copies down the complete ciphertext. However, unlike the intended recipient, he does not know what the decryption key is and so cannot decrypt the ciphertext easily. Sometimes the intruder can not only listen to the communication

channel (passive intruder) but can also record messages and play them back later, inject his own messages, or modify legitimate messages before they get to the receiver (active intruder). The art of breaking ciphers is known as **Cryptanalysis** and the art of devising them is known as **Cryptography**. Both Cryptanalysis and Cryptography are collectively known as **Cryptology**.



Encryption Model

- There are two categories of encryption/decryption methods: the **Secret Key Method** and the **Public Key Method**.
 - ◆ In Secret key encryption/decryption method, the same key is used by both sender and the receiver. The sender uses this key and an encryption algorithm to encrypt data; the receiver uses the same key and the corresponding decryption algorithm to decrypt the data. In this, the algorithm used for decryption is the inverse of the algorithm used for encryption.
 - ◆ In Public key encryption, there are two keys: a private key and a public key. The private key is kept by the receiver and the public key is announced to the public.
- (b) The task of a Security Administration in an organization is to conduct a security program which is a series of ongoing, regular and periodic review of controls exercised to ensure safeguarding of assets and maintenance of data integrity. Security programs involve the following eight steps –
 - (i) **Preparing project plan for enforcing security:** The project plan components are at first outlining the objectives of the review followed by in sequence determining the scope of the review and tasks to be accomplished, assigning tasks to the project team after organizing it, preparing resources budget which

will be determined by the volume and complexity of the review and fixing a target / schedule for task completion.

- (ii) **Asset identification:** Assets which need to be safeguarded can be identified and subdivided into Personnel, Hardware, Facilities, Documentation, Supplies, Data, Application Software and System Software.
 - (iii) **Asset valuation:** The process of asset valuation can differ depending on who is asked to render the valuation, the way in which the asset can be lost and the period for which it is lost and how old is the asset. Valuation of physical assets cannot be considered apart from the valuation of the logical assets. For example, the replacement value of the contents in a micro computer's hard disk may be several times more than the replacement value of the disk itself.
 - (iv) **Threat identification:** The source of a threat can be external or internal and the nature of a threat can be accidental / non-deliberate or deliberate. The example of a non-deliberate external threat is an act of God, non-deliberate internal threat is pollution, deliberate external threat is hackers, and deliberate internal threat is employees.
 - (v) **Threats probability of occurrence assessment:** This step is an assessment of the probability of occurrence of threats over a given time period. This exercise is not so difficult if prior period statistical data is available. If however, prior period data is not available, it has to be elicited from the associated stakeholders like end users (furnishing the data aspect) and the management (furnishing the control aspect).
 - (vi) **Exposure analysis:** This step is the Exposures Analysis by first identifying the controls in the place, secondly assessing the reliability of the existing controls, thirdly evaluating the probability that a threat can be successful and lastly assessing the resulting loss if the threat is successful.
 - (vii) **Controls adjustment:** The involves the adjustment of controls which means whether over some time period any control can be designed, implemented and operated such that the cost of control is lower than the reduction in the expected losses.
 - (viii) **Report generation outlining the levels of security to be provided for individual systems, end user, etc.:** This is the last step that involves report generation documenting, the findings of the review and specially recommending new assets safeguarding techniques that should be implemented and existing assets safeguarding mechanisms that should be eliminated / rectified, and also recommending the assignment of the levels of security to be pervaded for individual end users and systems.
3. (a) **A Human Resources Management System (HRMS)** is a software application that coalesce many human resources functions, together with benefits administration,

payroll, recruiting and training, and performance analysis and assessment into one parcel. Some of the key modules of HRMS are as follows:

- **Workforce Management:** Workforce Management provides powerful tools to effectively manage labor rules, ensure compliance, and control labor costs and expenses.
 - **Time and Attendance Management:** The time and attendance module gathers standardized time and work related efforts.
 - **Payroll Management:** This module of the system is designed to automate manual Payroll functions and facilitate salary, deductions etc calculations, eliminates errors and free up HR staff for more productive tasks.
 - **Training Management:** The module tracks the trainer or training organization, costs associated with training schedules, training locations, required supplies and equipment and registered attendees.
 - **Compensation Management:** This module requires integrating employee processes, information and programs with organizational processes and strategies to achieve optimal organizational results.
 - **Recruitment Management:** This module helps in hiring the right people with the right target skills. This module includes processes for managing open positions/requisitions, applicant screening, assessments, selection and hiring, correspondence, reporting and cost analysis.
 - **Personnel Management:** The personnel management comprises of HR master-data, personnel administration, recruitment and salary administration.
 - **Organizational Management:** Organizational management includes organizational structure, staffing schedules & job description.
 - **Employee Self Service (ESS):** The employee self-service module allows employees to query HR related data and perform some HR transactions over the system. Employees may query their attendance record from the system without asking the information from HR personnel.
 - **Analytics:** The Analytics module enables organizations to extend the value of an HRMS implementation by extracting HR related data for use with other business intelligence platforms. For example, organizations combine HR metrics with other business data to identify trends and anomalies in headcount in order to better predict the impact of employee turnover on future output.
- (b) **Knowledge Management Systems (KMS):** This refers to any kind of IT system that stores and retrieves knowledge, improves collaboration, locates knowledge sources, mines repositories for hidden knowledge, captures and uses knowledge, or in some other way enhances the KM process. KMS treats the knowledge component of any organization's activities as an explicit concern reflected in strategy, policy, and

practice at all levels of the organization. There are two broad types of knowledge—**Explicit** and **Tacit**.

- ◆ **Explicit knowledge:** Explicit knowledge is that which can be formalized easily and as a consequence is easily available across the organization. Explicit knowledge is articulated, and represented as spoken words, written material and compiled data. This type of knowledge is codified, easy to document, transfer and reproduce. For example – Online tutorials, Policy and procedural manuals.
- ◆ **Tacit knowledge:** Tacit knowledge, on the other hand, resides in a few often-in just one person and hasn't been captured by the organization or made available to others. Tacit knowledge is unarticulated and represented as intuition, perspective, beliefs, and values that individuals form based on their experiences. It is personal, experimental and context-specific. It is difficult to document and communicate the tacit knowledge. For example – hand-on skills, special know-how, employee experiences. It is this tacit knowledge that differentiates between organizations when push comes to shove, and hence provides the strategic edge to any organization. A regular example in the software industry is how to write code to get around a particular limitation, or to include a particularly tricky condition.

A close and firm link between information and knowledge has always existed.

- ◆ Information is piecemeal, fragmented, particular, whereas knowledge is structured, coherent, and often universal.
- ◆ Information is timely, transitory, perhaps even short-lived, whereas knowledge is of enduring significance.
- ◆ Information is a flow of messages, whereas knowledge is a stock, largely resulting from the flow, in the sense that the "input" of information may affect the stock of knowledge by adding to it, restructuring it, or changing it in any way.
- ◆ Information is acquired by being told, whereas knowledge can be acquired by thinking. Thus, new knowledge can be acquired without new information being received.

To sum up, data refers to the raw figures, information is essentially data in a context and knowledge is interpreted data/information. Knowledge Management encompasses both the content and the process of creating the content. It refers both to what is known and how it came to be known. In process terms, knowledge represents the human ability to recognize new patterns in content and to relate these to older patterns, in context.

4. (a) Many applications are available today that help enterprise to achieve Business Process Automation (BPA). Some of them are as below:
- ◆ **TALLY:** It is an accounting application that helps entity to automate processes relating to accounting of transactions. It also helps to achieve automation of few processes in inventory management. The latest version has been upgraded to help user achieve TAX compliances also. It has features such as Remote Access Capabilities, Tax Audit and Statutory Compliance, Payroll, Excise for Manufacturers, Multilingual Support, VAT Composition Returns, TDS, VAT (Value Added Tax), Rapid Implementation, Real Time Processing, Dynamic Interactive Reports and Unique Drill-Down Facility, Unlimited Companies and Periods of Accounting.
 - ◆ **SAP R/3:** It is ERP software, which allows an entity to integrate its business processes. ERP stands for Enterprise Resource Planning, which aims at better utilization of the resources and helps entity achieve better business performance. It has the features such as time management, reporting and analytics, budget monitoring, workflow approval, sales management, team management, leave management, travel management, recruitment management and demand planning. This is used by most of the large enterprises across the world and covers enterprise automation end-to-end.
 - ◆ **MS Office Applications:** These are various office automation systems made available by Microsoft Corporation which include MS Word, MS Excel, MS PowerPoint, MS Access, etc. Each of these software help to achieve automation of various tasks in the office. It has features such as customized ribbon, backstage view, built-in graphics toolset, enhanced security, excel spark lines, pivot for Excel, PowerPoint broadcast, Power Point compression, paste, preview and outlook conversation view.
 - ◆ **Attendance Systems:** Many attendance automation systems are available in the market. The application helps entity to automate the process of attendance tracking and report generation. It has features such as supervisor login access, holiday pay settings, labour distribution, employee scheduling and rounding, employee view time card, overtime settings, battery-backed employee database and optional door/gate access control.
 - ◆ **Vehicle Tracking System:** A lot of applications have been developed that allow entity to track their goods while in transit. Few applications are high end, allowing owner of goods to check the temperature of cold stored goods while in transit. It has features such as GPS based location, GPRS connection based real-time online data-logging and reporting, route accuracy on the fly while device is moving, real-time vehicle tracking, geo-fencing, SMS & e-mail notifications, over-the-air location query support, on-board memory to store

location inputs during times when GPRS is not available or cellular coverage is absent.

- ◆ **Automated Toll Collection Systems:** As India progresses through creation of the golden quadrilateral project, many toll booths have been built to collect tolls. Many toll booths allow users to buy pre-paid cards, where user need not stop in lane to pay toll charges, but just swipe / wave the card in front of a scanner. The system keeps the track of card and the number of time same has been swiped / waved. It has features such as real-time toll plaza surveillance system, automatic vehicle identification system (based on in-road sensors), license plate recognition, zoom capability on captured images, laser based toll audit systems, automated vehicle classification, transaction processing and violation enforcement.
- ◆ **Department Stores Systems:** The critical elements for managing departmental include the billing processes and inventory management. It has features such as point of sale, multi-channel operation, supplier database, products database, purchase ordering, management reporting, multiple promotions, loyalty schemes, stock control and inventory management.
- ◆ **Travel Management Systems:** This includes ticket booking for air, bus, train, hotel, etc; streamlined foreign travel approval process, configurable to match enterprise's foreign travel program, build-in and manage travel policy compliance, 'safe return' process for people tracking, traveler portal for up to date information, secure traveler profile information, online retrieval of e-tickets, reservations, visas & inoculation records, management of entry visas & medical requirements, front, mid and back office tools on a single, and web based platform.
- ◆ **Educational Institute Management Systems:** It has features such as student's registration, student's admission, fee collection, student's attendance, result management, result analysis, library management, HR management, staff attendance, payroll system, time-table management, financial accounting, assets management and MIS.
- ◆ **File Management System:** With increasing inventory of office files and records, many office automation systems have been developed. These allow office records to be kept in soft copy and easy tracking of the same. It has features such as web access, search, Microsoft office integration, records management software, electronic forms (e-forms), calendar, document version control, document scanning and imaging, check documents out/ check documents in, document "tagging" or metadata capture, virtual folders and document linking.

- ◆ **Other Systems:** The banking systems, the railway reservations systems and stock exchange systems are another good examples of business process automations achieved.

(b) **Programming Management Controls:** Program development and implementation is a major phase within the Systems Development Life Cycle. The primary objectives of this phase are to produce or acquire and to implement high-quality programs. The program development life cycle comprises six major phases – Planning; Design; Control; Coding; Testing; and Operation and Maintenance with Control phase running in parallel for all other phases. The purpose of the control phase during software development or acquisition is to monitor progress against plan and to ensure software released for production use is authentic, accurate, and complete.

Phases of Program Development Life Cycle

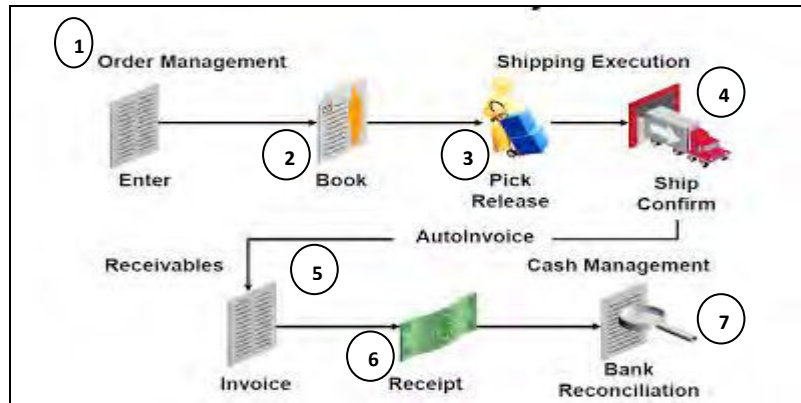
Phase	Controls
Planning	Techniques like Work Breakdown Structures (WBS), Gantt charts and PERT (Program Evaluation and Review Technique) Charts can be used to monitor progress against plan.
Design	A systematic approach to program design, such as any of the structured design approaches or object-oriented design is adopted.
Coding	Programmers must choose a module implementation and integration strategy (like Top-down, bottom-up and Threads approach), a coding strategy (that follows the percepts of structured programming), and a documentation strategy (to ensure program code is easily readable and understandable).
Testing	<p>Three types of testing can be undertaken:</p> <ul style="list-style-type: none"> • Unit Testing – which focuses on individual program modules; • Integration Testing – Which focuses in groups of program modules; and • Whole-of-Program Testing – which focuses on whole program. <p>These tests are to ensure that a developed or acquired program achieves its specified requirements.</p>
Operation and Maintenance	Management establishes formal mechanisms to monitor the status of operational programs so maintenance needs can be identified on a timely basis. Three types of maintenance can be used –

	Repair maintenance – in which program errors are corrected; Adaptive Maintenance – in which the program is modified to meet changing user requirements; and Perfective Maintenance - in which the program is tuned to decrease the resource consumption.
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5. (a) The general objectives of Auditing in a computerized environment could include the following objectives of manual (external/internal) audit although the extent of coverage could vary based on scope and objectives:
- ◆ **Existence:** Verify that the assets, liabilities, ownership, and/or activities are real;
 - ◆ **Authorization:** Verify that events have occurred in accordance with management`s intent;
 - ◆ **Valuation:** Verify that the accounting values fairly present items worth;
 - ◆ **Cutoff:** Verify that the transaction is re-coded in the proper accounting period;
 - ◆ **Compliance:** Verify that the processing is in compliance with governmental laws and regulations, generally accepted accounting procedures, and the organization`s policies and procedures;
 - ◆ **Operational:** Verify that the program, area, or activity is performed economically, efficient, and effectively;
 - ◆ Assisting management in finding ways to implementing internal control recommendations;
 - ◆ Participating in specifying and designing computer control and other features for systems to be installed;
 - ◆ Determining whether efficient use is made of the organization`s Computer resources; and
 - ◆ Determining whether Computer system used accomplishes the business objectives and goals.
- (b) Mobile devices provide the capability to conduct business anywhere and enable users to seamless communicate and access information whether they are in the office or anywhere. The change driven largely by video, web-browsing, gaming, and other entertainment related applications is one of the hottest trends in the consumer sector. Mobile computing enables enterprises to connect with their employees at all times resulting in increased productivity and a better return on investments. Some examples of business applications are as follows:
- ◆ There is increase in workforce productivity as mobile device enables employees to work from anywhere, anytime by accessing and updating

information as required. For example: employees can read/respond to emails using laptops, PDAs or smart phones from office, residence and even when on the move.

- ◆ Customer service can be improved by responding to customer queries on site or off site. For example: customer complaints can be accessed and responded by accessing past/latest information of client as required.
 - ◆ Incident management can be improved by resolving problems faster without limitation of time as the concerned employees can attend to these regardless of their location. For example: Computer breakdowns can be serviced by service engineers from their desks/outside by logging into the specific computer, identify problem and resolve it online.
 - ◆ Business processes can be transformed by using mobile devices. Enterprises can reengineer core business processes. The new and reengineered processes can focus on utilizing the key features of location and time independence. Enterprises can focus on providing customers and employees with access to information in different ways and provide the latest information. This enables employees, customers, and businesses to be available to one another as per their choice. For example: billing can be done by employees using hand held devices at customer site and the information updated online and deliveries to customers can be speeded up.
 - ◆ Enterprises can dynamically modify and update their offerings and offer new products and services altogether. For example: enterprises can implement telecommuting with flexible working hours and locations allowing for cost savings and better efficiency.
 - ◆ Mobile Computing gives users the freedom to roam, with access to data and services at any time and in any place. Most of the high-end ERP and business software applications for SMEs have in-built capabilities of mobile computing enabling users to access data. Used with proper security, enterprises can harness the power of this technology to create innovative opportunities for improving the quality and efficiency of business processes and services. Mobile devices are increasingly acquiring the must-have status for enterprises on account of the increasing acceptance as business tools.
6. (a) **Sales: Order to Cash (OTC or O2C) or Sales** covers all the business processes relating to fulfilling customer requests for goods or services. It involves transactional flow of data from the initial point of documenting a customer order to the final point of collecting the cash.



Order to cash process flow

The typical life cycle of a sales transaction that may include the following transactions as given below:

- (i) **Customer Order:** A purchase order is received from a customer specifying the type, quantity and agreed prices for products.
 - (ii) **Recording:** Availability of the items is checked and customer order is booked.
 - (iii) **Pick release:** The items are moved from the warehouse to the staging area.
 - (iv) **Shipping:** The items are loaded onto the carrier for transport to the customer.
 - (v) **Invoice:** Invoice of the transaction is generated and sent to the customer.
 - (vi) **Receipt:** Money is received from the customer against the invoices.
 - (vii) **Reconciliation:** The bank reconciliation of all the receipts is performed.
- (b) Key factors to be considered in implementing Business Process Management (BPM) are as follows:

Factors	Key Considerations
Scope	A single process, a department, the entire company
Goals	Process understanding, improvement, automation, re-engineering, optimization
Methods to be used	Six Sigma, BPM Life Cycle Method, TQM, Informal methods
Skills Required	Consultants, Train Employees, Formal Certification, Basic Education, Existing Skill sets
Tools to be used	White-Boards, Sticky Notes, Software For Mapping, Documenting, Software for Simulation, Comprehensive BPMS

Investments to Make	Training, Tools, Time
Sponsorship/ Buy-in Needed	Executive Level, Department Level, Process Owner Level, Employee Level

7. (a) **Data Flow in Data Flow Diagram (DFD):** Data flow is the movement of data between the entity, the process and the data store. Data flow portrays the interface between the components of the DFD. The flow of data in a DFD is named to reflect the nature of the data used (these names should also be unique within a specific DFD). Data flow is represented by an arrow, where the arrow is annotated with the data name.
- (b) **Registers in CPU:** These are high speed memory units within CPU for storing small amount of data (mostly 32 or 64 bits). Registers could be:
- **Accumulators:** They can keep running totals of arithmetic values.
 - **Address Registers:** They can store memory addresses which tell the CPU as to where in the memory an instruction is located.
 - **Storage Registers:** They can temporarily store data that is being sent to or coming from the system memory.
 - **Miscellaneous:** These are used for several functions for general purpose.
- (c) **Secure Socket Layer (SSL):** It is essentially a protocol that provides a secure channel between two machines operating over the Internet or an internal network. The SSL protocol is typically used when a web browser needs to securely connect to a web server over the inherently insecure Internet. In practice, SSL is used to secure online credit card transactions, system logins and any sensitive information exchanged online, to secure webmail and applications like Outlook Web Access, Exchange and Office Communications Server, to secure the connection between an email client such as Microsoft Outlook and an email server such as Microsoft Exchange, to secure intranet based traffic such as internal networks, file sharing, extranets, and database connections etc.
- (d) In a credit card transaction, the consumer presents preliminary proof of his ability to pay by presenting his credit card number to the merchant. The merchant can verify this with the bank, and create a purchase slip for the consumer to endorse. The merchant then uses this purchase slip to collect funds from the bank, and, on the next billing cycle; the consumer receives a statement from the bank with a record of the transaction.

Authorization is the first step in processing a credit card. After a merchant swipes the card, the data is submitted to merchant's bank, called an acquirer, to request authorization for the sale. The acquirer then routes the request to the card-issuing

bank, where it is authorized or denied, and the merchant is allowed to process the sale.

- (e) **Platform as a Service (PaaS):** PaaS delivery model allows a customer to rent virtualized servers and associated services used to run existing applications, or to design, develop, test, deploy and host applications. The consumer may create software using tools and/or libraries from the provider. The consumer may also control software deployment and configuration settings. The provider provides the networks, servers, storage, and other services. For example, AppScale allows a user to deploy some applications written for Google App Engine to their own servers.

MOCK TEST PAPER – 2

INTERMEDIATE (IPC): GROUP – II

PAPER – 7: INFORMATION TECHNOLOGY AND STRATEGIC MANAGEMENT

SECTION – B: STRATEGIC MANAGEMENT

SUGGESTED ANSWERS/HINTS

1. (a) No. All organizations have competition. Multinationals and large organizations clash directly on every level of product and service. Mid-sized and small business also chases same customers and finds that prices and product quality are bounded by the moves of their competitors. Even large public sector monopolies are gradually getting privatised and facing competition. The monopolies enjoyed by the Bharat Sanchar Nigam Ltd and Mahanagar Telephone Nigam Ltd have faded away after entry of private players. For a single business organization the competition spells out freedom of entry and exit in the market and affects its prices and scale of operations.
- (b) Peter F Drucker was of the view that businesses cannot be explained in terms of profit. The economic criterion of maximising profits for a firm has little relevance in the present times. Profit maximization, in simple terms is selling at a higher price than the cost. Profit maximization is subject to the long-term perspective and includes development of wealth and several non-financial factors such as goodwill, societal factors, relations and so on.
- (c) The thrust of operational control is on individual tasks or transactions as against total or more aggregative management functions. For example, procuring specific items for inventory is a matter of operational control, in contrast to inventory management as a whole. One of the tests that can be applied to identify operational control areas is that there should be a clear-cut and somewhat measurable relationship between inputs and outputs which could be predetermined or estimated with least uncertainty.
- (d) Augmented marketing refers to deliberate and accelerated efforts to get better marketing returns through additional means. It includes provision of additional customer services and benefits built around the care and actual products that relate to introduction of hi-tech services like movies on demand, on-line computer repair services, secretarial services, etc. Such innovative offerings provide a set of benefits that promise to elevate customer service to unprecedented levels.
- (e) Decision making is a managerial process and function of choosing a particular course of action out of several alternative courses for the purpose of accomplishment of the organizational goals. Decisions are routine, tactical or

strategic in nature. Strategic decisions are different from other decisions that are taken at various levels of the organization during day-to-day working of the organizations. They have long term implications, steer organisation to its future path and have organisation wide implications and so on. These decisions are taken considering different internal and external factors. They are also taken with partial or no definite knowledge of different factors affecting the decision situation.

- 2 (a) (i) **Correct:** Changes in strategy may require changes in structure as the structure dictates how resources will be allocated. Structure should be designed to facilitate the strategic pursuit of a firm and, therefore, should follow strategy. Without a strategy or reasons for being, companies find it difficult to design an effective structure.
- (ii) **Correct:** In vertically integrated diversification, firms opt to engage in businesses that are related to the existing business of the firm. It moves forward or backward in the chain and enters specific product with the intention of making them part of new businesses for the firm.
- (b) (i) 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.
- (ii) A strategic vision delineates organisation's aspirations for the business, providing a panoramic view of the position where the organisation is going. A strategic vision points an organization in a particular direction, charts a strategic path for it to follow in preparing for the future, and moulds organizational identity.
- (iii) Portfolio analysis can be defined as a set of techniques that help strategists in taking strategic decisions with regard to individual products or businesses in a firm's portfolio. It is primarily used for competitive analysis and corporate strategic planning in multi product and multi business firms.
- 3 (a) Socio-cultural environment consist of factors related to human relationships and the impact of social attitudes and cultural values which has bearing on the business of the organization. The beliefs, values and norms of a society determine how individuals and organizations should be interrelated. The core beliefs of a particular society tend to be persistent. It is difficult for businesses to change these core values, which becomes a determinant of its functioning.
- (b) Benchmarking is an approach of setting goals and measuring productivity based on best industry practices. It developed out of need to have information against which performances can be measured. It is a process of continuous improvement in search for competitive advantage. It measures a company's products, services and

practices against those of its competitors or other acknowledged leaders in their field.

- (c) A company exhibits strategic intent when it relentlessly pursues an ambitious strategic objective and concentrates its full resources and competitive actions on achieving that objective. A company's objectives sometimes play an other role – that of signaling unmistakable strategic intent to make quantum gains in competing against key rivals and establish itself as a clear-cut winner in the marketplace, often against long odds. A company's strategic intent can entail becoming the dominant company in the industry, unseating the existing industry leader, delivering the best customer service of any company in the industry (or the world), or turning a new technology into products capable of changing the way people work and live. Ambitious companies almost invariably begin with strategic intents that are out of proportion to their immediate capabilities and market positions. They set aggressive objectives and pursue them relentlessly, sometimes even obsessively.
4. The model has been used by General Electric Company (developed by GE with the assistance of the consulting firm McKinsey & Company) known as “Stop-Light” Strategy Model. This model is also known as Business Planning Matrix, GE Nine-Cell Matrix and GE Model. The strategic planning approach in this model has been inspired from traffic control lights. The lights that are used at crossings to manage traffic are: green for go, amber or yellow for caution, and red for stop. This model uses two factors while taking strategic decisions: Business Strength and Market Attractiveness. The vertical axis indicates market attractiveness and the horizontal axis shows the business strength in the industry. The market attractiveness is measured by a number of factors like:
1. Size of the market.
 2. Market growth rate.
 3. Industry profitability.
 4. Competitive intensity.
 5. Availability of Technology.
 6. Pricing trends.
 7. Overall risk of returns in the industry.
 8. Opportunity for differentiation of products and services.
 9. Demand variability.
 10. Segmentation.
 11. Distribution structure (e.g. retail, direct, wholesale) etc.
- Business strength is measured by considering the typical drivers like:
1. Market share.

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

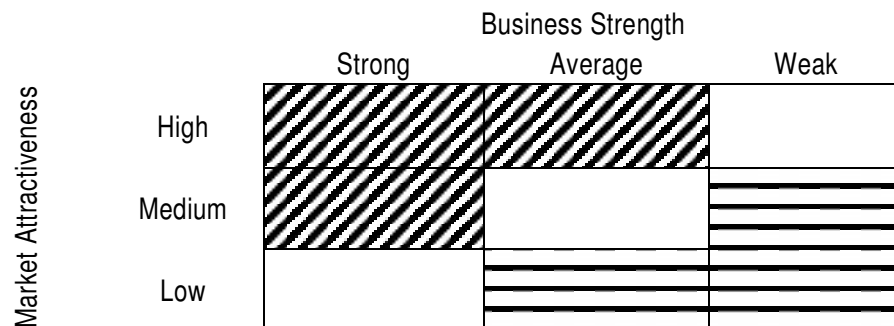
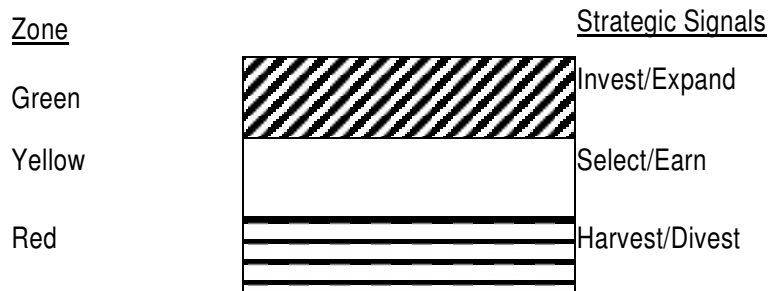


Figure : The GE Portfolio Matrix



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

5. The organisation can implement the desired changes in its structure, technology and people through three phases of the change process as given by Kurt Lewin. These stages are: **unfreezing, changing and refreezing**.
- (i) **Unfreezing the situation:** Unfreezing is the process of breaking down the old attitudes and behaviours, customs and traditions.
 - (ii) **Changing to new situation:** Once the unfreezing process has been completed, members' behaviour patterns need to be redefined. This can be done through compliance (through rewards and punishment), identification (impressing people to identify with new patterns) and internalisation (changing the thought processes)
 - (iii) **Refreezing:** Refreezing occurs when the new behaviour becomes a normal way of life replacing the former behaviour completely for successful and permanent change to take place.

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

- Create awareness on compelling reasons for change.
 - Steer the organization on the desired path with wide acceptance.
 - Implement and install the necessary changes in the desired manner for the overall benefit of the organisation.
 - Aim to stabilize the operation at a higher level of performance.
6. Action plan for turnaround strategy, an organization can implement:
- **Stage One – Assessment of current problems:** The first step is to assess the current problems and get to the root causes and the extent of damage the problem has caused. Once the problems are identified, the resources should be focused toward those areas essential to efficiently work on correcting and repairing any immediate issues.
 - **Stage Two – Analyze the situation and develop a strategic plan:** Before you make any major changes; determine the chances of the business's survival. Identify appropriate strategies and develop a preliminary action plan. For this one should look for the viable core businesses, adequate bridge financing and available organizational resources. Analyze the strengths and weaknesses in the areas of competitive position. Once major problems and opportunities are identified, develop a strategic plan with specific goals and detailed functional actions.
 - **Stage Three – Implementing an emergency action plan:** If the organization is in a critical stage, an appropriate action plan must be developed to stop the bleeding

and enable the organization to survive. The plan typically includes human resource, financial, marketing and operations actions to restructure debts, improve working capital, reduce costs, improve budgeting practices, prune product lines and accelerate high potential products. A positive operating cash flow must be established as quickly as possible and enough funds to implement the turnaround strategies must be raised.

- **Stage Four – Restructuring the business:** The financial state of the organization's core business is particularly important. If the core business is irreparably damaged, then the outlook for the entire organization may be bleak. Prepare cash forecasts, analyze assets and debts, review profits and analyze other key financial functions to position the organization for rapid improvement.

During the turnaround, the "product mix" may be changed, requiring the organization to do some repositioning. Core products neglected over time may require immediate attention to remain competitive. Some facilities might be closed; the organization may even withdraw from certain markets to make organization leaner or target its products toward a different niche.

The 'people mix' is another important ingredient in the organization's competitive effectiveness. Reward and compensation systems that encourage dedication and creativity encourage employees to think profits and return on investments.

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

7. The critical elements of six sigma can be put into six themes as follows:

- **Theme one – genuine focus on the customer:** Companies launching six sigma often to find that how little they really understand about their customers. In six sigma, customer focus becomes the top priority. For example, the measures of six sigma performance begin with the customer. Six sigma improvements are defined by their impact on customer satisfaction and value.
- **Theme two – data and fact-driven management:** Six sigma takes the concept 'of "management by fact" to a new, more powerful level. Despite the attention paid in recent years to improved information systems, knowledge management, and so on, many business decisions are still being based on opinions, assumptions and gut feeling. Six sigma discipline begins by clarifying what measures are key to gauging business performance and then gathers data and analyzes key variables. Problems are effectively defined, analyzed, and resolved. Six sigma also helps managers to answer two essential questions to support data-driven decisions and solutions.

What data/information is really required?

How to use the data/information for maximum benefit?

- **Theme three** – *processes are where the action is* Designing products and services, measuring performance, improving efficiency and customer satisfaction and so on. Six sigma positions the process as the key vehicle of success. One of the most remarkable breakthroughs in Six Sigma efforts to date has been convincing leaders and managers. Process may relate to build competitive advantage in delivering value to customers.
- **Theme four** – *proactive management*: In simple terms, being proactive means acting in advance of events rather than reacting to them. In the real world, though, proactive management means making habits out of what are, too often, neglected business practices: defining ambitious goals and reviewing them frequently, setting clear priorities, focusing on problem prevention rather than fire-fighting, and questioning why we do things instead of blindly defending them.

Far from being boring or overly analytical, being truly proactive is a starting point for creativity and effective change. Six sigma, encompasses tools and practices that replace reactive habits with a dynamic, responsive, proactive style of management.
- **Theme five** – *boundaryless collaboration*: "Boundarylessness" is one of Jack Welch's mantras for business success. Years before launching six sigma, GE's chairman was working to break barriers and to improve teamwork up, down, and across organizational lines. The opportunities available through improved collaboration within companies and with vendors and customers are huge. Billions of dollars are lost every day because of disconnects and outright competition between groups that should be working for a common cause: providing value to customers.
- **Theme six** – *drive for perfection; tolerate failure*: Organizations need to make efforts to achieve perfection and yet at the same time tolerate failure. In essence, though, the two ideas are complementary. No company will get even close to six sigma without launching new ideas and approaches-which always involve some risk. Six sigma cannot be implemented by individuals who are overly cautious and are scared of making mistakes.