

Test Series: September, 2016

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: Three hours)

(Maximum marks: 100)

1. (a) Path Ltd. purchased a fixed asset for US \$ 50 lakhs on 01.04.2014 and the same was fully financed by the foreign currency loan [i.e. US \$] repayment in five equal instalments annually. (Exchange rate at the time of purchase was 1 US \$=Rs. 60]. As on 31.03.2015 the first instalment was paid when 1 US \$ fetched Rs. 62.00. The entire loss on exchange was included in cost of goods sold. Path Ltd. normally provides depreciation on fixed assets at 20% on WDV basis and exercised the option to adjust the cost of asset for exchange difference arising out of loan restatement and payment. Calculate the amount of exchange loss and its treatment.
- (b) Power Ltd. has acquired a generator on 1.4.2013 for Rs. 100 lakhs. On 2.4.2013, it applied to Indian Renewal Energy Development Authority (IREDA) for a subsidy. The subsidy was granted in June, 2014 after the accounts for 2013-14 were finalized. The company has not accounted for the subsidy for the year ended 31.3.2014.
State
 - (i) Is this a prior period item?
 - (ii) How should the subsidy be accounted in the accounting year 2014-15?
- (c) F Ltd. has finalized their financial statements for the year ending 31st March, 2015 and approved by their approving authority on 30th June, 2015.
 - (1) A major fire broke out in the night of 31st May, 2015 destroying factory premises. Loss of property estimated to be Rs. 25 lakhs.
 - (2) Negotiations with another company started in April 2015 for acquisition of two manufacturing units which may involve additional investments of Rs. 50 lakhs.
 - (3) Foreign exchange loss during the period 1st April, 2015 and 1st June 2015 has resulted that assets being reduced by Rs. 30 lakhs.

You are requested to state how to deal with the above information in the annual accounts.

- (d) Ryan International Limited has given a machinery on lease for 36 months, and its useful life is 60 months. Cost & fair market value of the machinery is Rs. 5,00,000. The amount will be paid in 3 equal annual installments and the lessee will return the machinery to lessor at termination of lease. The unguaranteed residual value at the end of 3 years is Rs. 50,000. IRR of investment is 10% and present value of annuity factor of Rs. 1 due at the end of 3 years at 10% IRR is 2.4868 and present value of Rs. 1 due at the end of 3rd year at 10% IRR is 0.7513.

You are required to comment with reason whether the lease constitute finance lease or operating lease. (4 x 5 = 20 Marks)

2. Aman, Baal and Chand share profits and losses of a business as to 3:2:1 respectively. Their balance sheet as at 31st March, 2016 was as follows:

Liabilities	Rs.	Assets	Rs.
Capital Accounts:		Goodwill	10,000
Aman	70,000	Land	20,000
Baal	80,000	Buildings	1,10,000
Chand	10,000	Machinery	50,000
General Reserve	18,000	Motor Car	28,000
Investment Fluctuation Fund	4,000	Furniture	12,000
Chand's Loan	33,000	Investments	18,000
Mrs. Aman's loan	15,000	Loose tools	7,000
Creditors	96,000	Stock	18,000
Bills Payable	14,000	Bills receivable	20,000
Bank overdraft	60,000	Debtors: 40,000	
		Less: Provision <u>2,000</u>	38,000
		Cash	1,000
		Chand's current A/c	56,000
		Profit and Loss A/c	<u>12,000</u>
	<u>4,00,000</u>		<u>4,00,000</u>

The partners decide to convert their firm into a Joint Stock Company. For this purpose ABC Ltd. was formed with an authorized capital of Rs. 10,00,000 divided into Rs. 100 equity Shares. The business of the firm was sold to the company as at the date of balance sheet given above on the following terms:

- (i) Motor car, furniture, investments, loose tools, debtors and cash are not to be taken over by the company.
- (ii) Liabilities for bills payable and bank overdraft are to be taken over by the company.
- (iii) The purchase price is settled at Rs. 1,95,500 payable as to Rs. 75,500 in cash and the balance in company's fully paid shares of Rs. 100 each.
- (iv) The remaining assets and liabilities of the firm are directly disposed of by the firm as per details given below:

Investments are taken over by Aman for Rs. 13,000; debtors realize in all Rs. 20,000; Motor Car, furniture and loose tools fetch Rs. 24,000, Rs. 4,000, and Rs. 1,000 respectively. Aman agrees to pay his wife's loan. The creditors were paid Rs. 94,000 in final settlement of their claims. The realization expenses amount to Rs. 500.

- (v) The equity share received from the vendor company are to be divided among the partners in profit-sharing ratio.

You are required to prepare the necessary ledger accounts. (16 Marks)

3. (a) On 31st March, 2016 the books of Shah Insurance Company Limited, contained the following particulars in respect of fire insurance:

Particulars	Amount Rs.
Reserve for unexpired risks on March 31, 2015	10,00,000
Additional Reserve for unexpired risks on March 31, 2015	2,00,000
Premiums	22,40,000
Claims paid	12,80,000
Estimated liability in respect of outstanding claims:	
On March 31, 2015	1,30,000
On March 31, 2016	1,80,000
Expenses of management (including Rs. 60,000 legal expenses paid in connection with the claims)	5,60,000
Interest and dividend (Gross)	1,28,500
Income tax on the above	13,040
Profit on sale of investments	22,000
Commission paid	3,04,000

On 31st March, 2016 provide Rs. 11,20,000 as unexpired risk reserve and Rs. 1,50,000 as additional reserve.

You are required to prepare the Fire Insurance Revenue account as per the regulations of IRDA, for the year ended 31st March, 2016.

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

From Department A to Department B 10% above cost

From Department A to Department D 20% above cost

From Department C to Department D 20% above cost

From Department C to Department B 20% above cost

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

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

(10 + 6 = 16 Marks)

4. The following figures have been taken from the books of Centura Bank Limited as on 31st March, 2016:

	Rs.
Paid up share capital	20,00,000
Interest and discount received	74,11,000
Interest paid on deposits	40,74,000
Salaries and allowances	4,00,000
Rent and taxes paid	1,80,000

Directors' fees and allowances	60,000
Statutory reserve fund	16,00,000
Postages and telegrams	1,20,000
Rent received	1,30,000
Commission, exchange and brokerage	3,80,000
Profit on sale of investments	4,00,000
Depreciation on bank's property	60,000
Law charges	80,000
Auditors' fees	10,000

The following additional information is given to you:

- (i) One customer to whom a sum of Rs. 20 lakhs was advanced has become insolvent and it is expected that only 50% of the amount will be recovered from his estate.
- (ii) Auditors find that a provision of Rs. 3 lakhs is necessary against other debts.
- (iii) Rebate on bills discounted on 31st March, 2015 was Rs. 24,000 and on 31st March, 2016 was Rs. 32,000.
- (iv) Provide Rs. 13,00,000 for income tax.
- (v) The Board of Directors decides to declare dividend @ 10% after transfer of 25% of the year's profit to Statutory Reserve.

You are required to prepare Profit and Loss Account of the bank with all the necessary schedules for the year ended 31st March, 2016. Ignore figures for the previous year and corporate dividend tax. (16 Marks)

5. (a) From the following particulars relating to Pune branch for the year ending December 31, 2015, prepare Branch Account in the books of Head office.

	Rs.
Stock at Branch on January 1, 2015	10,000
Branch Debtors on January 1, 2015	4,000
Branch Debtors on Dec. 31, 2015	4,900
Petty cash at branch on January 1, 2015	500
Furniture at branch on January 1, 2015	2000
Prepaid fire insurance premium on January 1, 2015	150
Salaries outstanding at branch on January 1, 2015	100
Good sent to Branch during the year	80,000
Cash Sales during the year	1,30,000

Credit Sales during the year		40,000
Cash received form debtors		35,000
Cash paid by the branch debtors directly to the Head Office		2,000
Discount allowed to debtors		100
Cash sent to branch for Expenses:		
Rent	2,000	
Salaries	2,400	
Petty Cash	1,000	
Insurance up to March 31, 2016	<u>600</u>	6,000
Goods returned by the Branch		1,000
Goods returned by the debtors		2,000
Stock on December 31,2015		5000
Petty Cash spent by branch		850
Provide depreciation on furniture 10% p.a.		

Goods costing Rs. 1,200 were destroyed on account of fire and a sum of Rs. 1,000 was received from the Insurance Company.

- (b) Alia Ltd. took over the assets of Rs. 5,00,000 and creditors of Rs. 70,000 of Bharat & Co. for an agreed amount of Rs. 5,50,000 by the issue of fully paid 12% Debentures of Rs. 100 each at a premium of 10%. These Debentures are redeemable at a premium of 5% after 3 years. Pass the necessary journal entries both at the time of issue and Redemption of Debentures without providing for the interest.
(10 + 6 = 16 Marks)

6. The summarized Balance Sheet of Reckless Ltd. as on 31st March, 2015 is as follows:

		Rs.
Assets:		
Freehold premises		2,20,000
Machinery		1,77,000
Furniture & fittings		90,800
Inventory		3,87,400
Trade receivables	95,000	
Less: Provision for doubtful debts	<u>(4,000)</u>	91,000
Cash in hand		2,300
Cash at bank		<u>1,56,500</u>
		<u>11,25,000</u>

Liabilities:		
60,000 Equity shares of Rs.10 each		6,00,000
Pre-incorporation profit		21,000
Contingency reserve		1,35,000
Profit and loss account		1,26,000
Trade payables		1,33,000
Provision for income-tax		<u>1,10,000</u>
		<u>11,25,000</u>

Trade receivables consist of debtors amounting Rs. 80,000 and bill receivables worth Rs. 15,000. Trade payables consist of creditors amounting to Rs. 1,13,000 and acceptances worth Rs. 20,000.

Careful Ltd. decided to take over Reckless Ltd. from 31st March, 2015 with the following assets at value noted against them:

	Rs.
Bills receivable	15,000
Freehold premises	4,00,000
Furniture and fittings	80,000
Machinery	1,60,000
Stock	3,45,000

$\frac{1}{4}$ of the consideration was satisfied by the allotment of fully paid preference shares of Rs. 100 each at par which carried 13% dividend on cumulative basis. The balance was paid in the form of Careful Ltd's equity shares of Rs. 10 each, Rs. 8 paid up.

Sundry Debtors realised Rs. 79,500. Acceptances were settled for Rs. 19,000. Income-tax authorities fixed the taxation liability at Rs. 1,11,600. Creditors were finally settled with the cash remaining after meeting liquidation expenses amounting to Rs.4,000.

You are required to :

- Calculate the number of equity shares and preference shares to be allotted by Careful Ltd. in discharge of consideration.
- Prepare the important ledger accounts in the books of Reckless Ltd. (16 Marks)

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

- From the following information, you are required to compute the basic and adjusted earnings per share:

Net profit for 2013-14	11 lakh
Net profit for 2014-15	15 lakh

No. of shares issued before rights issue	5 lakhs
Right issue	One for every 5 held
Right issue price	15 per share
Last date of exercising right option	1-06-2014
Fair value of shares before right issue	21 per share

- (b) On 31-03-2015, the Balance Sheet of Alpha Ltd. shows an item of Intangible assets at Rs. 30 Lakhs. The asset was acquired on 1-4-2010 for Rs. 80 lakhs and was available for use on that date. The company has been following a policy of amortizing intangible assets over a period of 8 years on straight line basis. How you will deal in the books of accounts if the company determines by applying the best estimate of its useful life on 1-4-2015, and the amortization period to be 10 years, being the best estimate of its useful life from the date, it was available for use.
- (c) A company capitalizes interest cost of holding investments and adds to cost of investment every year, thereby understating interest cost in profit and loss account. State whether the accounting done by the company is usual or not?
- (d) What financial disclosures and returns are required to be filed by an LLP as per the LLP Act, 2008?
- (e) Beta Ltd. has its share capital divided into shares of Rs. 10 each. On 1st April, 2015, it granted 25,000 employees stock options at Rs. 50 when the market price was Rs. 140 per share. The options were to be exercised between 1st January, 2016 and 28th February, 2016. The employees exercised options for 24,000 shares only; the remaining options lapsed. The company closes its books of account on 31st March every year. You are required to show necessary journal entries reflecting these transactions.
(4 x 4 = 16 Marks)

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

1. (a) Exchange differences arising on restatement or repayment of liabilities incurred for the purpose of acquiring fixed assets should be adjusted in the carrying amount of the respective fixed assets as Path Ltd. has exercised the option and it is long term foreign currency monetary item.

Thus, the entire exchange loss due to variation of Rs. 20 lakhs on 31.03.2015 on payment of US \$ 10 lakhs, should be added to the carrying amount of fixed assets and not to the cost of goods sold.

Calculation of Exchange loss:

Foreign currency loan (in Rs.) = (50 lakhs \$ x Rs. 60) = Rs. 3,000 lakhs

Exchange loss on outstanding loan on 31.03.2015 = Rs. 40 lakhs US \$ x (62.00-60.00) = Rs. 80 lakhs.

So, Rs. 80 lakhs should also be added to cost of fixed asset with corresponding credit to outstanding loan in addition to Rs. 20 lakhs on account of exchange loss on payment of instalment. The total cost of fixed asset to be increased by Rs. 100 lakhs.

Total depreciation to be provided for the year 2014-15 = 20% of (Rs. 3,000 lakhs + 100 lakhs) = Rs. 620 lakhs.

- (b) (i) Whether a subsidy applied is to be classified as prior period item as per AS 5, depends upon whether the company has committed an error in 2013-14 by not recognising the subsidy? The answer is in para 13 of AS 12 "Accounting for Government Grants" which permits recognition of grant only when there is reasonable assurance that (i) the enterprise will comply with the conditions attached to them and (ii) the subsidy will be received. Mere making of an application does not provide the reasonable assurance that the subsidy will be received. Letter of sanction from IREDA is required to provide this assurance. Since, the subsidy was granted in June, 2014 after approval of accounts, non-recognition of grant in 2013-14 will not be considered as an error. Hence, this is not a prior period item. Therefore, the company was right in not recognizing the grant.

Further, AS 4 requires adjustment of events occurring after the balance sheet date only upto the date of approval of accounts by the Board of Directors. In

view of this, the company is correct in not adjusting the same in the accounts in the year 2013-14.

- (ii) The subsidy should be deducted from the cost of the generator. The revised unamortised amount of generator should be written off over the remaining useful life.

Alternatively, the same may be treated as Deferred Income and allocated over the remaining useful life in the proportion in which depreciation is charged.

- (c) For the information given, the following will be recommended treatment with reference to the provisions of AS 4: Contingencies and Events Occurring After the Balance Sheet Date.

(1) The event is a non-adjusting event since it occurred after the year-end and does not relate to the conditions existing at the year-end. However, the event would appear to be of such significance as to require a disclosure in the report of the approving authority to enable users of the financial statements to make proper evaluation and decision, hence, such disclosure is recommended.

(2) AS 4 defines events occurring after the balance sheet date as those significant event- both favorable and unfavorable – that occur between the balance sheet date and the date on which the financial statements are approved by the approving authority. Accordingly, negotiation for acquisitions of two manufacturing units which started on 30th April, 2015 should be disclosed in the Board's Report. No adjustments of assets and liabilities are required, as the negotiation does not affect the determination and the conditions of the amounts stated in the financial statements for the year ended 31st March, 2015.

(3) The foreign exchange loss due to changes in exchange rates during the period 1st April 2015 and 1st June 2015, is a non adjusting event since it does not relate to the conditions existing at the balance sheet date. The amount of loss appears material and may be of such significance that requires disclosure in the report of the approving authority.

(d) Determination of Nature of Lease

Present value of unguaranteed residual value at the end of 3rd year

$$= \text{Rs. } 50,000 \times 0.7513 = \text{Rs. } 37,565$$

Present value of lease payments

$$= \text{Rs. } 5,00,000 - \text{Rs. } 37,565$$

$$= \text{Rs. } 4,62,435$$

The percentage of present value of lease payments to fair value of the equipment is $(\text{Rs. } 4,62,435 / \text{Rs. } 5,00,000) \times 100 = 92.487\%$.

Since, it substantially covers the major portion of the lease payments, the lease constitutes a finance lease.

2.

Realisation Account

Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
To Goodwill		10,000	By provision to doubtful Debts		2,000
To land		20,000	By Trade creditors		96,000
To Buildings		1,10,000	By Bills Payable		14,000
To Machinery		50,000	By Bank overdraft		60,000
To Motor Car		28,000	By Mrs. Aman's loan		15,000
To Furniture		12,000	By ABC Ltd. (Purchase price)		1,95,500
To Investments		18,000	By Aman's Capital A/c (Investments)		13,000
To Loose tools		7,000	By Cash A/c:		
To Stock		18,000	Debtors	20,000	
To Bill receivable		20,000	Motor Car	24,000	
To Debtors		40,000	Furniture	4,000	
To Aman's Capital A/c (Mrs. Aman's Loan)		15,000	Loose tools	<u>1,000</u>	49,000
To Cash A/c:					
Creditors	94,000				
Realisation expenses	<u>500</u>	94,500			
To Profit on Realisation t/f to:					
Aman's Capital A/c	1,000				
Baal's Capital A/c	667				
Chand's Capital A/c	<u>333</u>	<u>2,000</u>			
		4,44,500			<u>4,44,500</u>

ABC Ltd. Account

Particulars	Rs.	Particulars	Rs.
To Realisation A/c	1,95,500	By Cash A/c	75,500
	<u> </u>	By Shares in ABC Ltd.	<u>1,20,000</u>
	1,95,500		1,95,500

Partners' Capital Accounts

Particulars	Aman Rs.	Baal Rs.	Chand Rs.	Particulars	Aman Rs.	Baal Rs.	Chand Rs.
To Profit and Loss A/c	6,000	4,000	2,000	By Balance b/d	70,000	80,000	10,000
To Realisation A/c	13,000	-	-	By Chand's Loan A/c	-	-	33,000
To Chand's Current A/c	-	-	56,000	By General reserve	9,000	6,000	3,000
To shares in ABC Ltd.	60,000	40,000	20,000	By Investment Fluctuation Fund	2,000	1,333	667
To Cash A/c	18,000	44,000	-	By Realization A/c	1,000	667	333
				By Realisation A/c (Mrs. Aman's loan A/c)	15,000	-	-
				By Cash A/c	-	-	31,000
	<u>97,000</u>	<u>88,000</u>	<u>78,000</u>		<u>97,000</u>	<u>88,000</u>	<u>78,000</u>

Chand's Current Account

Particulars	Rs.	Particulars	Rs.
To Balance b/d	<u>56,000</u>	By Chand's Capital A/c-transfer	<u>56,000</u>
	<u>56,000</u>		<u>56,000</u>

Shares in ABC Ltd. Account

Particulars	Rs.	Particulars	Rs.
To ABC Ltd. Account	1,20,000	By Aman's Capital A/c	60,000
		By Baal's Capital A/c	40,000
		By Chand's Capital A/c	20,000
	1,20,000		1,20,000

Cash Account

Particulars	Rs.	Particulars	Rs.
To Balance b/d	1,000	By Realisation A/c (Liabilities and expenses)	94,500
To ABC Ltd.	75,500	By Aman's Capital A/c	18,000

To Realisation A/c (sale of assets)	49,000	By Baal's Capital A/c	44,000
To Chand's Capital A/c	<u>31,000</u>		<u>-</u>
	<u>1,56,500</u>		<u>1,56,500</u>

Note: Investment Fluctuation Fund Account may be transferred to Realisation Account.

3. (a)

FORM B- RA

Name of the Insurer: Shah Insurance Company Limited

Registration No. and Date of registration with IRDA:

Revenue Account for the year ended 31st March, 2016

<i>Particulars</i>	<i>Schedule</i>	<i>Amount (Rs.)</i>
Premium earned (net)	1	21,70,000
Profit or loss on sale/redemption of investment		22,000
Others		-
Interest dividend & rent (Gross)		<u>1,28,500</u>
Total (A)		<u>23,20,500</u>
Claim incurred (Net)	2	13,90,000
Commission	3	3,04,000
Operating expenses related to insurance	4	<u>5,00,000</u>
Total (B)		<u>21,94,000</u>
Operating profit/loss from fire insurance business		<u>1,26,500</u>
Schedule -1 (Premium earned net)		Rs.
Premium received		22,40,000
Less: Adjustment for change in Reserve for Unexpired risk (as per W.N.)		<u>70,000</u>
Total premium earned		<u>21,70,000</u>
Schedule -2 (Claims incurred net)		
Claim paid		12,80,000
Add: Legal expenses regarding claims		<u>60,000</u>
		13,40,000
Add: Claims outstanding as on 31st March 2016		<u>1,80,000</u>
		15,20,000
Less: Claims outstanding as on 31st March 2015		<u>1,30,000</u>
		<u>13,90,000</u>

Schedule-3 (Commission)	
Commission paid	3,04,000
Schedule-4 (Operating expenses related to Insurance Business)	-
Expenses of management (5,60,000 – 60,000)	5,00,000

Working Note:

Calculation for change in Reserve for Unexpired risk:		Rs.
As on 31 st March, 2016:		
Reserve for Unexpired Risk	11,20,000	
Additional Reserve	<u>1,50,000</u>	12,70,000
Less: Reserve for Unexpired risks as on 31 st March, 2015	10,00,000	
Additional reserve as on 31 st March, 2015	<u>2,00,000</u>	<u>(12,00,000)</u>
		<u>70,000</u>

Note: Interest and dividends are shown at gross value in Revenue A/c. Income tax on the above will not be included in Revenue A/c of an insurance company.

(b) Statement showing the recomputation of Departmental Profit or Loss

	Particulars	A Rs.	B Rs.	C Rs.	D Rs.
A	Final Profit/(Loss) (Computed earlier)	(38,000)	50,400	72,000	1,08,000
B	Add: Departmental Manager's Commission @ 10% of Deptt. Profit subject to a minimum of Rs. 6,000 [Working Note (i)]	6,000	6,000	8,000	12,000
C	Profit before Deptt. Manager's commission (A+B)	(32,000)	56,400	80,000	1,20,000
D	Less: Profit earned through transfer of goods at loaded price remaining in stock at transfer department (W.N. 2)	<u>(2,200)</u>	—	<u>(8,600)</u>	—
E	Correct Departmental Profit (before manager's commission)(C-D)	(34,200)	56,400	71,400	1,20,000
F	Less: Manager's commission @ 10% of profit subject to a minimum of Rs. 6,000	<u>(6,000)</u>	<u>(6,000)</u>	<u>(7,140)</u>	<u>(12,000)</u>
G	Departmental Profit after Manager's commission (E-F)	(40,200)	50,400	64,260	1,08,000

Working Note:**1. Manager's Commission:**

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

2. Unrealised Profit on stock transfer:

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

4.

Centura Bank Limited**Profit and Loss account for the year ended 31st March, 2016**

		Schedule No.	Year ended 31.3.2016
			Rs.
I.	<u>Income</u>		
	Interest earned	13	74,03,000
	Other income	14	<u>9,10,000</u>
			<u>83,13,000</u>
II.	<u>Expenditure</u>		
	Interest expended	15	40,74,000
	Operating expenses	16	9,10,000
	Provisions and contingencies (W.N.2)		<u>26,00,000</u>

		<u>75,84,000</u>
III.	<u>Profit</u>	
	Net profit for the year	7,29,000
	Profit brought forward	<u>-</u>
		<u>7,29,000</u>
IV.	<u>Appropriations</u>	
	Transfer to Statutory Reserve	1,82,250
	Proposed dividend	2,00,000
	Balance carried over to balance sheet	<u>3,46,750</u>
		<u>7,29,000</u>

Schedule 13 – Interest earned

	Rs.
Interest and discount earned (W.N.1)	<u>74,03,000</u>
	<u>74,03,000</u>

Schedule 14 - Other Income

	Rs.
Commission, exchange and brokerage	3,80,000
Profit on sale of investment	4,00,000
Rent	<u>1,30,000</u>
	<u>9,10,000</u>

Schedule 15-Interest Expended

	Rs.
Interest paid on deposits	<u>40,74,000</u>
	<u>40,74,000</u>

Schedule 16-Operating Expenses

	Rs.
Payment and provisions for employees	4,00,000
Rent and taxes paid	1,80,000
Depreciation on bank's property	60,000
Directors' fees and allowances	60,000
Auditors' fees	10,000

Law charges	80,000
Postage and Telegrams	<u>1,20,000</u>
	<u>9,10,000</u>

Working Notes:

		Rs.
1.	Calculation of interest earned	
	Interest and discount received	74,11,000
	<i>Add:</i> Rebate on bills discounted as on 31 st March, 2013	<u>24,000</u>
		74,35,000
	<i>Less:</i> Rebate on bills discounted as on 31 st March, 2014	<u>(32,000)</u>
		<u>74,03,000</u>
2.	Provisions and Contingencies	
	Provision for doubtful debts:	
	Doubtful debts due to insolvency of a customer (50% of Rs. 20 lakhs)	10,00,000
	Provision for other debts	<u>3,00,000</u>
	Provision for income tax	<u>13,00,000</u>
		<u>26,00,000</u>

5. (a)

Pune Branch Account

Particulars		Rs.	Particulars	Rs.	Rs.
To Opening Balance			By Opening Balance:		
Stock		10,000	Salaries outstanding		100
Debtors		4,000	By Remittances:		
Petty Cash		500	Cash sales	1,30,000	
Furniture		2,000	Cash received from debtors	35,000	
Prepaid Insurance		150	Cash paid by debtors directly to H.O.	2,000	
To Goods sent to Branch Account		80,000	Received from Insurance Company	<u>1,000</u>	1,68,000
To Bank (expenses)			By Goods sent to branch (return of goods by the branch to H.O.)		1,000
Rent	2,000		By Closing Balances:		

Salaries	2,400		Stock		5,000
Petty Cash	1,000		Petty Cash		650
Insurance	<u>600</u>	6,000	Debtors		4,900
To Net Profit		78,950	Furniture (2,000 10% depreciation)	–	1,800
			Prepaid insurance (1/4 x Rs. 600)		150
		<u>1,81,600</u>			<u>1,81,600</u>

Working Note:

Calculation of petty cash balance at the end:	Rs.
Opening balance	500
Add: Cash received form the Head Office	<u>1,000</u>
Total Cash with branch	1,500
Less : Spent by the branch	<u>850</u>
Closing balance	<u>650</u>

(b)

Journal of Alia Ltd.

			(Rs.)	(Rs.)
1	Sundry Assets A/c	Dr.	5,00,000	
	Goodwill [Balancing Figure]	Dr.	1,20,000	
	To Creditors			70,000
	To Bharat & Co.			5,50,000
	(Being the purchase of Business from Bharat & Co.)			
2	Bharat & Co.	Dr.	5,50,000	
	Loss on Issue of Debentures A/c	Dr.	25,000	
	To 12% Debentures A/c			5,00,000
	To Securities Premium A/c			50,000
	To Premium on Redemption of Debenture A/c			25,000
	(Being the issue of 5000, 12% Debentures at a premium of 10% and repayable at a premium of 5%)			
4	Profit & Loss A/c	Dr.	1,25,000	
	To Debenture Redemption Reserve A/c			1,25,000

	(Being the creation of DRR @ 25% of the value of debentures issued)			
5	Debenture Redemption Reserve Investments A/c To Bank A/c	Dr.	75,000	75,000
	(Being the DRR Investments made equal to 15% of the value of debentures)			
6	Bank A/c To Debenture Redemption Reserve Investments A/c	Dr.	75,000	75,000
	(Being the DRR investments realized)			
7	12% Debentures A/c	Dr.	5,00,000	
	Premium on Redemption of Debentures A/c To Debentureholders A/c	Dr.	25,000	5,25,000
	(Being the amount due on redemption)			
8	Debentureholders A/c To Bank A/C	Dr.	5,25,000	5,25,000
	(Being the payment made to Debentureholders)			
9	Debenture Redemption Reserve A/c To General Reserve	Dr.	1,25,000	1,25,000
	(Being the transfer of DRR to General Reserve)			

6. (i) **Calculation of the number of equity shares and preference shares to be allotted by Careful Ltd. in discharge of purchase consideration**

Calculation of purchase consideration:	Rs.
Agreed value of assets taken over:	
Bills receivable	15,000
Freehold premises	4,00,000
Furniture & fittings	80,000
Machinery	1,60,000
Inventory	<u>3,45,000</u>
	<u>10,00,000</u>

Discharge of purchase consideration:

1. Amount paid by allotment of 13% preference shares

$$= \text{Rs. } 10,00,000 \times \frac{1}{4} = \text{Rs. } 2,50,000$$

Number of 13% preference shares of Rs. 100 each

$$= \frac{2,50,000}{100} = 2,500 \text{ preference shares}$$

2. Amount paid by allotment of equity shares

$$= \text{Rs. } 10,00,000 - \text{Rs. } 2,50,000 = \text{Rs. } 7,50,000$$

Paid up value of one equity share = Rs. 8 each

Hence, the number of equity shares allotted =

$$\frac{\text{Rs. } 7,50,000}{\text{Rs. } 8} = 93,750 \text{ equity shares}$$

(ii) Ledger accounts in the books of Reckless Ltd.**Realisation Account**

		Rs.			Rs.
To	Freehold Premises	2,20,000	By	Creditors	1,13,000
To	Machinery	1,77,000	By	Acceptances	20,000
To	Furniture & Fittings	90,800	By	Provision for tax	1,10,000
To	Inventory	3,87,400	By	Provision for doubtful debts	4,000
To	Sundry Debtors	80,000	By	Careful Ltd.	10,00,000
To	Bills Receivable	15,000	By	Cash/Bank:	
To	Cash/ Bank:			Sundry Debtors	79,500
	Acceptances	19,000			
	Provision for tax	1,11,600			
	Creditors	1,03,700			
To	Cash/Bank:				
	Liquidation expenses	4,000			
To	Profit	<u>1,18,000</u>			
		<u>13,26,500</u>			<u>13,26,500</u>

Cash and Bank Account

		Rs.			Rs.
To	Balance b/d	1,56,500	By	Realisation A/c	19,000

	(cash at bank)			(Acceptances)	
To	Cash in hand	2,300	By	Provision for tax	1,11,600
To	Realisation A/c	79,500	By	Realisation (Expenses)	4,000
		_____	By	Realisation A/c [Creditors (bal fig.)]	<u>1,03,700</u>
		<u>2,38,300</u>			<u>2,38,300</u>

Equity Shareholders Account

		Rs.			Rs.
To	13% Cumulative preference shares in Careful Ltd.	2,50,000	By	Equity Share Capital	6,00,000
			By	Pre-incorporation profit	21,000
			By	Contingency reserve	1,35,000
To	Equity Shares in Careful Ltd.	7,50,000	By	Profit & Loss Account	1,26,000
		_____	By	Realisation Account	<u>1,18,000</u>
		<u>10,00,000</u>			<u>10,00,000</u>

Careful Ltd. Account

		Rs.			Rs.
To	Realisation Account	10,00,000	By	13% Cumulative preference shares in Careful Ltd.	2,50,000
		_____	By	Equity shares in Careful Ltd.	<u>7,50,000</u>
		<u>10,00,000</u>			<u>10,00,000</u>

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

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

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

Theoretical ex-rights fair value per share = Rs. 20.00

(a) Computation of adjustment factor

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

Computation of earnings per share

	Year 2013-14	Year 2014-15
EPS for the year 2013-14 as originally reported: (Rs. 11,00,000/5,00,000 shares)	Rs. 2.20	
EPS for the year 2013-14 restated for rights issue: [Rs. 11,00,000/ (5,00,000 shares x 1.05)]	Rs. 2.10	
EPS for the year 2014-15 including effects of rights issue $\frac{\text{Rs. 15,00,000}}{(5,00,000 \times 1.05 \times 2/12) + (6,00,000 \times 10/12)}$		Rs. 2.55

- (b) As per AS 26 'Intangible Assets', the depreciable amount of an intangible asset should be allocated on a systematic basis over its useful life. Also there is a rebuttable presumption that the useful life of an intangible asset will not exceed 10 years from the date it is available for use. The amortization should commence when the asset is available for use. As per para 78 of AS 26, if there has been a significant change in the expected pattern of economic benefits from the asset, the amortisation method should be changed to reflect the changed pattern.

The company has been following a policy of amortization over a period of 8 years. As on 01-4-2015, 5 years have passed and the carrying amount stands at Rs. 30 lakhs. If the same treatment were to be continued, this would have been amortized over the next 3 years. But the revised estimate of remaining useful life would extend the period by another 5 years to amortize the carrying amount, the Company would be advised to amortise the carrying value over the next 5 years. Thus after revision in estimated useful life, the amount of Rs. 30 lacs would be amortised over next 5 years.

- (c) Investments other than investment properties are not qualifying assets as per AS 16 "Borrowing Costs". Therefore, interest cost of holding such investments cannot be capitalized. Further, even interest in respect of investment properties can only be capitalized if such properties meet the definition of qualifying asset, namely, that it necessarily takes a substantial period of time to get ready for its intended use or sale. Even where the investment properties meet the definition of 'qualifying asset', for the capitalisation of borrowing costs the other requirements of the standard such as that borrowing cost should be directly attributable to the acquisition or construction of the investment property and suspension of capitalization as per paragraphs 17 and 18 of AS 16 have to be complied with.
- (d) As per section 34 of the LLP Act, 2008, every LLP shall maintain such proper books of accounts as may be prescribed relating to its affairs for each year of its existence on cash basis or accrual basis and according to the double entry system of

accounting and shall maintain the same at its registered office for such period as may be prescribed. Every LLP shall, within six months of the end of each financial year, prepare a Statement of Account and Solvency for the said financial year as at the last day of the said financial year, in such form as may be prescribed, and such statement shall be signed by the designated partners of the LLP. Every LLP shall also file within the prescribed time, the Statement of Account and Solvency with the Registrar every year in such form and manner and accompanied by such fee as may be prescribed. The accounts of an LLP must be audited in accordance with such rules as may be prescribed.

Under Section 35 (1) of the LLP Act every LLP is required to file an Annual Return which is duly authenticated with the registrar within sixty days of the closure of its financial year in such form and manner and with such fees as may be prescribed

(e)

Journal Entries

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

Test Series: September, 2016

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. Discuss the following:
 - (a) The auditor is faced with sampling risk in both tests of control and substantive procedures.
 - (b) Mention any four information which assists the auditor in accepting and continuing of relationship with the client as per SA 220.
 - (c) State the significant difficulties encountered during audit with reference to SA-260 (communication with those charged with governance).
 - (d) Despite of several disadvantages, audit programme is required to start an audit.
(5 x 4 = 20 Marks)

2. State with reason (in short) whether the following statements are correct or incorrect (Answer any eight):
 - (i) The Board of Directors of a company may contribute any amount to charitable funds without any prior permission of the company in general meeting.
 - (ii) A Chartered Accountant holding securities of S Ltd. having face value of Rs. 950 is qualified for appointment as an auditor of S Ltd.
 - (iii) None of the joint auditors shall be held responsible in respect of the work not divided among them.
 - (iv) Reporting on adequate internal financial controls system of a company is out of the scope of statutory auditor.
 - (v) The auditor shall disclaim an opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements.
 - (vi) A company can issue its sweat equity shares at discounted price.
 - (vii) An auditor appointed under section 139 may be removed from his office before the expiry of his term by an ordinary resolution of the company.

- (viii) Premium received on issue of shares prior to the date of Balance Sheet has been transferred to Statement of Profit and Loss for arriving at the figure of commission payable to the managing director.
- (ix) Observation consists of seeking information of knowledgeable persons, both, financial and non- financial, within the entity or outside the entity.
- (x) Test checks refers to the routine audit checks that are carried out in the normal course of audit. *(2 x 8 = 16 Marks)*
3. How will you vouch/verify the following:
- (a) Petty Cash.
- (b) Borrowings from Bank.
- (c) Sale Proceeds of Junk Material.
- (d) Repayment of amount of foreign loan for purchase of an asset. *(4 x 4 = 16 Marks)*
4. (a) The auditor may exercise his judgement to identify which risks are significant risks. Explain the above in context of SA-315. *(4 Marks)*
- (b) The auditor shall perform additional audit procedures to determine whether or not a material uncertainty exists, when an event has been identified that may cast significant doubt on the entity's ability to continue as a going concern. Mention the audit procedures need to be performed in accordance with SA 570. *(6 Marks)*
- (c) In case of initial audit engagements, the auditor may consider additional matters in establishing the overall audit strategy and audit plan. Explain those additional matters need to be considered as per SA 300. *(6 Marks)*
5. (a) "Provisions regarding rotation of auditors affect only specific class of companies". Discuss. *(4 Marks)*
- (b) State the manner of rotation of auditors on expiry of their term. *(6 Marks)*
- (c) Mention any eight important points which an auditor will consider while conducting audit of a club? *(6 Marks)*
6. (a) The management of an entity informed you that Work-in-Progress (WIP) is not valued since it is difficult to know the same in view of multiple processes involved and in any case opening & closing WIP would be more or less the same. Comment as an auditor. *(4 Marks)*
- (b) What are sweat equity shares? How an auditor would verify issue of such sweat equity shares? *(4 Marks)*
- (c) Mr. A was appointed auditor of AAS Ltd. by Board to fill the casual vacancy that arose due to death of the auditor originally appointed in AGM. Subsequently, Mr. A also resigned on health grounds during the tenure of appointment. The Board filled this vacancy by appointing you through duly passed Board resolution. Comment. *(4 Marks)*

- (d) Discuss how would you as an auditor report under CARO, 2016 in respect of statutory dues. *(4 Marks)*
7. Write short notes on any four of the following:
- (a) Statistical Sampling.
 - (b) Manipulation of Accounts.
 - (c) Removal of company auditor before expiry of term.
 - (d) Assertions about account balances at the period end.
 - (e) Disclosure requirements of bank balances of a limited company. *(4 x 4 = 16 Marks)*

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

1. (a) **Sampling Risk:** As per SA 530 “Audit Sampling”, audit sampling enables the auditor to obtain and evaluate audit evidence about some characteristic of the items selected in order to form or assist in forming a conclusion concerning the population from which the sample is drawn. Audit sampling can be applied using either non-statistical or statistical sampling approaches.

When designing a sample, the auditor determines tolerable misstatement in order to address the risk that the aggregate of individually immaterial misstatements may cause the financial statements to be materially misstated and provide a margin for possible undetected misstatements.

Sampling Risk is the risk that the auditor’s conclusion based on a sample may be different from the conclusion if the entire population were subjected to the same audit procedure. Sampling risk can lead to two types of erroneous conclusions:

- (i) In the case of a test of controls, that controls are more effective than they actually are, or in the case of a substantive procedure i.e. test of details, that a material misstatement does not exist when in fact it does. The auditor is primarily concerned with this type of erroneous conclusion because it affects audit effectiveness and is more likely to lead to an inappropriate audit opinion.
- (ii) In the case of a test of controls, that controls are less effective than they actually are, or in the case of a substantive procedure i.e. test of details, that a material misstatement exists when in fact it does not. This type of erroneous conclusion affects audit efficiency as it would usually lead to additional work to establish that initial conclusions were incorrect.

- (b) **Information which assist the Auditor in accepting and continuing of relationship with Client:** As per SA 220, “Quality Control for an Audit of Financial Statements” the auditor should obtain information considered necessary in the circumstances before accepting an engagement with a new client, when deciding whether to continue an existing engagement and when considering acceptance of a new engagement with an existing client. The following information would assist the auditor in accepting and continuing of relationship with the client:

- (i) The integrity of the principal owners, key management and those charged with governance of the entity;

- (ii) Whether the engagement team is competent to perform the audit engagement and has the necessary capabilities, including time and resources;
 - (iii) Whether the firm and the engagement team can comply with relevant ethical requirements; and
 - (iv) Significant matters that have arisen during the current or previous audit engagement, and their implications for continuing the relationship.
- (c) **Significant Difficulties Encountered During the Audit:** As per SA 260 “Communication with Those Charged with Governance”, significant difficulties encountered during the audit may include such matters as:
- ◆ Significant delays in management providing required information.
 - ◆ An unnecessarily brief time within which to complete the audit.
 - ◆ Extensive unexpected effort required to obtain sufficient appropriate audit evidence.
 - ◆ The unavailability of expected information.
 - ◆ Restrictions imposed on the auditor by management.
 - ◆ Management’s unwillingness to make or extend its assessment of the entity’s ability to continue as a going concern when requested.
- (d) **Audit Programme:** Despite of several disadvantages, the audit programme is required to start an audit due to the following considerations-
- (i) The audit programme lists down areas of audit before commencement.
 - (ii) The audit timing is built therein; thereby it becomes a schedule of audit plan .
 - (iii) The staff who are entrusted with the audit assignment is also specified. It is a plan of resource allocation of the firm.
 - (iv) It specifies the procedures to be checked during the audit.
 - (v) As the audit work is split into various elements of procedures to be performed, the audit programme acts as a guiding chart or check list during the performance of audit.
 - (vi) Since the staff-in-charge of each work is specified and they sign the programme, it extracts the responsibility from the audit assistants.
 - (vii) The working papers of the audit staff can be reviewed against the audit programme which helps a base of reference for evaluation of the performance before reporting on the financial statements.
 - (viii) It also helps in preparing a diary of the performance and plan and also base for billing the clients for the time and manpower involved in the audit.

2. (i) **Incorrect:** As per section 181 of the Companies Act, 2013, the Board of Directors of a company may contribute to *bona fide* charitable and other funds. However, prior permission of the company in general meeting is required in case any amount the aggregate of which, in any financial year, exceeds 5 per cent of its average net profits for the three immediately preceding financial years.
- (ii) **Incorrect:** As per the provisions of the Companies Act, 2013, a person is disqualified to be appointed as an auditor of a company if he is holding any security of or interest in the company.
- (iii) **Incorrect:** According to SA 299 “Responsibilities of Joint Auditors”, all the joint auditors are jointly and severally responsible in respect of the work which is not divided among joint auditors and is carried out by all of them.
- (iv) **Incorrect:** Section 143(3) of the Companies Act, 2013 requires the statutory auditor of the company to state in auditor’s report whether the company has adequate internal financial controls system in place and the operating effectiveness of such controls.
- (v) **Incorrect:** The auditor shall disclaim an opinion when the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, and the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive.
- (vi) **Correct:** According to section 53 of the Companies Act, 2013, a company shall not issue shares at a discount. However, exception has been given in the case of an issue of sweat equity shares.
- (vii) **Incorrect:** As per sub-section (1) of Section 140 of the Companies Act, 2013, an auditor appointed under section 139 may be removed from his office before the expiry of his term only by a special resolution of the company, after obtaining the prior approval of the Central Government in that behalf as per Rule 7 prescribed under Companies (Audit & Auditors) Rules, 2014:
- (viii) **Incorrect:** Premium received on issue of shares is capital receipt and should not be credited to Statement of Profit and Loss. As per the provisions of Section 198 of the Companies Act, 2013, premium on issue of shares should not be considered in computation of net profit for the purpose of managerial remuneration.
- (ix) **Incorrect:** Inquiry consists of seeking information of knowledgeable persons, both, financial and non- financial, within the entity or outside the entity.
Observation consists of looking at a process or procedure being performed by others.
- (x) **Incorrect:** Test checks refers to an audit procedure wherein only a part is checked to form an opinion instead of checking all the transactions.

3. (a) Petty Cash

- (i) Trace the amounts advanced to the petty cashier for meeting petty office expenses from the Cash Book in the Petty Cash Book.
- (ii) Vouch payments with docket vouchers which must be supported, wherever possible, by external evidence e.g., payee's receipted bill or invoices, cash memo, etc.
- (iii) Trace payments made for the purchase of postage stamps recorded in the Postage Book. The totals of the Postage Book should be test checked. The amounts of postage stamps in hand, at the end of the year, should be credited to Postage Account by debiting the amounts to Postage in Hand Account. It should be seen that the amount paid for postage stamps is not unduly large and the Postage Book is normally checked by the petty cashier from time to time before the amount of imprest is reimbursed. Confirm that the postage expenses for the year are reasonable as compared with that in the postage expenses from month to month.
- (iv) See where a columnar Petty Cash Book is maintained, that the extension have been carried forward into appropriate amount columns.
- (v) Check the column totals and cross totals.
- (vi) Trace posting of the various columns in which payments are classified to the respective ledger accounts.
- (vii) Verify the cash balance in hand.
- (viii) Auditor should also verify whether the amount of petty cash imprest is fixed. Is this amount reasonable considering the total amount of petty cash payments made during a month or so?

(b) Borrowings from a Bank: Borrowings from a bank may be either in the form of overdraft limits; or short term or medium term or long term loans. The audit procedures which an auditor may adopt are outlined below-

- (i) Ensure that balance as per books of the client and the bank statement tally. In case of difference between the two amounts, reconciliation statement prepared by the client should account for reasons.
- (ii) Examine whether borrowings from the bank have been duly authorized.
- (iii) Examine documents to ensure that statutory requirements, if any, with regards to creation and registration charges have been met.
- (iv) Examine the loan agreement and ensure that the terms therein have been duly complied with.
- (v) Ascertain the purpose for which loan has been raised and examine whether end use of the funds have been accordingly made.

(c) Sale Proceeds of Junk Material

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

(d) Repayment of Amount of Foreign Loan for Purchase of an Asset

- (i) Check the loan agreement, rate of interest, terms of security.
- (ii) Check the remittances made during the year towards installments of repayments made.
- (iii) Check the receipted voucher/account confirmation for the balance of outstanding.
- (iv) The year end liability of foreign loan should be translated to the rate of exchange prevalent as on the closing date.
- (v) The gain or loss arising on exchange conversion is to be credited or debited to Statement of Profit and Loss in accordance with the Accounting Standard 11.
- (vi) Check banker exchange rate chart for correctness of the conversion.
- (vii) Check RBI or other agencies' permission for remittances outside India.

- 4. (a) Identification of Significant Risks:** SA 315 "Identifying and Assessing the Risk of Material Misstatement through understanding the Entity and its Environment" defines 'significant risk' as an identified and assessed risk of material misstatement that, in the auditor's judgment, requires special audit consideration.

As part of the risk assessment, the auditor shall determine whether any of the risks identified are, in the auditor's judgment, a significant risk. In exercising this judgment, the auditor shall exclude the effects of identified controls related to the risk.

In exercising judgment as to which risks are significant risks, the auditor shall consider at least the following-

- (i) Whether the risk is a risk of fraud;
- (ii) Whether the risk is related to recent significant economic, accounting or other developments like changes in regulatory environment etc. and therefore requires specific attention;
- (iii) The complexity of transactions;
- (iv) Whether the risk involves significant transactions with related parties;
- (v) The degree of subjectivity in the measurement of financial information related to the risk, especially those measurements involving a wide range of measurement uncertainty; and
- (vi) Whether the risk involves significant transactions that are outside the normal course of business for the entity or that otherwise appear to be unusual.

(b) Audit Procedures to be Performed When There Exist Significant Doubt on Entity's Ability to Continue as a Going Concern: According to SA 570 "Going Concern", when events or conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern, the auditor shall obtain sufficient appropriate audit evidence to determine whether or not a material uncertainty exists through performing additional audit procedures, including consideration of mitigating factors. These procedures shall include-

- (i) Analysing and discussing cash flow, profit and other relevant forecasts with management.
- (ii) Analysing and discussing the entity's latest available interim financial statements.
- (iii) Reading the terms of debentures and loan agreements and determining whether any have been breached.
- (iv) Reading minutes of the meetings of shareholders, those charged with governance and relevant committees for reference to financing difficulties.
- (v) Inquiring of the entity's legal counsel regarding the existence of litigation and claims and the reasonableness of management's assessments of their outcome and the estimate of their financial implications.
- (vi) Confirming the existence, legality and enforceability of arrangements to provide or maintain financial support with related and third parties and assessing the financial ability of such parties to provide additional funds.

- (vii) Evaluating the entity's plans to deal with unfilled customer orders.
- (viii) Performing audit procedures regarding subsequent events to identify those that either mitigate or otherwise affect the entity's ability to continue as a going concern.
- (ix) Confirming the existence, terms and adequacy of borrowing facilities.
- (x) Obtaining and reviewing reports of regulatory actions.
- (xi) Determining the adequacy of support for any planned disposals of assets.

(c) **Consideration of Additional Matters in Case of Initial Audit Engagements:** In accordance with SA 300 "Planning an Audit of Financial Statements", the purpose and objective of planning the audit are the same whether the audit is an initial or recurring engagement. However, for an initial audit, the auditor may need to expand the planning activities because the auditor does not ordinarily have the previous experience with the entity that is considered when planning recurring engagements. For initial audits, additional matters the auditor may consider in establishing the overall audit strategy and audit plan include the following-

- (i) Unless prohibited by law or regulation, arrangements to be made with the predecessor auditor, for example, to review the predecessor auditor's working papers.
- (ii) Any major issues (including the application of accounting principles or of auditing and reporting standards) discussed with management in connection with the initial selection as auditor, the communication of these matters to those charged with governance and how these matters affect the overall audit strategy and audit plan.
- (iii) The audit procedures necessary to obtain sufficient appropriate audit evidence regarding opening balances (SA 510 "Initial Audit Engagements-Opening Balances").
- (iv) Other procedures required by the firm's system of quality control for initial audit engagements (for example, the firm's system of quality control may require the involvement of another partner or senior individual to review the overall audit strategy prior to commencing significant audit procedures or to review reports prior to their issuance).

5. (a) **Applicability of Provisions Related to Rotation of Auditors:** The provisions related to rotation of auditor as provided under section 139(2) of the Companies Act, 2013 are applicable to all listed companies and other class or classes of companies as prescribed under Companies (Audit and Auditors) Rules, 2014.

As per rules prescribed in Companies (Audit and Auditors) Rules, 2014, for applicability of section 139(2) the class of companies shall mean the following classes of companies excluding one person companies and small companies-

- (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.

(b) Manner of Rotation of Auditors on Expiry of their Term: Prescribed manner of rotation of auditors on expiry of their term is given below-

- (1) The Audit Committee shall recommend to the Board, the name of an individual auditor or of an audit firm who may replace the incumbent auditor on expiry of the term of such incumbent.
- (2) Where a company is required to constitute an Audit Committee, the Board shall consider the recommendation of such committee and in other cases, the Board shall itself consider the matter of rotation of auditors and make its recommendation for appointment of the next auditor by the members in annual general meeting.
- (3) For the purpose of the rotation of auditors-
 - (i) in case of an auditor (whether an individual or audit firm), the period for which the individual or the firm has held office as auditor prior to the commencement of the Act shall be taken into account for calculating the period of five consecutive years or ten consecutive years, as the case may be;
 - (ii) the incoming auditor or audit firm shall not be eligible if such auditor or audit firm is associated with the outgoing auditor or audit firm under the same network of audit firms.

The term "same network" includes the firms operating or functioning, hitherto or in future, under the same brand name, trade name or common control.

Further, for the purpose of rotation of auditors,-

- (a) a break in the term for a continuous period of five years shall be considered as fulfilling the requirement of rotation;
- (b) if a partner, who is in charge of an audit firm and also certifies the financial statements of the company, retires from the said firm and joins another firm of chartered accountants, such other firm shall also be ineligible to be appointed for a period of five years.

- (4) Where a company has appointed two or more individuals or firms or a combination thereof as joint auditors, the company may follow the rotation of auditors in such a manner that both or all of the joint auditors, as the case may be, do not complete their term in the same year.
- (c) **Audit of Club:** A club is usually constituted as a company limited by guarantee. Therefore, various provisions of the Companies Act, 2013 relating to the audit of accounts of companies are also applicable to its audit. The special steps involved in such an audit are stated below-
- (i) Vouch the receipt on account of entrance fees with members' applications, counterfoils issued to them, as well as on a reference to minutes of the Managing Committee.
 - (ii) Vouch members' subscriptions with the counterfoils of receipt issued to them, trace receipts for a selected period to the Register of Members; also reconcile the amount of total subscriptions due with the amount collected and that outstanding.
 - (iii) Ensure that arrears of subscriptions for the previous year have been correctly brought over and arrears for the year under audit and subscriptions received in advance have been correctly adjusted.
 - (iv) Check totals of various columns of the Register of members and tally them across.
 - (v) See the Register of Members to ascertain the Member's dues which are in arrear and enquire whether necessary steps have been taken for their recovery; the amount considered irrecoverable should be mentioned in the Audit Report.
 - (vi) Verify the internal check as regards members being charged with the price of foodstuffs and drinks provided to them and their guests, as well as, with the fees chargeable for the special services rendered, such as billiards, tennis, etc.
 - (vii) Trace debits for a selected period from subsidiary registers maintained in respect of supplies and services to members to confirm that the account of every member has been debited with amounts recoverable from him.
 - (viii) Vouch purchase of sports items, furniture, crockery, etc. and trace their entries into the respective inventory registers.
 - (ix) Vouch purchases of foodstuffs, cigars, wines, etc. and test their sale price so as to confirm that the normal rates of gross profit have been earned on their sales. The inventory of unsold provisions and stores, at the end of year, should be verified physically and its valuation checked.
 - (x) Check the inventory of furniture, sports material and other assets physically with the respective inventory registers or inventories prepared at the end of the

year.

- (xi) Inspect the share scrips and bonds in respect of investments, check their current values for disclosure in final accounts; also ascertain that the arrangements for their safe custody are satisfactory.
- (xii) Examine the financial powers of the secretary and, if these have been exceeded, report specific case for confirmation by the Managing Committee.

6. (a) **Valuation of Work-in-Progress:** AS 2 “Valuation of Inventories” deals with the principles and methods for determining the value at which inventories should be carried in the financial statements. Thus, items which are held up in the process of production are included in the definition of inventory.

Work-in-Progress (WIP) is normally valued by taking the basic cost of materials, labour and proportionate factory overheads incurred upto the stage of completion.

In view of the above, the argument that the value of opening and closing WIP is more or less same is not tenable as the cost of material, labour and overhead might be different and accordingly arriving at the different valuation of opening and closing WIP is possible.

In the given case, the management should have determined the stage of completion of the production and valued the work in process accordingly.

If the management refuses to value the work in process then the auditor shall modify auditor’s report accordingly.

- (b) **Meaning of Sweat Equity Shares:** “Sweat Equity Shares” means equity shares issued by the company to employees or directors at a discount or for consideration other than cash for providing know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called.

Verification of Issue of Sweat Equity Shares: As per section 54 of the Companies Act, 2013, the employees may be compensated in the form of ‘Sweat Equity Shares’.

The auditor may check that the Sweat Equity Shares issued by the company are of a class of shares already issued and following conditions are fulfilled:

- (i) the issue is authorised by a special resolution passed by the company;
- (ii) the resolution specifies the number of shares, the current market price, consideration, if any, and the class or classes of directors or employees to whom such equity shares are to be issued;
- (iii) not less than one year has, at the date of such issue, elapsed since the date on which the company had commenced business; and
- (iv) where the equity shares of the company are listed on a recognised stock exchange, the sweat equity shares are issued in accordance with the

regulations made by the Securities and Exchange Board in this behalf and if they are not so listed, the sweat equity shares are issued in accordance with such rules as may be prescribed.

The rights, limitations, restrictions and provisions as are for the time being applicable to equity shares shall be applicable to the sweat equity shares issued under this section and the holders of such shares shall rank *pari passu* with other equity shareholders.

- (c) **Filling of a Casual Vacancy:** Section 139(8) of the Companies Act, 2013 provides that 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.

In the present case, the auditor Mr. A resigned and the vacancy had been filled in by Board. But, the vacancy caused by resignation cannot be filled by Board itself, such appointment shall also be approved by the company at general meeting.

The fact that the Mr. A was appointed by Board originally is a matter irrelevant in this situation. If the cause of vacancy is resignation, then the power of appointment shall vest with the general meeting only. As such, the appointment made by Board is invalid.

- (d) **As per clause (vii) of CARO, 2016,** reporting requirements in respect of statutory dues are :

(a) whether the company is regular in depositing undisputed statutory dues including provident fund, employees' state insurance, income-tax, sales-tax, service tax, duty of customs, duty of excise, value added tax, cess and any other statutory dues to the appropriate authorities and if not, the extent of the arrears of outstanding statutory dues as on the last day of the financial year concerned for a period of more than six months from the date they became payable, shall be indicated;

(b) where dues of income tax or sales tax or service tax or duty of customs or duty of excise or value added tax have not been deposited on account of any dispute, then the amounts involved and the forum where dispute is pending shall be mentioned. (A mere representation to the concerned Department shall not be treated as a dispute).

7. (a) **Statistical Sampling:** Statistical sampling has reasonably wide application where a population to be tested consists of a large number of similar items and more in the case of transactions involving compliance testing, trade receivables' confirmation, payroll checking, vouching of invoices and petty cash vouchers. Audit testing done through this approach is more scientific than testing based entirely on the auditor's

own judgment because it involves use of mathematical laws of probability in determining the appropriate sample size in varying circumstances.

It is unnecessary for the auditor to gain in depth knowledge of statistics before making use of statistical sampling for audit testing since published statistical tables are available which indicate the sample size based on pre-determined criteria.

(b) Manipulation of Accounts: Accounts are falsified in order to conceal the true position of the business for some purpose. They are always intentional, for a predetermined purpose and are generally committed either by the owners or top management personnel or senior officers of the business. This type of fraud is generally committed-

- (i) to avoid incidence of income-tax or other taxes by showing profits at a lower figure.
- (ii) for delaying a dividend when there are insufficient profits by showing profits at inflated figures.
- (iii) to withhold declaration of dividend even there is adequate profit (this is often done to manipulate the value of shares in stock market to make it possible for selected persons to acquire shares at a lower cost).
- (iv) for receiving higher remuneration where managerial remuneration is payable by reference to profits.

Such frauds are difficult to be detected as they are committed by persons holding position of trust and use carefully guarded by them. Such frauds are generally of the following nature:

- (i) Recording fictitious sales or omission of sales.
- (ii) Recording fictitious purchases or suppression of purchases.
- (iii) Over valuation or under valuation of stock.
- (iv) Recording fictitious expenses or omission of expenses.
- (v) Taking credit for accrued income not likely to be received or omission of income.
- (vi) Revenue expenses changed to capital and vice-versa.

SA 240 "The Auditor's Responsibilities relating to fraud in an Audit of Financial Statements" states that the auditor is responsible for obtaining reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error. If an auditor identifies a fraud or has obtained information that indicates that a fraud may exist, it is his responsibility to communicate the matter with those charged with the governance on a timely basis and, in some circumstances, when so required by laws or regulations, to regulatory and enforcement authorities also.

In addition, as per sub-section (12) of section 143 of the Companies Act, 2013, if an auditor of a company, in the course of the performance of his duties as auditor, has reason to believe that an offence involving fraud is being or has been committed against the company by officers or employees of the company, he shall immediately report the matter to the Central Government within 60 days of his knowledge and after following the prescribed procedure.

The auditor is also required to comment under clause (xii) of Para 3 of CARO, 2015 whether any fraud on or by the company has been noticed or reported during the year. If yes, the nature and the amount involved is to be indicated.

- (c) **Removal of Auditor Before Expiry of Term:** According to section 140(1) of the Companies Act, 2013, the auditor appointed under section 139 may be removed from his office before the expiry of his term only by a special resolution of the company, after obtaining the previous approval of the Central Government in that behalf as per rule 7 of Companies (Audit and Auditors) Rules, 2014-
- (i) The application to the Central Government for removal of auditor shall be made in Form ADT-2 and shall be accompanied with fees as provided for this purpose under the Companies (Registration Offices and Fees) Rules, 2014.
 - (ii) The application shall be made to the Central Government within 30 days of the resolution passed by the Board.
 - (iii) The company shall hold the general meeting within 60 days of receipt of approval of the Central Government for passing the special resolution.

It is important to note that before taking any action for removal before expiry of terms, the auditor concerned shall be given a reasonable opportunity of being heard.

- (d) **Assertions about Account Balances at the Period End:** As per SA 315 "Identifying and Assessing the Risk of Material Misstatement through understanding the Entity and its Environment", assertions used by the auditor to consider the different types of potential misstatements that may occur, fall into the three categories out of which "assertions about account balances at the period end" is one of the category. It may take the following forms-
- (i) Existence—assets, liabilities, and equity interests exist.
 - (ii) Rights and obligations—the entity holds or controls the rights to assets, and liabilities are the obligations of the entity.
 - (iii) Completeness—all assets, liabilities and equity interests that should have been recorded have been recorded.
 - (iv) Valuation and allocation—assets, liabilities, and equity interests are included in the financial statements at appropriate amounts and any resulting valuation or allocation adjustments are appropriately recorded.

(e) **Disclosure Requirements for Bank Balance:** As per Part I of Schedule III to the Companies Act, 2013, the disclosure of bank balances is under the head “Cash and Cash Equivalents” in Current Assets as -

- (i) Balances with Banks.
- (ii) Earmarked balances with banks (for example, for unpaid dividend).
- (iii) Balances with banks to the extent held as margin money or security against borrowings, guarantees, other commitments.

The extract of the Schedule III, under Companies Act, 2013 regarding disclosure requirements is given below:

[General Instructions for Current Assets under Schedule III to the Companies Act, 2013]:
<ul style="list-style-type: none">• Cash and cash equivalents:<ol style="list-style-type: none">1. Cash and cash equivalents shall be classified as:<ul style="list-style-type: none">(a) Balances with banks;(b) Cheques, drafts on hand;(c) Cash on hand;(d) Others (specify nature).2. Earmarked balances with banks (for example, for unpaid dividend) shall be separately stated;3. Balances with banks to the extent held as margin money or security against the borrowings, guarantees, other commitments shall be disclosed separately;4. Repatriation restrictions, if any, in respect of cash and bank balances shall be separately stated;5. Bank deposits with more than 12 months maturity shall be disclosed separately.

Test Series: September, 2016

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 are the limitations of using Flowchart?
 - (ii) What are the concerns relating to Mobile Computing?
 - (iii) Discuss Virtual Private Networks (VPN) in brief.
 - (iv) Mention the components of Supply Chain Management (SCM)?
 - (v) What do you understand by the term “Real Time Processing”? (2 x 5 = 10 Marks)
2. (a) Discuss the reasons why documentation is important to Information Systems. (4 Marks)
- (b) Discuss the basic functions of an Accounting Information Systems. (4 Marks)
3. (a) Discuss some advantages and disadvantages of application software. (4 Marks)
- (b) Discuss Information Systems Life Cycle, in brief. (4 Marks)
4. (a) Discuss Peer-to-Peer Network. (5 Marks)
- (b) Discuss in brief, the steps involved in Security Programs to ensure safeguarding of assets and maintenance of data integrity. (3 Marks)
5. (a) You are requested to implement the Online Transaction Processing in an e-Commerce environment. Briefly explain step by step online transaction processing in such environment. (4 Marks)
- (b) Discuss in brief, the commercial applications of Artificial Intelligence (AI). (4 Marks)
6. (a) Differentiate between Manual Information Processing Cycle and Computerized Information Processing Cycle. (4 Marks)
- (b) Discuss in brief, the benefits of Grid Computing. (4 Marks)

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

- (a) Total Quality Management (TQM)
- (b) Communication as a Service
- (c) Parallel Transmission
- (d) General Purpose Planning Languages
- (e) Travel Management Systems

(4 × 2 = 8 Marks)

Test Series: September, 2016

MOCK TEST PAPER – II
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) Premise control is a tool for systematic and continuous monitoring of the environment. Discuss. (3 Marks)
- (b) Is it possible to simultaneously adopt both low-cost and differentiation strategies? Explain with help of an example. (3 Marks)
- (c) Globalization means different things to different people. Elucidate the statement. (3 Marks)
- (d) The first step in strategic management model is developing a strategic vision and mission. Explain. (3 Marks)
- (e) BCG growth share matrix classifies businesses on two dimensional scales. Explain. (3 Marks)
2. (a) State with reasons which of the following statements is correct/incorrect:
 - (i) “Efficiency and effectiveness mean the same in strategic management”.
 - (ii) Publicity is a non-personal form of promotion similar to advertising.(2 × 2 = 4 Marks)
- (b) Explain the meaning of the following concepts:
 - (i) Joint venture
 - (ii) Strategic change
 - (iii) Product development(3 × 1 = 3 Marks)
3. Write short notes on the following:
 - (a) Demographic Environment. (2 Marks)
 - (b) Corporate culture (2 Marks)
 - (c) Components of marketing mix (3 Marks)
4. Why is it necessary to do a SWOT analysis before selecting a particular strategy for a business organization? (7 Marks)

5. What do you understand by 'Strategy'? Explain the four generic strategies as discussed by Glueck and Jauch. *(7 Marks)*
6. What is the rationale behind Business Process Reengineering (BPR)? What steps would you recommend to implement BPR in an organization? *(7 Marks)*
7. Strategic leadership involves two approaches transformational and transactional. Discuss. *(7 Marks)*

MOCK TEST PAPER – 2
INTERMEDIATE (IPC): GROUP – II
PAPER – 7: INFORMATION TECHNOLOGY AND STRATEGIC MANAGEMENT
SECTION – A: INFORMATION TECHNOLOGY
SUGGESTED ANSWERS/HINTS

1. (i) Limitations of using Flowchart are as follows:
- (a) **Complex logic** – Flowchart becomes complex and clumsy where the problem logic is complex. The essentials of what is done can easily be lost in the technical details of how it is done.
 - (b) **Modification** – If modifications to a flowchart are required, it may require complete re-drawing.
 - (c) **Reproduction** – Reproduction of flowcharts is often a problem because the symbols used in flowcharts cannot be typed.
 - (d) **Link between conditions and actions** – Sometimes it becomes difficult to establish the linkage between various conditions and the actions to be taken there upon for a particular condition.
 - (e) **Standardization** – Program flowcharts, although easy to follow, are not such a natural way of expressing procedures as writing in English, nor are they easily translated into Programming language.
- (ii) Major concerns relating to mobile computing are given as follows:
- Mobile computing has its fair share of security concerns as any other technology.
 - Dangers of misrepresentation - Another problem plaguing mobile computing are credential verification.
 - Power consumption: When a power outlet or portable generator is not available, mobile computers must rely entirely on battery power.
 - Potential health hazards.
- Being an ever growing and emerging technology, mobile computing will continue to be a core service in computing, Information Communication and Technology.
- (iii) **Virtual Private Networks (VPN)**: VPN is a secure network that uses the Internet as its main backbone network, but relies on the firewalls and other security features of the Internet and Intranet connections and those of participating organizations.

- (iv) **Components of SCM are as follows:**
- (a) **Procurement/Purchasing**—begins with the purchasing of parts, components, or services.
 - (b) **Operations** – This includes transformation of raw materials and production of the products or the services that meet the needs of its consumers.
 - (c) **Distribution** - This involves several activities—transportation (logistics), warehousing, and customer relationship management (CRM).
 - (d) **Integration** - It is critical that all participants in the service chain recognize the entirety of the service chain.
- (v) **Real-time Processing:** Real time processing is a subset of interactive or online processing. Input is continuously, automatically acquired from sensors, for example, which is processed immediately in order to respond to the input in as little time as possible. After the system is finished responding, it reads the next set of input data immediately to process that.
2. (a) Some of the reasons why documentation is important to Information Systems are as follows:
- (i) **Depicting how the system works:** In computerized systems, the processing is electronic and invisible. Therefore documentation is required to help employees understand how a system works, assist accountants in designing controls for it, demonstrates to managers that it will meet their information needs, and assists auditors in understanding the systems that they test and evaluate.
 - (ii) **Training users:** Documentation also includes user guides, manuals, and similar operating instructions that help people learn how an Information System operates. These documentation aids help train users to operate Information systems hardware and software, solve operational problems, and perform their jobs better.
 - (iii) **Designing new systems:** Documentation helps system designers develop new systems in much the same way that blueprints help architects design building, Well-written documentation and related graphical systems-design methodologies play key roles in reducing system failures and decreasing the time spent correcting emergency errors.
 - (iv) **Controlling system development and maintenance costs:** Personal computer applications typically employ prewritten, off-the-shelf software that is relatively reliable and inexpensive. Good documentation helps system designers develop object-oriented software, which is software that contains

modular, reusable code that further avoid writing duplicate programs and facilitate changes when programs must be modified later.

- (v) **Standardizing communications with others:** Documentation aids such as E-R Diagrams, System Flowcharts, and Data Flow Diagrams are more standardized tools, and they are more likely to be interpreted the same way by all parties viewing them. Thus, documentation tools are important because they help describe an existing or proposed system in a common language and help users communicate with one another about these systems.
 - (vi) **Auditing Information Systems:** Documentation helps depict audit trails, For example- when investigation and Accounting Information system, the auditors typically focus on internal controls. In such circumstances, documentation helps auditors determine the strengths and weaknesses of a system's controls and therefore the scope and complexity of the audit.
 - (vii) **Documenting business processes:** Understanding business processes can lead to better systems and better decision. Documentation helps managers better understand how their businesses operate what controls are involved or missing from critical organizational activities, and how to improve core business activities.
- (b) The three basic functions of Accounting Information Systems (AIS) are as follows:
- (i) **Collect and store data:** Collect and store data about organization's business activities and transactions by capturing transaction data from source documents and posting data from journals to ledgers. Source documents are special forms used to capture transaction data such as sales order, sales invoice, order processing, purchase order, etc. Control over data collection is improved by pre-numbering each source document.
 - (ii) **Record transaction:** Record transactions data into journals. These journals present a chronological record of what occurred and provide management with information useful for decision making. These documents are in the form of reports like financial statements, managerial reports, etc.
 - (iii) **Safeguard organisational assets:** Provide adequate controls to ensure that data are recorded and processed accurately by safeguarding organizational assets (data and systems). The two important methods for accomplishing this objective are by providing adequate documentation of all business activities and an effective segregation of duties. Documentation allows management to verify that assigned responsibilities were completed correctly. Segregation of duties refers to dividing responsibility for different portions of a transaction among several people.

3. (a) Some of the most popular advantages of Application Software are:
- **Addressing User needs:** Their single biggest advantage is that it meets the exact needs of the user. Since it is designed specifically with one purpose in mind, the user knows that he has to use the specific software to accomplish his task.
 - **Less threat from virus:** The threat of viruses invading custom-made applications is very small, since any business that incorporates it can restrict access and can come up with means to protect their network as well.
 - **Regular updates:** Licensed application software gets regular updates from the developer for security reasons. Additionally, the developer also regularly sends personnel to correct any problems that may arise from time to time.

Certain disadvantages of Application software are as follows:

- **Development is costly:** Developing application software designed to meet specific purposes can prove to be quite costly for developers.
- **Infection from Malware:** If application software is used commonly by many people and shared online, it carries a highly real threat of infection by a computer virus or other malicious programs.

- (b) Various phases for developing an information system are as follows:

Phase 1: System Investigation - This phase examines that 'What is the problem and is it worth solving'? We would be doing a feasibility study under the following dimensions:

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

Phase 2: System Analysis - This phase examines that 'What must the Information System do to solve the problem'? System analyst would be gathering details about the current system and will involve:

- ◆ **Interviewing staff:** at different levels from end-users to senior management;

- ◆ **Examine current business:** systems documents and output including current order documents, computer system procedures and reports used by operations and senior management;
- ◆ **Sending out questionnaires:** that have to be carefully constructed to elicit unambiguous answers; and
- ◆ **Observation of current procedures:** by spending time in various departments. A time and motion study can show where procedures could be more efficient or to detect bottlenecks.

Phase 3: System Designing - This phase examines that 'How will the Information System do that it must do to obtain the solution to the problem'? This phase specifies the technical aspects of a proposed system in terms of:

- ◆ **Hardware platform:** Computer, network capabilities, input, storage and output devices;
- ◆ **Software:** Programming language, package and database;
- ◆ **Outputs:** Report layouts and screen designs;
- ◆ **Inputs:** Documents, screen layouts and validation procedures;
- ◆ **User interface:** How users will interact with the computer system;
- ◆ **Modular design:** Of each program in the application;
- ◆ **Test plan:** Develop test data;
- ◆ **Conversion plan:** How the new system is to be implemented; and
- ◆ **Documentation:** Including systems and operations documentation. Later, a user manual will be produced.

Phase 4: System Implementation: This phase examines that 'How will the Solution be put into effect'? This phase involves the following steps:

- ◆ Coding and testing of the system;
- ◆ Acquisition of hardware and software; and
- ◆ Either installation of the new system or conversion of the old system to the new one.

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

System maintenance could be with following different objectives:

- ◆ **Perfective Maintenance:** This implies that while the system runs satisfactorily, there is still room for improvement.

- ◆ **Adaptive Maintenance:** All systems will need to adapt to changing needs within a company.
- ◆ **Corrective Maintenance:** Problems frequently surface after a system has been in use for a short time, however thoroughly it was tested. Any errors must be corrected.

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

4. (a) **Peer-to-Peer Network:** A **Peer-to-Peer (P2P) network** is created with two or more PCs connected together and share resources without going through a separate server computer. A P2P network can be an ad hoc connection - a couple of computers connected via a universal serial bus to transfer files. A P2P network also can be a permanent infrastructure that links half-dozen computers in a small office over copper wires. Example – Napster, Freenet etc. Refer to the Fig. 3.6.2.

The prime objective goal of a P2P (Peer-to-Peer) file-sharing network is that many computers come together and pool their resources to form a content distribution system. The computers are often simply home computers. They do not need to be machines in Internet data centers. The computers are called peers because each one can alternately act as a client to another peer, fetching its content, and as a server, providing content to other peers. Though there is no dedicated infrastructure, P2P networks handle a very high volume of file sharing traffic by distributing the load across many computers on the Internet. Everyone participates in the task of distributing content, and there is often no central point of control.

Configured computers in P2P workgroups allow sharing of files, printers and other resources across all of the devices. Peer networks allow data to be shared easily in both directions, whether for downloads to the computer or uploads from the computer. Because they do not rely exclusively on central servers, P2P networks both scale better and are more resilient than client-server networks in case of failures or traffic bottlenecks. A P2P network can be a network on a much grander scale in which special protocols and applications set up direct relationships among users over the Internet.

Advantages

Following are the major advantages of Peer-to-Peer networks:

- (i) Peer-to-Peer Networks are easy and simple to set up and only require a Hub or a Switch to connect all the computers together.
- (ii) It is very simple and cost effective.
- (iii) If one computer fails to work, all other computers connected to it continue to work.

Disadvantages

The major disadvantages of peer-to-peer networks are as below:

- (i) There can be problem in accessing files if computers are not connected properly.
 - (ii) It does not support connections with too many computers as the performance gets degraded in case of high network size.
 - (iii) The data security is very poor in this architecture.
- (b) The steps involved in Security Programs to ensure safeguarding of assets and maintenance of data integrity are as follows –
- (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:** This step of valuation of assets can pose a difficulty. The process of 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.
 - (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. For each asset and each threat the expected loss can be estimated as the product of the

probability of threat occurrence, probability of control failure and 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. The reduction in the expected losses is the difference between expected losses with the (i) existing set of controls and (ii) improved set of controls.

(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.

5. (a) Step by step explanation of online transaction is as follows:

- ◆ **Advertising:** The company communicates its products and services (catalogue);
- ◆ **Offering:** The company offers specific goods and services;
- ◆ **Selling:** The company agrees with the customer on the content of a specific order;
- ◆ **Billing:** The company produces the invoice;
- ◆ **Paying:** The buyer pays the seller by giving a payment instruction;
- ◆ **Matching:** The seller matches the payment information (the authorization results and the actual crediting of account) with the orders and feeds the result into the back-office;
- ◆ **Delivering:** The seller delivers to the buyer; and
- ◆ **Resolving:** The seller and buyer try to resolve delivery or payment issues related to the purchase.

(b) Some of the commercial applications of AI are as follows:

Decision Support

- Intelligent work environment that will help you capture the “why” as well as the “what” of engineered design and decision making.
- Intelligent human–computer interface (HCI) systems that can understand spoken language and gestures, and facilitate problem solving by supporting organization wide collaborations to solve particular problems.

- Situation assessment and resource allocation software for uses that range from airlines and airports to logistics centers.

Information Retrieval

- AI-based Intranet and Internet systems that distill tidal waves of information into simple presentations.
- Natural language technology to retrieve any sort of online information, from text to pictures, videos, maps, and audio clips, in response to English questions.
- Database mining for marketing trend analysis, financial forecasting, and maintenance cost reduction, and more.

Virtual Reality

- X-ray-like vision enabled by enhanced-reality visualization that allows brain surgeons to “see through” intervening tissue to operate, monitor, and evaluate disease progression.
- Automated animation interfaces that allow users to interact with virtual objects via touch (e.g., medical students can “feel” what it’s like to stitch severed aortas).

Robotics

- Machine-vision inspections systems for gauging, guiding, identifying, and inspecting products and providing competitive advantage in manufacturing.
- Cutting-edge robotics systems, from micro-robots and hands and legs.

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

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

As the level of human intervention is very high the quality of information generated from these systems is prone to flaws such as delayed information, inaccurate information, incomplete information and low levels of detail.

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

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

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

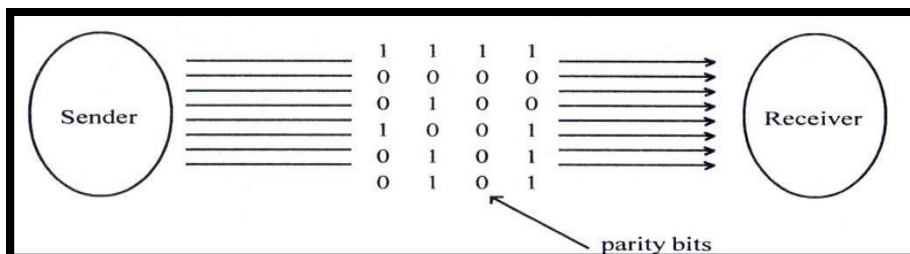
(b) Benefits of Grid Computing are as follows:

- **Making use of Underutilized Resources:** In most organizations, there are large amounts of underutilized computing resources. In some organizations, even the server machines can often be relatively idle. Grid computing provides a framework for exploiting these underutilized resources and thus has the possibility of substantially increasing the efficiency of resource usage.
- **Resource Balancing:** For applications that are grid-enabled, the grid can offer a resource balancing effect by scheduling grid jobs on machines with low utilization. This feature of grid computing handles occasional peak loads of activity in parts of a larger organization.
- **Parallel CPU Capacity:** The potential for usage of massive parallel CPU capacity is one of the most common visions and attractive features of a grid. A CPU-intensive grid application can be thought of as many smaller sub-jobs, each executing on a different machine in the grid.
- **Virtual resources and virtual organizations for collaboration:** Another capability enabled by grid computing is to provide an environment for collaboration among a wider audience. The users of the grid can be organized dynamically into a number of virtual organizations, each with different policy requirements. These virtual organizations can share their resources such as data, specialized devices, software, services, licenses, and so on, collectively as a larger grid.
- **Access to additional resources:** In addition to CPU and storage resources, a grid can provide access to other resources as well. For example, if a user needs to increase their total bandwidth to the Internet to implement a data mining search engine, the work can be split among grid machines that have independent connections to the Internet. In this way, total searching capability is multiplied, since each machine has a separate connection to the Internet.
- **Reliability:** High-end conventional computing systems use expensive hardware to increase reliability. The machines also use duplicate processors in such a way that when they fail, one can be replaced without turning the other off. Power supplies and cooling systems are duplicated. The systems are operated on special power sources that can start generators if utility power is

interrupted. All of this builds a reliable system, but at a great cost, due to the duplication of expensive components.

- **Management:** The goal to virtualize the resources on the grid and more uniformly handle heterogeneous systems create new opportunities to better manage a larger, more distributed IT infrastructure. The grid offers management of priorities among different projects.

7. (a) **Total Quality Management:** Total Quality Management (TQM) is a comprehensive and structured approach to organizational management that seeks to improve the quality of products and services through ongoing refinements in response to continuous feedback. TQM requirements may be defined separately for a particular organization or may be in adherence to established standards, such as the International Organization for Standardization's ISO 9000 series. TQM can be applied to any type of organization; it originated in the manufacturing sector and has since been adapted for use in almost every type of organization imaginable, including schools, highway maintenance, hotel management, and churches. As a current focus of e-business, TQM is based on quality management from the customer's point of view. TQM processes are divided into four sequential categories: **Plan, Do, Check, and Act** (the PDCA cycle).
- (b) **Communication as a Service (CaaS):** CaaS has evolved in the same lines as SaaS. CaaS is an outsourced enterprise communication solution that can be leased from a single vendor. The CaaS vendor is responsible for all hardware and software management and offers guaranteed Quality of Service (QoS). It allows businesses to selectively deploy communication devices and modes on a pay-as-you-go, as-needed basis. This approach eliminates the large capital investments. Examples are: Voice over IP (VoIP), Instant Messaging (IM), Collaboration and Videoconferencing application using fixed and mobile devices.
- (c) **Parallel Transmission:** In Parallel transmission, there are separate parallel paths corresponding to each bit of the byte so that all character bits are transmitted simultaneously. Centronic port is the example of parallel port used for printer.



Parallel Transmission

- (d) **General-purpose planning languages** allow users to perform many routine tasks, for example; retrieving various data from a database or performing statistical analyses. The languages in most electronic spreadsheets are good examples of general-purpose planning languages. These languages enable user to tackle a broad range of budgeting, forecasting, and other worksheet-oriented problems.
- (e) **Travel Management Systems:** Many business processes specific to this industry have been automated, including ticket booking for air, bus, train, hotel, etc. It has features such as 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.

MOCK TEST PAPER – II

INTERMEDIATE (IPC): GROUP – II

PAPER –7: INFORMATION TECHNOLOGY AND STRATEGIC MANAGEMENT

SECTION – B: STRATEGIC MANAGEMENT

SUGGESTED ANSWERS/HINTS

1. (a) A strategy is formed on the basis of certain assumptions or premises about the complex and turbulent organizational environment. Over a period of time these premises may not remain valid. Premise control is a tool for systematic and continuous monitoring of the environment to verify the validity and accuracy of the premises on which the strategy has been built. It primarily involves monitoring two types of factors:
- (i) Environmental factors such as economic (inflation, liquidity, interest rates), technology, social and regulatory.
 - (ii) Industry factors such as competitors, suppliers, substitutes.
- It is neither feasible nor desirable to control all types of premises in the same manner. Different premises may require different amount of control. Thus, managers are required to select those premises that are likely to change and would severely impact the functioning of the organization and its strategy.
- (b) Integrating cost leadership and differentiation is possible by providing the product/service at low cost through technologies that enable differentiation through focus on niche segments. Developments in process technology have made it possible to offer a wider variety of products and yet keep the cost low. An organisation that produces through mass production, but can use technological means to create variety in the product/service can sometimes combine the benefits of low-cost and differentiation. For e.g. the use of CAD and CAM and robot technology, results in manufacturing of small batch of products at low cost.
- (c) Globalization refers to the process of integration of the world into one huge market. Such unification calls for removal of all trade barriers among countries. Globalization is an opportunity for organizations to expand their markets and reach out to different customers. Globalization can also have other meanings. For some it is a new paradigm - a set of fresh beliefs, working methods, and economic, political and socio-cultural realities in which the previous assumptions are no longer valid. For developing countries, it means integration with the world economy.

- (d) Identifying an organisation's existing vision, mission, objectives are the starting point for any strategic management process. Determining vision and mission provides long-term direction, delineate what kind of enterprise the company is trying to become and infuse the organisation with a sense of purposeful action.
 - (e) The BCG growth share matrix represents businesses on a two-dimensional scale. The vertical axis represents market growth rate and provides a measure of market attractiveness. The horizontal axis represents relative market share and serves as a measure of company strength in the market. On the basis of different positions of the businesses on the matrix they are classified as stars, cash cows, question marks and dogs.
2. (a) (i) **Incorrect:** Efficiency pertains to designing and achieving suitable input output ratios of funds, resources, facilities and efforts whereas effectiveness is concerned with the organization's attainment of goals including that of desired competitive position. While efficiency is essentially introspective, effectiveness highlights the links between the organization and its environment. In general terms, to be effective is to do the right things while to be efficient is to do things rightly.
- (ii) **Correct:** Publicity is also a non-personal form of promotion similar to advertising. However, no payments are made to the media as in case of advertising. Organizations skillfully seek to promote themselves and their product without payment. Publicity is communication of a product, brand or business by placing information about it in the media without paying for the time or media space directly. Thus it is way of reaching customers with negligible cost. Basic tools for publicity are press releases, press conferences, reports, stories, and internet releases. These releases must be of interest to the public.
- (b) (i) A **joint venture** is a business agreement in which parties agree to develop, for a finite time, a new entity and new assets by contributing equity. They exercise control over the enterprise and consequently share revenues, expenses and assets.
- (ii) The changes in the environmental forces often require businesses to make modifications in their existing strategies and bring out new strategies. Strategic change is a complex process and it involves a corporate strategy focused on new markets, products, services and new ways of doing business.
- (iii) Customers and suppliers must work together in the product development process. Right from the start the partners will have knowledge of all Involving all partners will help in shortening the life cycles. Products are developed and launched in shorter time and help organizations to remain competitive.

3. (a) The term demographics denote characteristics of population in an area, district, country or in world. Some of the demographic factors have great impact on the business. Factors such as general age profile, sex ratio, income, education, growth rate affect the business with different magnitude.
- (b) Corporate culture refers to a company's values, beliefs, business principles, traditions, ways of operating and internal work environment. Every corporation has a culture that exerts powerful influences on the behaviour of managers.
- (c) Marketing mix is a systematic way of classifying the key decision areas of marketing management. It is the set of controllable marketing variables that the firm blends to produce the response it wants in the target market. The original framework of marketing mix comprises of 4Ps- product, price, place and promotion. These are subsequently expanded to highlight certain other key decision areas like people, processes, and physical evidence. The elements of original framework are:
- **Product:** It stands for the “goods-and-service” combination the company offers to the target market.
 - **Price:** It stands for the amount of money customers have to pay to obtain the product.
 - **Place:** It stands for company activities that make the product available to target consumers and include marketing channel, distribution policies and geographical availability.
 - **Promotion:** It stands for activities that communicate the merits of the product and persuade target consumers to buy it.
4. An important component of strategic thinking requires the generation of a series of strategic alternatives, or choices of future strategies to pursue, given the company's internal strengths and weaknesses and its external opportunities and threats. The comparison of strengths, weaknesses, opportunities, and threats is normally referred to as SWOT analysis.
- **Strength:** Strength is an inherent capability of the organization which it can use to gain strategic advantage over its competitors.
 - **Weakness:** A weakness is an inherent limitation or constraint of the organization which creates strategic disadvantage to it.
 - **Opportunity:** An opportunity is a favourable condition in the organisation's environment which enables it to strengthen its position.
 - **Threat:** A threat is an unfavourable condition in the organisation's environment which causes a risk for, or damage to, the organisation's position.

SWOT analysis helps managers to craft a business model (or models) that will allow a company to gain a competitive advantage in its industry (or industries). Competitive advantage leads to increased profitability, and this maximizes a company's chances of surviving in the fast-changing, competitive environment. Key reasons for SWOT analyses are:

- It provides a logical framework.
 - It presents a comparative account.
 - It guides the strategist in strategy identification.
5. Businesses have to respond to a dynamic and often hostile environment for pursuit of their mission. Strategies provide an integral framework for management and negotiate their way through a complex and turbulent external environment. Strategy seeks to relate the goals of the organisation to the means of achieving them.

A company's strategy is the game plan management is using to stake out market position and conduct its operations. A company's strategy consists of the combination of competitive moves and business approaches that managers employ to please customers, compete successfully and achieve organisational objectives.

Strategy may be defined as a long range blueprint of an organisation's desired image, direction and destination what it wants to be, what it wants to do and where it wants to go. Strategy is meant to fill in the need of organisations for a sense of dynamic direction, focus and cohesiveness.

The Generic Strategies

According to Glueck and Jauch there are four generic ways in which strategic alternatives can be considered. These are stability, expansion, retrenchment and combinations.

- (i) **Stability strategies:** One of the important goals of a business enterprise is stability to safeguard its existing interests and strengths, to pursue well established and tested objectives, to continue in the chosen business path, to maintain operational efficiency on a sustained basis, to consolidate the commanding position already reached, and to optimise returns on the resources committed in the business.
- (ii) **Expansion Strategy:** Expansion strategy is implemented by redefining the business by adding the scope of business substantially increasing the efforts of the current business. Expansion is a promising and popular strategy that tends to be equated with dynamism, vigor, promise and success. It is often characterised by significant reformulation of goals and directions, major initiatives and moves involving investments, exploration and onslaught into new products, new technology and new markets,

innovative decisions and action programmes and so on. Expansion includes diversifying, acquiring and merging businesses.

- (iii) **Retrenchment Strategy:** A business organisation can redefine its business by divesting a major product line or market. Retrenchment or retreat becomes necessary or expedient for coping with particularly hostile and adverse situations in the environment and when any other strategy is likely to be suicidal. In business parlance also, retreat is not always a bad proposition to save the enterprise's vital interests, to minimise the adverse environmental effects, or even to regroup and recoup the resources before a fresh assault and ascent on the growth ladder is launched.
 - (iv) **Combination Strategies:** Stability, expansion or retrenchment strategies are not mutually exclusive. It is possible to adopt a mix to suit particular situations. An enterprise may seek stability in some areas of activity, expansion in some and retrenchment in the others. Retrenchment of ailing products followed by stability and capped by expansion in some situations may be thought of. For some organisations, a strategy by diversification and/or acquisition may call for a retrenchment in some obsolete product lines, production facilities and plant locations.
6. Business Process Reengineering (BPR) is an approach to unusual improvement in operating effectiveness through the redesigning of critical business processes and supporting business systems. It is revolutionary redesign of key business processes that involves examination of the basic process itself. It looks at the minute details of the process, such as why the work is done, who does it, where is it done and when it is done. BPR refers to the analysis and redesign of workflows and processes both within the organization and between the organization and the external entities like suppliers, distributors, and service providers.

The orientation of redesigning efforts is basically radical. In other words, it is a total deconstruction and rethinking of business process in its entirety, unconstrained by its existing structure and pattern. Its objective is to obtain quantum jump in process performance in terms of time, cost, output, quality, and responsiveness to customers. BPR is a revolutionary redesigning of key business processes. BPR involves the following steps:

1. **Determining objectives and framework:** Objectives are the desired end results of the redesign process which the management and organization attempts to achieve. This will provide the required focus, direction, and motivation for the redesign process. It helps in building a comprehensive foundation for the reengineering process.
2. **Identify customers and determine their needs:** The designers have to understand customers – their profile, their steps in acquiring, using and disposing a product. The purpose is to redesign business process that clearly provides added value to the customer.

3. **Study the existing process:** The existing processes will provide an important base for the redesigners. The purpose is to gain an understanding of the 'what', and 'why' of the targeted process. However, some companies go through the reengineering process with clean perspective without laying emphasis on the past processes.
 4. **Formulate a redesign process plan:** The information gained through the earlier steps is translated into an ideal redesign process. Formulation of redesign plan is the real crux of the reengineering efforts. Customer focused redesign concepts are identified and formulated. In this step alternative processes are considered and the best is selected.
 5. **Implement the redesign:** It is easier to formulate new process than to implement them. Implementation of the redesigned process and application of other knowledge gained from the previous steps is key to achieve dramatic improvements. It is the joint responsibility of the designers and management to operationalise the new process.
7. Two basic approaches to leadership can be transformational leadership style and transactional leadership style.

Transformational leadership style use charisma and enthusiasm to inspire people to exert them for the good of the organization. They offer excitement, vision, intellectual stimulation and personal satisfaction. It inspires involvement in a mission, giving followers a 'dream' or 'vision' of a higher calling so as to elicit more dramatic changes in organizational performance. Such a leadership motivates followers to do more than originally affected to do by stretching their abilities and increasing their self-confidence, and also promote innovation throughout the organization.

Transformational leadership style may be appropriate in turbulent environments, in industries at the very start or end of their life-cycles, in poorly performing organizations when there is a need to inspire a company to embrace major changes. The use of charismatic behaviours to make people feel important and cherished is arguably important during periods of uncertainty when people are generally feeling quite distressed. Transformational leaders will challenge established paradigms and ways of working.

However, some researchers believe that leaders who rely too heavily upon charisma are not always effective in the long term. This is because few individuals may be talented and energetic are able to handle all types of business problems alone. They require people around them who are able to support them, and who are prepared to tell them when things are going wrong.

Whereas, transactional leadership style focus more on designing systems and controlling the organization's activities and are more likely to be associated with improving the current situation. It tries to build on the existing culture and enhance current practices. Transactional

leadership style uses the authority of its office to exchange rewards, such as pay and status. They prefer a more formalized approach to motivation, setting clear goals with explicit rewards or penalties for achievement or non-achievement. For employees' work efforts and generally seek to enhance an organisation's performance steadily, but not dramatically.

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

In conclusion, neither style of leadership is suitable for all circumstances. Effective executives use a leadership style that is appropriate to the needs of the organization and its business situation.