PAPER – 5: ADVANCED ACCOUNTING

PART – I: ANNOUNCEMENTS STATING APPLICABILITY & NON-APPLICABILITY FOR NOVEMBER, 2015 EXAMINATION

A. <u>Applicable for November, 15 Examination</u>

(i) Paragraphs 46 for entities other than Companies

In line with para 46 inserted by the MCA for corporate entities, the Council of the ICAI has also inserted Paragraph 46 in AS 11 for entities other than Companies in the month of February, 2014:

46(1) In respect of accounting periods commencing on or after 7th December, 2006 (such option to be irrevocable and to be applied to all such foreign currency monetary items), the exchange differences arising on reporting of long-term foreign currency monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, in so far as they relate to the acquisition of a depreciable capital asset, can be added to or deducted from the cost of the asset and should be depreciated over the balance life of the asset, and in other cases, can be accumulated in a "Foreign Currency Monetary Item Translation Difference Account" in the enterprise's financial statements and amortized over the balance period of such long-term asset or liability, by recognition as income or expense in each of such periods, with the exception of exchange differences dealt with in accordance with the provisions of paragraph 15.

(2) To exercise the option referred to in sub-paragraph (1), an asset or liability shall be designated as a long-term foreign currency monetary item, if the asset or liability is expressed in a foreign currency and has a term of twelve months or more at the date of origination of the asset or the liability:

Provided that the option exercised by the enterprise should disclose the fact of such option and of the amount remaining to be amortized in the financial statements of the period in which such option is exercised and in every subsequent period so long as any exchange difference remains unamortized."

(ii) Companies Act, 2013

The relevant Sections of the Companies Act, 2013 notified up to 31st March, 2015 will be applicable for Nov., 2015 Examination.

(iii) Maintenance of Statutory Liquidity Ratio (SLR)

As per Notification No. DBOD No.Ret. BC.70/12.02.001/2014-15 dated February 3, 2015, the SLR of Scheduled Commercial Banks, Local Area Banks and Regional

Rural Banks should not be less than 21.5% of its demand and time liabilities with effect from the fortnight beginning February 7, 2015.

(iv) Maintenance of Cash Reserve Ratio (CRR)

Reserve Bank of India has decided to reduce the Cash Reserve Ratio (CRR) of Scheduled Commercial Banks by 25 basis points from 4.25 per cent to ***4.00 per cent of their Net Demand and Time Liabilities (NDTL)*** with effect from the fortnight beginning February 09, 2013 vide circular DBOD.No.Ret.BC.76/ 12.01.001/2012-13 dated January 29, 2013. The Local Area Banks shall also maintain CRR at 3.00 per cent of its net demand and time liabilities up to February 08, 2013 and 4.00 per cent of its net demand and time liabilities from the fortnight beginning from February 09, 2013.

(v) SLR Holdings under Held to Maturity Category

In order to further develop the government securities market and enhance liquidity, it has been decided to bring down the ceiling on SLR securities under the HTM category from 24 per cent of NDTL to 22 per cent* in a graduated manner. Accordingly it is advised that: Banks are permitted to exceed the limit of 25 per cent of total investments under HTM category provided:

a. the excess comprises only of SLR securities, and

b. the total SLR securities held in the HTM category is not more than 23.50 per cent with effect from January 10, 2015, 23.0 per cent with effect from April 4, 2015, 22.5 per cent with effect from July 11, 2015 and 22.0 per cent with effect from September 19, 2015, of their DTL as on the last Friday of the second preceding fortnight.

* As per DBOD.No.BP.BC.42/21.04.141/2014-15 dated 7 October, 2014.

(vi) Revision in date of commencement of commercial operations

Circular no. DBOD.No.BP.BC.33/21.04.048/2014-15 dated 14 August, 2014, states that: revisions of the date of commencement of commercial operations (DCCO) and consequential shift in repayment schedule for equal or shorter duration (including the start date and end date of revised repayment schedule) will not be treated as restructuring provided that:

(a) The revised DCCO falls within the period of two years and one year from the original DCCO stipulated at the time of financial closure for infrastructure projects and non-infrastructure projects respectively; and

(b) All other terms and conditions of the loan remain unchanged.

(vii) Securities and Exchange Board of India (Share Based Employee Benefits) Regulations, 2014

SEBI vide Circular No. LAD-NRO/GN/2014-15/16/1729 dated 28th October, 2014 has formulated the SEBI (Share Based Employee Benefits) Regulations, 2014 which replaces the SEBI (Employees Stock Option Plan) Guidelines, 1999. The said Regulations deal with various provisions relating to employee stock option schemes, employee stock purchase schemes, stock appreciation rights schemes, general employee benefits schemes and retirement benefit schemes formulated by listed companies. The regulations deal with definition of eligible employees, formation of compensation committee, shareholders approvals variation of terms of issue, listing, compliances etc. For the complete text of this notification please refer to the link: http://www.sebi.gov.in/cms/sebi_data/attachdocs/1414568485252.pdf

B. Not applicable for November, 15 examination

(i) Ind ASs issued by the Ministry of Corporate Affairs

These Ind ASs are not applicable for the students appearing in November, 15 Examination.

(ii) Financial Reporting of Electricity Companies

The topic on “Financial Statements of Electricity Companies” has been excluded from the syllabus w.e.f. November, 2015 Examination and onwards.

PART – II : QUESTIONS AND ANSWERS

QUESTIONS

Partnership Accounts

Dissolution of partnership firm

1. P, Q, R and S are sharing profits and losses in the ratio 3 : 3 : 2 : 1. Frauds committed by R during the year were found out and it was decided to dissolve the partnership on 31st March, 2014 when their Balance Sheet was as under:

Liabilities	Amount (₹)	Assets	Amount (₹)
Capitals:		Building	1,90,000
P	1,50,000	Stock	1,30,000
Q	1,50,000	Investments	50,000
R	-	Debtors	70,000
S	60,000	Cash	30,000

General reserve	40,000	R	40,000
Trade creditors	80,000		
Bills payable	30,000		
	5,10,000		5,10,000

Following information is given to you:

(i) A cheque for ₹ 7,000 received from debtor was not recorded in the books and was misappropriated by R.

(ii) Investments costing ₹ 8,000 were sold by R at ₹ 11,000 and the funds transferred to his personal account. This sale was omitted from the firm's books.

(iii) A creditor agreed to take over investments of the book value of ₹ 9,000 at ₹ 13,000. The rest of the creditors were paid off at a discount of 5%.

(iv) The other assets realized as follows:

Building 110% of book value

Stock ₹ 1,20,000

Investments The rest of investments were sold at a profit of ₹ 7,000

Debtors The rest of the debtors were realized at a discount of 10%

(v) The bills payable were settled at a discount of ₹ 500.

(vi) The expenses of dissolution amounted to ₹ 8,000

(vii) It was found out that realization from R's private assets would only be ₹ 7,000.

Prepare Realisation Accounts, Cash Account and Partner's Capital Account. All workings should part of your answer.

Sale of Partnership firm to Company

2. XYZ & Co. is a partnership firm consisting of Mr. X, Mr. Y and Mr. Z who share profits and losses in the ratio of 2:2:1 and ABC Ltd. is a company doing similar business.

Following is the summarized Balance Sheet of the firm and that of the company as at 31.3.2015:

Liabilities	XYZ & Co. ₹	ABC Ltd. ₹		XYZ & Co. ₹	ABC Ltd. ₹
Equity share capital:			Plant & machinery	5,00,000	16,00,000
Equity shares of ₹ 10 each		20,00,000	Furniture & fixture	50,000	2,25,000
Partners capital:			Inventories	2,00,000	8,50,000

X	2,00,000		Trade receivables	2,00,000	8,25,000
Y	3,00,000		Cash at bank	10,000	4,00,000
Z	1,00,000		Cash in hand	40,000	1,00,000
General reserve	1,00,000	7,00,000			
Trade payables	3,00,000	13,00,000			
	10,00,000	40,00,000		10,00,000	40,00,000

It was decided that the firm XYZ & Co. be dissolved and all the assets (except cash in hand and cash at bank) and all the liabilities of the firm be taken over by ABC Ltd. by issuing 50,000 shares of ₹ 10 each at a premium of ₹ 2 per share.

Partners of XYZ & Co. agreed to divide the shares issued by ABC Ltd. in the profit sharing ratio and bring necessary cash for settlement of their capital.

The trade payables of XYZ & Co. includes ₹ 1,00,000 payable to ABC Ltd. An unrecorded liability of ₹ 25,000 of XYZ & Co. must also be taken over by ABC Ltd.

Prepare:

(i) Realisation account, Partners' capital accounts and Cash in hand/Bank account in the books of XYZ & Co.

(ii) Pass journal entries in the books of ABC Ltd. for acquisition of XYZ & Co. and draw the Balance Sheet after the takeover.

Conversion of partnership into a Company

3. P, Q and R are partners sharing profits and losses in the ratio 3 : 2 : 1 after allowing interest on capital @ 9% p.a. Their Balance Sheet as at 31st March, 2015 are as follows:

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

They applied for conversion of the firm into a Private Limited Company named PQR Pvt. Ltd. and the certificate was received on 01-04-2015. They decided to maintain same profit sharing ratio and to preserve the priority in regard to repayment of capital as far as possible. For that purpose, they decided to insert a clause of issuance of Preference shares in Memorandum of Association in addition to issuance of Equity shares of ₹ 10 each.

On 01-04-2015, the value of goodwill is to be determined on the basis of 2 years' purchase of the average profit from the business of the last 5 years. The particulars of profits are as under:

		₹
Year ended 31.03.2011	Profit	10,000
Year ended 31.03.2012	Loss	5,000
Year ended 31.03.2013	Profit	18,000
Year ended 31.03.2014	Profit	27,000
Year ended 31.03.2015	Profit	30,000

The loss for the year ended 31-03-2012 was on account of loss by strike to the extent of 10,000.

It was agreed that rest of the assets are valued on the basis of the Balance Sheet as at 31-03-2015 except Plant & Machinery which is valued at ₹ 1,02,000.

You are required to prepare (a) the Balance Sheet of the Company as at 01-04-2015, (b) Partners' Capital Accounts and (c) Statement showing the final settlement between the partners taking Q's capital as basis.

Issues related to Accounting in LLPs

4. Differentiate on ordinary partnership firm with an LLP. Under what circumstances, an LLP may be wound up by the Tribunal?

Employees Stock Option Plan

5. On 1st April, 2014, a company offered 100 shares to each of its 400 employees at ₹ 25 per share. The employees are given a month to accept the shares. The shares issued under the plan shall be subject to lock-in to transfer for three years from the grant date i.e. 30, April 2014. The market price of shares of the company on the grant date is ₹ 30 per share. Due to post-vesting restrictions on transfer, the fair value of shares issued under the plan is estimated at ₹ 28 per share.

   Up to 30th April, 2014, 50% of employees accepted the offer and paid ₹ 25 per share purchased. Nominal value of each share is ₹ 10. Record the issue of shares in the books of the company under the aforesaid plan.

Redemption of Debentures

6. The summarised Balance Sheet of ABC Limited, as on 30th June, 2014, stood as follows:

Liabilities	₹
Share Capital : 8,00,000 equity shares of ₹ 10 each fully paid	80,00,000
General Reserve	1,10,00,000
Debenture Redemption Reserve	70,00,000
12% Convertible Debentures, 1,50,000 Debentures of ₹ 100 each	1,50,00,000
Other loans	70,00,000
Current Liabilities and Provisions	1,80,00,000
	6,60,00,000
Assets:	
Fixed Assets (at cost less depreciation)	2,50,00,000
Debenture Redemption Reserve Investments	60,00,000
Cash and bank Balances	80,00,000
Other Current Assets	2,70,00,000
	6,60,00,000

The debentures are due for redemption on 30th June, 2014. The terms of issue of debentures provided that they were redeemable at a 10% premium and also conferred option to the debenture holders to convert 25% of their holding into equity shares at a predetermined price of ₹ 27.50 per share and the balance payment in cash.

Assuming that:

(i) except for 80 debenture holders holding totally 50,000 debentures, the rest of them exercised the option for maximum conversion.

(ii) the investments realise ₹ 70 lakhs on sale; and

(iii) all the transactions are put through, without any lag, on 30th June, 2014.

Redraft the balance sheet of the company as on 30th June, 2014 after giving effect to the redemption. Show your calculations in respect of the number of equity shares to be allotted and the cash payment necessary.

Buy Back of Securities

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

	₹ in ‘000	₹ in ‘000
Equity & Liabilities		
Share Capital:		
Authorized Capital:		10,000

Issued and Subscribed Capital :		
6,00,000 Equity shares of ₹ 10 each fully paid up	6,000	
40,000 9% Preference Shares of 100 each	4,000	10,000
Reserve and Surplus:		
Capital reserve	20	
Revenue reserve	8,000	
Securities premium	1,000	
Profit and Loss account	3,600	12,620
Non-current liabilities - 10% Debentures		500
Current liabilities and provisions		380
		23,500
Assets		
Fixed Assets: Cost	6,000	
Less: Provision for depreciation	500	5,500
Non-current investments at cost		10,000
Current assets, loans and advances (including cash and bank balances)		8,000
		23,500

The company passed a resolution to buy back 10% of its equity capital @ ₹ 15 per share. For this purpose, it sold its investments of ₹ 60 lakhs for ₹ 50 lakhs. The company also redeemed all preference shares at par on 1st April, 2015.

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

Underwriting of Securities

8. Shri Ltd. company made a public issue of 10,00,000 equity shares of ₹ 100 each, ₹ 60 payable on application. The entire issue was underwritten by four parties: M, N, O, and P in the proportion of 35% and 30%, 25% and 10% respectively.

   Under the terms agreed upon, a commission of 3% was payable on the amounts underwritten.

   M, N, O, and P also agreed on 'firm'; underwriting of 30,000, 50,000, 40,000 and 18,500 shares respectively.

   The total subscriptions, excluding firm underwriting, including marked applications were for 8,00,000 shares. Marked applications received were as under :

M: 2,50,000 N: 2,00,000 O: 2,00,000 P: 80,000

Ascertain the liability of the individual underwriters, when benefit of firm underwriting is given to individual underwriters, and also show the journal entries that you would make in the books of the company. All workings should form part of your answer.

Internal Reconstruction of a Company

9. Platinum Limited has decided to reconstruct the Balance Sheet since it has accumulated huge losses. The following is the draft Balance Sheet of the company as on 31st March, 2014 before reconstruction:

Liabilities	Amount (₹)	Assets	Amount (₹)
Share Capital			
50,000 shares of ₹ 50		Goodwill	22,00,000
each fully paid up	25,00,000	Land & Building	42,70,000
1,00,000 shares of ₹ 50		Machinery	8,50,000
each ₹ 40 paid up	40,00,000	Computers	5,20,000
Capital Reserve	5,00,000	Inventories	3,20,000
8% Debentures of ₹ 100 each	4,00,000	Trade receivables	10,90,000
12% Debentures of ₹ 100 each	6,00,000	Cash at Bank	2,68,000
Trade payables	12,40,000	Profit & Loss Account	7,82,000
Outstanding Expenses	10,60,000		
Total	1,03,00,000	Total	1,03,00,000

Following is the interest of Mr. Shiv and Mr. Ganesh in Platinum Limited:

	Mr. Shiv	Mr. Ganesh
8% Debentures	3,00,000	1,00,000
12% Debentures	4,00,000	2,00,000
Total	7,00,000	3,00,000

The following scheme of internal reconstruction was framed and implemented, as approved by the court and concerned parties:

(1) Uncalled capital is to be called up in full and then all the shares to be converted into Equity Shares of ₹ 40 each.

(2) The existing shareholders agree to subscribe in cash, fully paid up equity shares of 40 each for ₹ 12,50,000.

(3) Trade payables are given option of either to accept fully paid equity shares of ₹ 40 each for the amount due to them or to accept 70% of the amount due to them in cash in full settlement of their claim. Trade payables for ₹ 7,50,000 accept equity

shares and rest of them opted for cash towards full and final settlement of their claim.

(4) Mr. Shiv agrees to cancel debentures amounting to ₹ 2,00,000 out of total debentures due to him and agree to accept 15% Debentures for the balance amount due. He also agree to subscribe further 15% Debentures in cash amounting to ₹ 1,00,000.

(5) Mr. Ganesh agrees to cancel debentures amounting to ₹ 50,000 out of total debentures due to him and agree to accept 15% Debentures for the balance amount due.

(6) Land & Building to be revalued at ₹ 51,84,000, Machinery at ₹ 7,20,000, Computers at ₹ 4,00,000, Inventories at ₹ 3,50,000 and Trade receivables at 10% less to as they are appearing in Balance Sheet as above.

(7) Outstanding Expenses are fully paid in cash.

(8) Goodwill and Profit & Loss A/c will be written off and balance, if any, of Capital Reduction A/c will be adjusted against Capital Reserve.

You are required to pass necessary Journal Entries for all the above transactions and draft the company's Balance Sheet immediately after the reconstruction.

Amalgamation of Companies

10. The following draft Balance Sheets are given as on 31st March, 2014:

	(₹ in lakhs)			(₹ in lakhs)	
	Best Ltd. ₹	Better Ltd. ₹		Best Ltd. ₹	Better Ltd. ₹
Share Capital:			Fixed Assets	25	15
Shares of ₹ 100, each			Investments	5	–
fully paid	20	10	Current Assets	20	5
Reserve and Surplus	10	8			
Other Liabilities	20	2			
	50	20		50	20

The following further information is given —

(a) Better Limited issued bonus shares on 1st April, 2014, in the ratio of one share for every two held, out of Reserves and Surplus.

(b) It was agreed that Best Ltd. will take over the business of Better Ltd., on the basis of the latter's Balance Sheet, the consideration taking the form of allotment of shares in Best Ltd.

(c) The value of shares in Best Ltd. was considered to be ₹ 150 and the shares in Better Ltd. were valued at ₹ 100 after the issue of the bonus shares. The allotment of shares is to be made on the basis of these values.

(d) Liabilities of Better Ltd., included ₹ 1 lakh due to Best Ltd., for purchases from it, on which Best Ltd., made profit of 25% of the cost. The goods of ₹ 50,000 out of the said purchases, remained in stock on the date of the above Balance Sheet.

Make the closing ledger in the Books of Better Ltd. and the opening journal entries in the Books of Best Ltd., and prepare the Balance Sheet as at 1st April, 2014 after the takeover.

Liquidation of Company

11. Raghu Ltd. went into voluntary liquidation on 31st March, 2014 when their Balance Sheet read as follows:—

Liabilities	₹
Issued and subscribed capital :	
2,500 equity shares of ₹ 100 each, ₹ 75 paid	1,87,500
7,500 equity shares of ₹ 100 each, ₹ 60 paid	4,50,000
5,000 6% cumulative preference shares of ₹ 100 each, fully paid	5,00,000
Reserve and Surplus	
Profit & Loss Account	(4,10,000)
Non –Current Liabilities	
5% Debentures (secured by a floating charge on all assets)	2,50,000
Current Liabilities	
Short term borrowings- Bank overdraft	1,00,000
Trade payables(unsecured)	2,25,000
Current Liabilities	
Interest due on Debentures	12,500
Taxes due to Government within 12 months	12,500
Salaries and wages to workers due for 4 months	60,000
	13,87,500
Assets	
Tangible assets	
Land	50,000
Building	2,00,000
Machinery and Plant	6,25,000

Current assets	
Inventories	1,37,500
Trade receivables	2,75,000
Cash and cash equivalents	1,00,000
	13,87,500

Other information:

1. Bank overdraft is secured by deposit of title deed of land and building which realised ₹ 3,00,000.
2. The assets realised as follows :

   Machinery and Plant ₹ 5,00,000;

   Inventories ₹ 1,50,000;

   Trade receivables ₹ 2,00,000
3. Preference dividends were in arrears for 2 years.
4. Expenses of liquidation amounted to ₹ 57,250.
5. The liquidator is entitled to a commission of 5% on all assets realised except cash and 1% on the amount distributed to Trade payables.
6. Liquidator realised all assets on the above date and discharged his obligation on the same date.

Prepare liquidator's Statement of Account.

Financial Statements of Insurance Companies

12. From the following balances extracted from the books of Gemini Insurance Company Limited as on 31.3.2014 you are required to prepare Revenue Accounts in respect of Fire and Marine Insurance business for the year ended 31.3.2014 to and a Profit and Loss Account for the same period:

	₹		₹
Directors' Fees	1,84,000	Interest received	44,000
Dividend received	2,30,000	Fixed Assets (1.4.2013)	20,00,000
Provision for Taxation		Income-tax paid during	
(as on 1.4. 2013)	1,95,000	the year	1,40,000

	Fire	Marine
	₹	₹
Outstanding Claims on 1.4. 2013	63,000	15,000

Claims paid	2,30,000	1,84,000
Reserve for Unexpired Risk on 1.4.2013	4,60,000	3,20,000
Premiums Received	10,00,000	7,50,000
Agent's Commission	92,000	46,000
Expenses of Management	1,40,000	1,00,000
Re-insurance Premium (Dr.)	60,000	35,000

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

(a) Depreciation on Fixed Assets to be provided at 5% p.a.

(b) Interest accrued on investments ₹ 23,000.

(c) Closing provision for taxation on 31.3. 2014 to be maintained at ₹ 2,05,000.

(d) Claims outstanding on 31.3. 2014 were Fire Insurance ₹ 23,000; Marine Insurance ₹ 34,000.

(e) Premium outstanding on 31.3.2014 were Fire Insurance ₹ 70,000; Marine Insurance ₹ 45,000.

(f) Reserve for unexpired risk to be maintained at 50% and 100% of net premiums in respect of Fire and Marine Insurance respectively.

(g) Expenses of management due on 31.3.2014 were ₹ 20,000 for Fire Insurance and ₹ 10,000 in respect of marine Insurance.

Financial Statements of a Banking Company

13. The following are the figures extracted from the books of TOP Bank Limited as on 31.3.2014.

	₹
Interest and discount received	59,29,180
Interest paid on deposits	32,59,920
Issued and subscribed capital	16,00,000
Salaries and allowances	3,20,000
Directors fee and allowances	48,000
Rent and taxes paid	1,44,000
Postage and telegrams	96,460
Statutory reserve fund	12,80,000
Commission, exchange and brokerage	3,04,000
Rent received	1,04,000
Profit on sale of investments	3,20,000

Depreciation on bank's properties	48,000
Statutory expenses	44,000
Preliminary expenses	40,000
Auditor's fee	28,000

The following further information is given:

(i) A customer to whom a sum of ₹ 16 lakhs has been advanced has become insolvent and it is expected only 40% can be recovered from his estate.

(ii) There were also other debts for which a provision of ₹ 2,10,000 was found necessary by the auditors.

(iii) Rebate on bills discounted on 31.3.2013 was ₹ 19,000 and on 31.3.2014 was ₹ 25,000.

(iv) Preliminary expenses are to be fully written off during the year.

(v) Provide ₹ 9,00,000 for Income-tax.

(vi) Profit and Loss account opening balance was Nil as on 31.3. 2013.

Prepare the Profit and Loss account of TOP Bank Limited for the year ended 31.3. 2014.

Departmental Accounts

14. Department P sells goods to Department S at a profit of 25% on cost and to Department Q at a profit of 15% on cost. Department S sells goods to P and Q at a profit of 20% and 30% on sales respectively. Department Q sells goods to P and S at 20% and 10% profit on cost respectively.

Departmental Managers are entitled to 10% commission on net profit subject to unrealized profit on departmental sales being eliminated. Departmental profits after charging Manager's commission, but before adjustment of unrealized profits are as below:

	₹
Department P	90,000
Department S	60,000
Department Q	45,000

Stock lying at different Departments at the end of the year are as below:

			Figures in ₹
	DEPARTMENTS		
	P	S	Q
Transfer from P	-	18,000	14,000
Transfer from S	48,000	-	38,000
Transfer from Q	12,000	8,000	-

Find out correct Departmental Profits after charging Managers' Commission.

Branch Accounting

15. Show adjustment Journal entry in the books of Head Office at the end of April, 2014 for incorporation of inter-branch transactions assuming that only Head Office maintains different branch accounts in its books.

A. A.P. Branch:

(1) Received goods from M.P. – ₹ 30,000 and ₹ 25,000 from U.P.

(2) Sent goods to W.B. – ₹ 20,000, U.P. – ₹ 30,000.

(3) Bill Receivable received – ₹ 10,000 from W.B.

(4) Acceptances sent to M.P. – ₹ 10,000, U.P. – ₹ 20,000.

B. M.P. Branch (apart from the above) :

(5) Received goods from U.P. – ₹ 20,000, A.P – ₹ 10,000.

(6) Cash sent to A.P – ₹ 20,000, U.P. – ₹ 10,000.

C. W.B. Branch (apart from the above) :

(7) Received goods from U.P. – ₹ 40,000.

(8) Acceptances and Cash sent to U.P. – ₹ 10,000 and ₹ 15,000 respectively.

D. U.P. Branch (apart from the above) :

(9) Paid cash to W.B. – ₹ 20,000 and M.P. – ₹ 10,000

Framework for Preparation and Presentation of Financial Statements

16. (a) With regard to financial statements name any four.

(1) Users

(2) Qualitative characteristics

(3) Elements

(b) What are fundamental accounting assumptions?

Problems based on Accounting Standards

AS 4

17. (a) An earthquake destroyed a major warehouse of PQR Ltd. on 30.4.2014. The accounting year of the company ended on 31.3.2014. The accounts were approved on 30.6.2014. The loss from earthquake is estimated at ₹ 25 lakhs. State with reasons, whether the loss due to earthquake is an adjusting or non-adjusting event and how the fact of loss is to be disclosed by the company.

AS 5

(b) Explain whether the following will constitute a change in accounting policy or not as per AS 5.

(i) Introduction of a formal retirement gratuity scheme by an employer in place of ad hoc ex-gratia payments to employees on retirement.

(ii) Management decided to pay pension to those employees who have retired after completing 5 years of service in the organistaion. Such employees will get pension of ₹ 20,000 per month. Earlier there was no such scheme of pension in the organization?

AS 11

18. (a) Assets and liabilities and income and expenditure items in respect of integral foreign operations are translated into Indian rupees at the prevailing rate of exchange at the end of the year. The resultant exchange differences in the case of profit, is carried to other Liabilities Account and the Loss, if any, is charged to revenue. Comment.

AS 12

(b) White Ltd. A fixed asset is purchased for ₹ 25 lakhs. Government grant received towards it is ₹ 10 lakhs. Residual Value is ₹ 5 lakhs and useful life is 5 years. Assume depreciation on the basis of Straight Line method. Asset is shown in the balance sheet net of grant. After 1 year, grant becomes refundable to the extent of ₹ 6 lakhs due to non compliance with certain conditions. Pass journal entries for first two years.

AS 16

19. (a) G Ltd. began construction of a new building on 1st January, 2014. It obtained ₹ 2 lakh special loan to finance the construction of the building on 1st January, 2014 at an interest rate of 11%. The company's other outstanding two non-specific loans were:

Amount	Rate of Interest
₹ 3,00,000	12%
₹ 7,00,000	14%

The expenditures that were made on the building project were as follows:

		₹
January	2014	1,60,000
May	2014	2,70,000
August	2014	4,20,000
December	2014	1,50,000

Building was completed by 31st December, 2014. Following the principles prescribed in AS 16 'Borrowing Cost,' calculate the amount of interest to be capitalized and pass one Journal Entry for capitalizing the cost and borrowing cost in respect of the building.

AS 19

(b) (i) Distinguish between operating lease and finance lease.

(ii) L Private Limited has taken machinery on lease from P Ltd. The information is as under:

Lease term = 4 years

Fair value at inception of lease = ₹ 20,00,000

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

Guaranteed residual value = ₹ 1,25,000

Expected residual value = ₹ 3,75,000

Implicit interest rate = 15%

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

Calculate the value of the lease liability as per AS19.

AS 20

20. (a) From the information furnished you are required to compute the Basic and Diluted EPS (earnings per share) for accounting year 01-04-2014 to 31-03-2015 and adjusted EPS for the year 01-04-2013 to 31-03-2014.

Net profit for year ended 31-03-2014	₹ 75,50,000
Net profit for year ended 31-03-2015	₹ 1,00,25,000
No. of equity shares as on 01-04-2014	50,00,250
Bonus issue on 01-01-2015	1 share for every 2 held
No. of 12% Convertible Debentures of ₹ 100 each issued on 01-01-2015	1,00,000

Conversion ratio of Debentures	10 shares per debenture
Tax rate	30 percent

AS 26

(b) AB Ltd. launched a project for producing product X in October, 2013. The Company incurred ₹ 20 lakhs towards Research and Development expenses upto 31st March, 2015. Due to prevailing market conditions, the Management came to conclusion that the product cannot be manufactured and sold in the market for the next 10 years. The Management hence wants to defer the expenditure write off to future years. Advise the Company as per the applicable Accounting Standard.

SUGGESTED ANSWERS/HINTS

1. Realisation Account

Particulars	₹	*Particulars*		₹
To Building	1,90,000	By Trade creditors		80,000
To Stock	1,30,000	By Bills payable		30,000
To Investment	50,000	By Cash		
To Debtors	70,000	Building	2,09,000	
To Cash-creditors paid (W.N.1)	63,650	Stock	1,20,000	
To Cash-expenses	8,000	Investments (W.N.2)	40,000	
To Cash-bills payable (30,000-500)	29,500	Debtors (W.N. 3)	56,700	4,25,700
To Partners' Capital A/cs		By R -Debtors-unrecorded		7,000
P 4,183		By R- Investments-unrecorded		11,000
Q 4,183				
R 2,789				
S 1,395	12,550			
	5,53,700			5,53,700

Cash Account

Particulars		*Amount* ₹	*Particulars*	*Amount* ₹
To Balance b/d		30,000	By Realisation-creditors paid	63,650
To Realisation – assets realised			By Realisation-bills payable	29,500
Building	2,09,000		By Realisation-expenses	8,000
Stock	1,20,000		By Capital account	
Investments	40,000		P	1,51,132
Debtors	56,700	4,25,700	Q	1,51,132
To R's capital A/c		7,000	S	59,286
		4,62,700		4,62,700

Partners' Capital Accounts

Particulars	*P*	*Q*	*R*	*S*	*Particulars*	*P*	*Q*	*R*	*S*
	₹	₹	₹	₹		₹	₹	₹	₹
To Balance b/d			40,000		By Balance b/d	1,50,000	1,50,000	-	60,000
To Realisation A/c- Debtors-misappropriation			7,000		By General reserve	13,333	13,333	8,889	4,445
To Realisation A/c- Investment-misappropriation			11,000		By Realisation profit	4,183	4,183	2,789	1,395
To R's capital A/c (W.N. 4)	16,384	16,384		6,554	By Cash A/c			7,000	
To Cash A/c	1,51,132	1,51,132		59,286	By P's capital A/c			16,384	
					By Q's capital A/c			16,384	
					By S's capital A/c			6,554	
	1,67,516	1,67,516	58,000	65,840		1,67,516	1,67,516	58,000	65,840

Working Notes:

1. **Amount paid to creditors in cash**

	₹
Book value	80,000
Less: Creditors taking over investments	(13,000)
	67,000
Less: Discount @ 5%	(3,350)
	63,650

2. **Amount received from sale of investments**

	₹
Book value	50,000
Less: Misappropriated by R	(8,000)
	42,000
Less: Taken over by a creditor	(9,000)
	33,000
Add: Profit on sale of investments	7,000
Cash received from sale of remaining investment	40,000

3. **Amount received from debtors**

	₹
Book value	70,000
Less: Unrecorded receipt	(7,000)
	63,000
Less: Discount @ 10%	(6,300)
	56,700

4. **Deficiency of R**

	₹
Balance of capital as on 31st March, 2014	40,000
Debtors-misappropriation	7,000
Investment-misappropriation	11,000
	58,000
Less: Realisation Profit	(2,789)

General reserve	(8,889)
Contribution from private assets	(7,000)
Net deficiency of capital	39,322

This deficiency of ₹ 39,322 in R's capital account will be shared by other partners P, Q and S in their capital ratio of 15 : 15 : 6.

Accordingly,

P's share of deficiency = [39,322 x (15/36)] = ₹ 16,384

Q's share of deficiency = [39,322 x (15/36)] = ₹ 16,384

S's share of deficiency = [39,322 x (6/36)] = ₹ 6,554

2. (i) **In the books of XYZ & Co.**

Realisation Account

		₹			₹
To	Plant & Machinery	5,00,000	By	Trade payables	3,00,000
To	Furniture & Fixture	50,000	By	ABC Ltd. (Refer W.N.)	6,00,000
To	Stock in trade	2,00,000	By	Partners' Capital Accounts (loss):	
To	Trade receivables	2,00,000		X's Capital A/c	20,000
				Y's Capital A/c	20,000
				Z's Capital A/c	10,000
		9,50,000			9,50,000

Partners' Capital Accounts

		X ₹	Y ₹	Z ₹			X ₹	Y ₹	Z ₹
To	Realisation A/c	20,000	20,000	10,000	By	Balance b/d	2,00,000	3,00,000	1,00,000
To	Shares in ABC Ltd.	2,40,000	2,40,000	1,20,000	By	General Reserve	40,000	40,000	20,000
To	Cash A/c	-	80,000	-	By	Cash A/c	20,000	-	10,000
		2,60,000	3,40,000	1,30,000			2,60,000	3,40,000	1,30,000

Cash and Bank Account

		Cash ₹	Bank ₹			Cash ₹	Bank ₹
To	Balance b/d	40,000	10,000	By	Cash A/c (Contra)*		10,000
To	Bank A/c (Contra)*	10,000		By	Y	80,000	
To	X	20,000					
To	Z	10,000					
		80,000	10,000			80,000	10,000

(ii) **In the Books of ABC Ltd.**

Journal Entries

			Dr. (₹)	Cr. (₹)
1.	Business Purchase Account	Dr.	6,00,000	
	To XYZ & Co.			6,00,000
	(Being business of XYZ & Co. purchased and payment due)			
2.	Plant and Machinery Account	Dr.	5,00,000	
	Furniture and Fixture Account	Dr.	50,000	
	Inventories Account	Dr.	2,00,000	
	Trade Receivables Account	Dr.	2,00,000	
	To Trade Payables Account			3,00,000
	To Unrecorded Liability Account			25,000
	To Business Purchase Account			6,00,000
	To Capital Reserve Account (Bal. Fig.)			25,000
	(Being take over of all assets and liabilities)			
3.	XYZ & Co.	Dr.	6,00,000	
	To Equity Share Capital Account			5,00,000

*It is assumed that cash at bank has been withdrawn to pay ₹ 80,000 to partner Y. However, payment to Y of ₹ 80,000 can also be made by cash ₹ 70,000 & by cheque ₹ 10,000.

	To Securities Premium Account			1,00,000
	(Being purchase consideration discharged in the form of shares of ₹ 10 each issued at a premium of ₹ 2 each)			
4.	Trade Payables Account	Dr.	1,00,000	
	To Trade Receivables Account			1,00,000
	(Being mutual owings eliminated)			

Balance Sheet of ABC Ltd. (After take over of XYZ & Co.)

as at 31.3.20015

	Note No.	₹
Equity and Liabilities		
Shareholders funds		
Share capital	1	25,00,000
Reserve and Surplus	2	8,25,000
Current liabilities		
Trade Payables (3,00,000 + 13,00,000 – 1,00,000)		15,00,000
Others (Unrecorded Liability)		25,000
Total		48,50,000
Assets		
Non-current assets		
Fixed assets		
Tangible assets	3	23,75,000
Current assets		
Inventories(2,00,000 + 8,50,000)		10,50,000
Trade Receivables (2,00,000 + 8,25,000 – 1,00,000)		9,25,000
Cash and cash equivalent	4	5,00,000
Total		48,50,000

Notes to Accounts

			₹
1.	*Share Capital*		
	2,50,000, Equity shares of ₹ 10 each fully paid up		25,00,000

	(out of which 50,000 shares has been issued for consideration other than cash)		
2	*Reserve and Surplus*		
	Securities Premium	1,00,000	
	Capital Reserve	25,000	
	General Reserve	7,00,000	8,25,000
3.	*Tangible assets*		
	Plant and Machinery (5,00,000 + 16,00,000)	21,00,000	
	Furniture and fixture (50,000 + 2,25,000)	2,75,000	23,75,000
4.	*Cash and cash equivalent*		
	Cash at Bank	4,00,000	
	Cash in hand	1,00,000	5,00,000

Working Note:

Computation of purchase consideration:

50,000, Equity shares of ₹ 12 (10+2) each = ₹ 6,00,000

Equity shares distributed among partners:

Partner X	=	20,000 shares @ ₹ 12	= ₹ 2,40,000
Partner Y	=	20,000 shares @ ₹ 12	= ₹ 2,40,000
Partner Z	=	10,000 shares @ ₹ 12	= ₹ 1,20,000
			₹ 6,00,000

3. (a) **Balance Sheet of the PQR Pvt. Ltd. as on 1-4-2015**

	Note No.	₹
Equity and Liabilities		
Shareholders funds		
Share capital	1	1,90,000
Current liabilities		
Trade Payables		48,000
Total		2,38,000
Assets		
Non-current assets		
Fixed assets		
Tangible assets	2	1,22,000

Intangible assets	3	36,000
Current assets		
Inventories		50,000
Trade Receivables		30,000
Total		2,38,000

Notes to Accounts

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

(b) In the books of Partnership Firm

Partners' Capital Accounts

	P ₹	*Q* ₹	*R* ₹		*P* ₹	*Q* ₹	*R* ₹
To Plant and machinery account	3,000	2,000	1,000	By Balance b/d	50,000	30,000	20,000
To Equity shares in PQR Pvt. Ltd.	90,000	60,000	30,000	By Reserve fund	30,000	20,000	10,000
To 9% Preference shares in PQR Pvt. Ltd.	5,000		5,000	By Realization A/c (Profit on sale of business)	18,000	12,000	6,000
	98,000	62,000	36,000		98,000	62,000	36,000

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

	P	Q	R	Total
	₹	₹	₹	₹
Value of Equity Shares to be allotted, taking Q's capital as basis P's Capital = 60,000 × 3/2 R's Capital = 60,000 × 1/2	90,000	60,000	30,000	
Total Value of Equity Shares allotted to P,Q and R				1,80,000
9% Preference Shares to be allotted to P ₹ (95,000-90,000)	5,000			
9%Preference Shares to be allotted to R ₹ (35,000-30,000)			5,000	
Total Value of Preference Shares allotted to P and R				10,000
Total Purchase Consideration				1,90,000

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

Working Notes:

1. Calculation of goodwill

	2010-11 ₹	2011-12 ₹	2012-13 ₹	2013-14 ₹	2014-15 ₹
Profits	10,000	(5,000)	18,000	27,000	30,000
Adjustment for abnormal loss in 2011-12	—	10,000	—	—	—
	10,000	5,000	18,000	27,000	30,000
Total Profit from 2010-11 to 2014-15					90,000
Average Profit (90,000 / 5)					18,000
Goodwill equal to 2 years' purchase					36,000

2 **Purchase consideration - Computation of Value placed on business:**

	₹
Assets :	
Goodwill	36,000
Plant & Machinery	1,02,000
Fixtures	20,000
Stock	50,000
Sundry Debtors	30,000
	2,38,000
Less: Liabilities:	
Creditors	48,000
Purchase Consideration	1,90,000

4. **Distinction between an ordinary partnership firm and an LLP**

	Key Elements	*Partnerships*	*LLPs*
1	Applicable Law	Indian Partnership Act 1932	The Limited Liability Partnerships Act, 2008
2	Registration	Optional	Compulsory with ROC
3	Creation	Created by an Agreement	Created by Law
4	Body Corporate	No	Yes
5	Separate Legal Entity	No	Yes
6	Perpetual Succession	Partnerships do not have perpetual succession	It has perpetual succession and individual partners may come and go
7	Number of Partners	Minimum 2 and Maximum 20 (subject to 10 for banks)	Minimum 2 but no maximum limit
8	Ownership of Assets	Firm cannot own any assets. The partners own the assets of the firm	The LLP as an independent entity can own assets
9	Liability of Partners / Members	Unlimited: Partners are severally and jointly liable for actions of other partners and the firm and their liability extends to personal assets	Limited to the extent of their contribution towards LLP except in case of intentional fraud or wrongful act of omission or commission

			by a partner.
10	Principal Agent Relationship	Partners are the agents of the firm and of each other	Partners are agents of the firm only and not of other partners

Under section 64 of the LLP Act, 2008, an LLP may be wound up by the Tribunal in the following circumstances:

- If the LLP decides that it should be wound up by the Tribunal;
- If for a period of more than six months, the number of partners of the LLP is reduced below two;
- If the LLP is unable to pay its debts;
- If the LLP has acted against the interests of the integrity and sovereignty of India, the security of the state or public order;
- If the LLP has defaulted in the filing of the Statement of Account and Solvency with the Registrar for five consecutive financial years;
- If the Tribunal is of the opinion that it is just and equitable that the LLP be wound up.

5. Fair value of an option = ₹ 28

Difference between Fair value and Issue Price =₹ 28 – ₹ 25 = 3.

Number of employees accepting the offer = 400 employees x 50% = 200 employees

Number of shares issued = 200 employees x 100 shares/employee = 20,000 shares

Employee Compensation Expenses recognized in 2014-15 =20,000 shares x ₹ 3 = ₹ 60,000

Securities Premium A/c = ₹ 28 – 10 = ₹ 18 per share = 20,000 x 18 = ₹ 3,60,000

Journal Entry

Date	*Particulars*		₹	₹
30.04.2014	Bank (20,000 shares x ₹ 25)	Dr.	5,00,000	
	Employees compensation expense A/c	Dr.	60,000	
	To Share Capital			2,00,000
	To Securities Premium			3,60,000
	(Being stock purchase option accepted by 200 employees for 100 shares each at ₹ 25 per share on a Fair Value of ₹ 28 per share)			

Note: Employees compensation expenses amounting ₹ 60,000 will ultimately be charged to profit & loss account.

6. **ABC Limited**

Balance Sheet as on June 30, 2014

Particulars	*Note No*	*Figures as at the end of current reporting period*
		₹
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	90,00,000
(b) Reserves and Surplus	2	1,92,50,000
(2) Non-Current Liabilities		
(a) Long-term borrowings		70,00,000
(3) Current Liabilities		
(a) Short-term provisions		1,80,00,000
Total		5,32,50,000
II. Assets		
(1) Non-current assets		
(a) Fixed assets		2,50,00,000
(2) Current assets		
(a) Cash and cash equivalents		12,50,000
(b) Other current assets		2,70,00,000
Total		5,32,50,000

Notes to Accounts

			₹
1.	**Share Capital**		
	9,00,000 Equity Shares of ₹10 each		90,00,000
2.	**Reserves and Surplus**		
	General Reserve	1,10,00,000	
	Add: Debenture Redemption Reserve transfer	70,00,000	
		1,80,00,000	
	Add: Profit on sale of investments	10,00,000	
		1,90,00,000	
	Less: Premium on redemption of debentures	(15,00,000)	1,75,00,000
	Securities Premium Account		17,50,000
			1,92,50,000

Working Notes :

(i) Calculation of number of shares to be allotted :

Total number of debentures	1,50,000
Less: Number of debentures not opting for conversion	(50,000)
	1,00,000
25% of 1,00,000	25,000
Redemption value of 25,000 debentures @ 110	₹ 27,50,000

Number of Equity Shares to be allotted :

$= \frac{27,50,000}{27.50}$ = 1,00,000 shares of ₹ 10 each.

(ii) Calculation of cash to be paid :

	₹
Total Number of debentures	1,50,000
Less: number of debentures to be converted into equity shares	(25,000)
	1,25,000
Redemption value of 1,25,000 debentures @110	₹ 1,37,50,000

(iii) Cash and Bank Balance:

Balance before redemption	80,00,000
Add : Proceeds of investments sold	70,00,000
	1,50,00,000
Less : Cash paid to debenture holders	(1,37,50,000)
	12,50,000

Note: The premium on redemption of debentures can also be adjusted against Securities Premium Account.

7. Journal Entries in the books of M Ltd.

			Dr.	*Cr.*
			₹ in '000	*₹ in '000*
1	Bank A/c	Dr.	5,000	
	Profit and Loss A/c	Dr.	1,000	
	To Investment A/c			6,000
	(Being investment sold for the purpose of buy-back of Equity Shares)			
2	Preference share capital A/c	Dr.	4,000	
	To Preference shareholders A/c			4,000
	(Being redemption of preference share capital at par)			

3	Preference shareholders A/c	Dr.	4,000	
	To Bank A/c			4,000
	(Being payment made to preference shareholders)			
4	Revenue Reserve A/c	Dr.	4,600	
	To Capital redemption reserve A/c			4,600
	(Being creation of capital redemption reserve to the extent of nominal value of preference shares redeemed and amount of equity bought back i.e. 4,000 + 600)			
5	Equity share capital A/c	Dr.	600	
	Securities Premium A/c (Premium payable on buy-back)	Dr.	300	
	To Equity shares buy-back A/c			900
	(Being the amount due on buy-back of equity shares)			
6	Equity shares buy-back A/c	Dr.	900	
	To Bank A/c			900
	(Being payment made for buy-back of equity shares)			

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

	Notes No.	₹ in '000
Equity and Liabilities		
1 Shareholders funds		
Share capital	1	5,400
Reserves and Surplus	2	11,320
2 Non-current liabilities		
Long term borrowings	3	500
3 Current liabilities		380
Total		17,600

Assets			
1	Non-current assets		
	(a) Fixed assets		5,500
	(b) Non-current investments	4	4,000
2	Current assets	5	8,100
	Total		17,600

Notes to Accounts

			₹ *in '000*	₹ *in '000*
1.	Share Capital			
	Authorized share capital:			10,000
	Issued, subscribed and fully paid up share capital:			
	5,40,000 Equity shares of ₹ 10 each, fully paid up			5,400
	(60,000 equity shares had been bought back and cancelled during the year)			
2.	Reserves and Surplus			
	Capital Reserves		20	
	Securities Premium	1,000		
	Less: Premium on buy-back of equity shares	(300)	700	
	Revenue Reserve	8,000		
	Less: Transfer to Capital Redemption Reserve	(4,600)	3,400	
	Capital Redemption reserve		4,600	
	Surplus (Profit & Loss Account)	3,600		
	Less: Loss on sale of investment	(1,000)	2,600	11,320
3.	Long term borrowings			
	10% Debentures			500
4.	Non-current investments			
	Balance			10,000
5	Current assets			
	Balance		8,000	
	Add: Cash received on sale of investment		5,000	
	Less: Payment made to equity shareholders for buy back of shares		(900)	
	Payment made to preference shareholders		(4,000)	8,100

8. When the benefit of firm underwriting is given to individual underwriters

(i) Total marked applications:

M	N	O	P	
2,50,000	2,00,000	2,00,000	80,000	= 7,30,000

(ii) Shares subscribed excluding firm underwriting

Total applications	8,00,000	shares
Less : Marked applications	(7,30,000)	shares
Unmarked	70,000	

(iii) Statement showing Liability of underwriters

	M	*N*	*O*	*P*	*Total*
Gross liability	3,50,000	3,00,000	2,50,000	1,00,000	10,00,000
Less: Marked applications	(2,50,000)	(2,00,000)	(2,00,000)	(80,000)	(7,30,000)
	1,00,000	1,00,000	50,000	20,000	2,70,000
Less: Unmarked (in Gross Ratio)	(24,500)	(21,000)	(17,500)	(7,000)	(70,000)
	75,500	79,000	32,500	13,000	2,00,000
Less: Firm underwriting	(30,000)	(50,000)	40,000	(18,500)	(1,38,500)
	45,500	29,000	(7,500)	(5,500)	61,500
Less: Surplus of 'O' and 'P' allotted to M,& N (35:30)	7,000	6,000	7,500	5,500	–
Net liability	38,500	23,000	-	-	61,500

(iv) Statement of underwriters' liability

	M	*N*	*O*	*P*	*Total*
Firm	30,000	50,000	40,000	18,500	1,38,500
Others	38,500	23,000	-	-	61,500
TOTAL	68,500	73,000	40,000	18,500	2,00,000

(v) Amounts due from underwriters

	M	*N*	*O*	*P*	Total
Shares to be subscribed as per (iv) above	68,500	73,000	40,000	18,500	2,00,000
Amount due @ ₹ 60 per share	41,10,000	43,80,000	24,00,000	11,10,000	1,20,00,000

Less: Commission due on shares underwritten	(10,50,000)	(9,00,000)	(7,50,000)	(3,00,000)	(30,00,000)
	30,60,000	34,80,000	16,50,000	8,10,000	90,00,000

(vi) Commission payable to underwriters

M	10,00,000 X 100 X 35% X 3% =	10,50,000
N	10,00,000 X 100 X 30% X 3% =	9,00,000
O	10,00,000 X 100 X 25% X 3% =	7,50,000
P	10,00,000 X 100 X 10% X 3% =	3,00,000

Journal Entry

	₹	₹
Bank A/c	5,70,00,000	
Underwriting Commission A/c Dr.	30,00,000	
To Equity share Application A/c		6,00,00,000

9. Journal Entries in the books of Platinum Ltd.

		₹	₹
	Bank A/c (1,00,000 x ₹ 10) Dr.	10,00,000	
	To Equity share capital A/c		10,00,000
	(Being money on final call received)		
	Equity share capital (₹ 50) A/c Dr.	75,00,000	
	To Equity share capital (₹ 40) A/c		60,00,000
	To Capital Reduction A/c		15,00,000
	(Being conversion of equity share capital of ₹ 50 each into ₹ 40 each as per reconstruction scheme)		
	Bank A/c Dr.	12,50,000	
	To Equity Share Capital A/c		12,50,000
	(Being new shares allotted at ₹ 40 each)		
	Trade payables A/c Dr.	12,40,000	
	To Equity share capital A/c		7,50,000
	To Bank A/c (4,90,000 x 70%)		3,43,000
	To Capital Reduction A/c		1,47,000
	(Being payment made to trade payables in shares or cash to the extent of 70% as per reconstruction scheme)		

	8% Debentures A/c	Dr.	3,00,000	
	12% Debentures A/c	Dr.	4,00,000	
	To Shiv A/c			7,00,000
	(Being cancellation of 8% and 12% debentures of Shiv)			
	Bank A/c	Dr.	1,00,000	
	To Shiv A/c			1,00,000
	(Being new debentures subscribed by Shiv)			
	Shiv A/c	Dr.	8,00,000	
	To 15% Debentures A/c			6,00,000
	To Capital Reduction A/c			2,00,000
	(Being issuance of new 15% debentures and balance transferred to capital reduction account as per reconstruction scheme)			
	8% Debentures A/c	Dr.	1,00,000	
	12% Debentures A/c	Dr.	2,00,000	
	To Ganesh A/c			3,00,000
	(Being cancellation of 8% and 12% debentures of Ganesh)			
	Ganesh A/c	Dr.	3,00,000	
	To 15% Debentures A/c			2,50,000
	To Capital Reduction A/c			50,000
	(Being issuance of new 15% debentures and balance transferred to capital reduction account as per reconstruction scheme)			
	Land and Building	Dr.	9,14,000	
	(51,84,000 – 42,70,000)			
	Inventories	Dr.	30,000	
	To Capital Reduction A/c			9,44,000
	(Being value of assets appreciated)			
	Outstanding expenses A/c	Dr.	10,60,000	
	To Bank A/c			10,60,000
	(Being outstanding expenses paid in cash)			
	Capital Reduction A/c	Dr.	33,41,000	
	To Machinery A/c			1,30,000
	To Computers A/c			1,20,000

	To Trade receivables A/c		1,09,000
	To Goodwill A/c		22,00,000
	To Profit and Loss A/c		7,82,000
	(Being amount of Capital Reduction utilized in writing off P & L A/c (Dr.) balance, goodwill and downfall in value of other assets)		
	Capital Reserve A/c Dr.	5,00,000	
	To Capital Reduction A/c		5,00,000
	(Being debit balance of capital reduction account adjusted against capital reserve)		

Balance Sheet (as reduced) as on 31.3.2014

		Particulars	*Notes*	₹
		Equity and Liabilities		
1		**Shareholders' funds**		
	a	Share capital	1	80,00,000
2		**Non-current liabilities**		
	a	Long-term borrowings	2	8,50,000
		Total		**88,50,000**
		Assets		
1		**Non-current assets**		
	a	Fixed assets		
		Tangible assets	3	63,04,000
2		**Current assets**		
	a	Inventories		3,50,000
	b	Trade receivables		9,81,000
	c	Cash and cash equivalents		12,15,000
		Total		**88,50,000**

Notes to accounts

			₹
1.	**Share Capital**		
	2,00,000 Equity shares of ₹ 40		80,00,000

2.	**Long-term borrowings**		
	Secured		
	15% Debentures (assumed to be secured)		8,50,000
3.	**Tangible assets**		
	Land & Building	51,84,000	
	Machinery	7,20,000	
	Computers	4,00,000	63,04,000

Working Notes:

1. **Cash at Bank Account**

	Particulars	₹		*Particulars*	₹
To	Balance b/d	2,68,000	By	Trade Creditors A/c	3,43,000
To	Equity Share capital A/c	10,00,000	By	Outstanding expenses A/c	10,60,000
To	Equity Share Capital A/c	12,50,000	By	Balance c/d (bal. fig.)	12,15,000
To	Shiv A/c	1,00,000			
		26,18,000			26,18,000

2. **Capital Reduction Account**

	Particulars	₹		*Particulars*	₹
To	Machinery A/c	1,30,000	By	Equity Share Capital A/c	15,00,000
To	Computers A/c	1,20,000	By	Trade Creditors A/c	1,47,000
To	Trade receivables A/c	1,09,000	By	Shiv A/c	2,00,000
To	Goodwill A/c	22,00,000	By	Ganesh A/c	50,000
To	Profit and Loss A/c	7,82,000	By	Land & Building	9,14,000
			By	Inventories	30,000
			By	Capital Reserve A/c	5,00,000
		33,41,000			33,41,000

10. LEDGER OF BETTER LIMITED

Fixed Assets Account

		₹			₹
To	Balance b/d	15,00,000	By	Realisation A/c (transfer)	15,00,000

Current Assets Account

		₹		₹
To	Balance b/d	5,00,000	By Realisation A/c (transfer)	5,00,000

Liabilities Account

		₹			₹
To	Realisation A/c	2,00,000	By	Balance b/d	2,00,000

Realisation Account

		₹			₹
To	Fixed Assets A/c	15,00,000	By	Liabilities A/c	2,00,000
To	Current Assets A/c	5,00,000	By	Best Limited (Purchase Consideration)	15,00,000
			By	Shareholders' A/c (Loss on Realisation)	3,00,000
		20,00,000			20,00,000

Share Capital Account

		₹			₹
To	Sundry shareholders A/c - (transfer)	15,00,000	By	Balance b/d	10,00,000
			By	Reserves & Surplus A/c (Bonus issue)	5,00,000
		15,00,000			15,00,000

Reserves & Surplus Account

		₹			₹
To	Share Capital (Bonus issue)	5,00,000	By	Balance b/d	8,00,000
To	Sundry Shareholders	3,00,000			
		8,00,000			8,00,000

Best Ltd.

		₹			₹
To	Realisation A/c - Purchase Consideration	15,00,000	By	Shares in Best Ltd	15,00,000
		15,00,000			15,00,000

Shares in Best Ltd.

		₹			₹
To	Best Ltd.	15,00,000	By	Sundry Shareholders A/c	15,00,000

Sundry Shareholders Account

		₹			₹
To	Realisation A/c (Loss)	3,00,000	By	Share Capital A/c	15,00,000
			By	Reserves & Surplus A/c	3,00,000
To	Share in Best Ltd.	15,00,000			
		18,00,000			18,00,000

Journal of Best Ltd.

2014			Dr. ₹	Cr. ₹
Apr. 1	Fixed Assets A/c	Dr.	15,00,000	
	Current Assets A/c	Dr.	5,00,000	
	To Liabilities A/c			2,00,000
	To Liquidator of Better Ltd.			15,00,000
	To Capital Reserve A/c			3,00,000
	(Assets & Liabilities of Better Ltd. taken over for an agreed purchase consideration of ₹ 15,00,000 as per agreement dated....)			
	Liquidator of Better Ltd.	Dr.	15,00,000	
	To Share Capital A/c			10,00,000
	To Securities Premium A/c			5,00,000
	(Discharge of Purchase consideration by the issue of equity shares of ₹ 10,00,000 at a premium of ₹ 50 per share as per agreement)			
	Trade payables A/c	Dr.	1,00,000	
	To Trade receivables A/c			1,00,000
	(Amount due from Better Ltd., and included in its creditors taken over,			

cancelled against own Trade receivables)			
Capital Reserve A/c	Dr.	10,000	
To Current Asset (Stock) A/c			10,000
(Unrealized profit on stock included in current assets of Better Ltd. written off to Reserve Account)			

Working Note :

Calculation of Purchase consideration:

Issued Capital of Better Ltd. (after bonus issue) at ₹ 100 per share ₹ 15,00,000 Purchase consideration has been discharged by Best Ltd. by the issue of shares for ₹ 10,00,000 at a premium of ₹ 5,00,000. This gives the value of ₹ 150 per share.

Balance Sheet of Best Ltd. (After absorption)

		Particulars	*Notes*	₹
		Equity and Liabilities		
1		**Shareholders' funds**		
	a	Share capital	1	30,00,000
	b	Reserves and Surplus	2	17,90,000
2		**Current liabilities**		21,00,000
		Total		**68,90,000**
		Assets		
1		**Non-current assets**		
	a	Fixed assets		
		Tangible assets	3	40,00,000
	b	Non-current investments		5,00,000
2		**Current assets** (24,00,000 – 10,000)		23,90,000
		Total		**68,90,000**

Notes to accounts

		₹
1 **Share Capital**		
Equity share capital		
Issued & Subscribed		

	30,000 shares of ₹ 100 (Of the above 10,000 shares have been issued for consideration other than cash)		30,00,000
	Total		30,00,000
2	**Reserves and Surplus**		
	Capital Reserve (3,00,000 – 10,000)		2,90,000
	Securities Premium		5,00,000
	Other reserves and surplus		10,00,000
	Total		17,90,000
3	**Tangible assets**		
	Fixed Assets	25,00,000	
	Acquired during the year	15,00,000	40,00,000
	Total		40,00,000

11. Liquidator's Statement of Account

	Receipts		₹		*Payments*		₹
To	Assets realised -			By	Liquidation expenses		57,250
	Cash & cash equivalent	1,00,000		By	Liquidator's Remuneration		59,750
	Plant &Machinery	5,00,000		By	Preferential creditors:		
	Inventories	1,50,000			Taxes	12,500	
	Trade receivables	2,00,000	9,50,000		Wages to workers	60,000	72,500
To	Sale proceeds of land & Building	3,00,000		By	Payment to Debenture holders:		
	Less: Applied to	1,00,000	2,00,000		Debentures	2,50,000	
	discharge bank overdraft				Interest due	12,500	2,62,500
To	Call on 7,500 equity shareholders of ₹ 60 paid up @ ₹ 12.45 per share		93,375	By	Trade payables		2,25,000
				By	Preference shareholders:		
					Preference capital	5,00,000	
					Arrear of Dividend	60,000	5,60,000
				By	Equity shareholders – refund on 2,500 equity shares of		
					₹ 75 paid up @ 2.55 per share		6,375
			12,43,375				12,43,375

Working Notes:

(i) Computation of Liquidator's remuneration

	₹
Assets realized	
Plant and Machinery	5,00,000
Inventories	1,50,000
Trade receivables	2,00,000
Land and Building	3,00,000
Total	11,50,000
Commission @ 5% on assets realized (A)	57,500
Liabilities discharged	
Trade payables	2,25,000
Total	2,25,000
Commission @ 1% on liabilities discharged (B)	2,250
Total (A+B)	59,750

(ii) Calls from Partly paid shares

	₹
Total receipts before considering call money	
Cash and cash equivalents	1,00,000
Plant and Machinery	5,00,000
Inventories	1,50,000
Trade receivable	2,00,000
Land and Building (after discharge of Bank overdraft)	2,00,000
Total	11,50,000
Total payments before final payment to equity Shareholders	
Liquidator's remuneration	59,750
Liquidation expenses	57,250
Preferential creditors	72,500
Payment to Debenture holders	2,62,500
Trade payables	2,25,000
Payment to Preference shareholders	5,60,000
Total	12,37,000
Surplus/(Deficit) from above before calls made on equity shares	(87,000)

Nominal call to be made:

2,500 equity shares @ ₹ 25 per share	62,500
7,500 equity shares @ ₹ 40 per share	3,00,000
Total	3,62,500
Surplus cash balance after notional call	2,75,500
Total number of equity shares for distribution of surplus cash (2,500 + 7,500)	10,000
Surplus cash per equity share	27.55
Amount of refund on ₹ 75 per share paid up (27.55-25)	2.55
Amount of call on ₹ 60 per share paid up (40-27.55)	12.45

12. **Form B – RA (Prescribed by IRDA)**

Gemini Insurance Co. Ltd

Revenue Account for the year ended 31st March, 2014
Fire and Marine Insurance Businesses

	Schedule	*Fire Current Year*	*Marine Current Year*
		₹	₹
Premiums earned (net)	1	9,65,000	3,20,000
Profit / (Loss) on sale / redemption of investments		—	—
Others (to be specified)			
Interest, Dividends and Rent – Gross		—	—
Total (A)		9,65,000	3,20,000
Claims incurred (net)	2	1,90,000	2,03,000
Commission	3	92,000	46,000
Operating expenses related to Insurance business	4	1,60,000	1,10,000
Total (B)		4,42,000	3,59,000
Operating Profit from Fire / Marine Insurance business (A-B)		5,23,000	(39,000)

Schedules forming part of Revenue Account

Schedule –1

Premiums earned (net)		*Fire Current Year*	*Marine Current Year*
		₹	₹
Premiums from direct business written		10,70,000	7,95,000
Less: Premium on reinsurance ceded		60,000	35,000
Total Premium earned		10,10,000	7,60,000
Less: Change in provision for unexpired risk		45,000	4,40,000
		9,65,000	3,20,000
Schedule – 2			
Claims incurred (net) (W.N. 1)		1,90,000	2,03,000
Schedule – 3			
Commission			
Commission paid direct		92,000	46,000
Schedule – 4			
Operating expenses related to insurance business			
Expenses of Management (W.N. 2)		1,60,000	1,10,000

Form B-PL

Gemini Insurance Co. Ltd.

Profit and Loss Account for the year ended 31st March, 2014

Particulars	*Schedule*	*Current Year*	*Previous Year*
		₹	₹
Operating Profit/(Loss)			
(a) Fire Insurance		5,23,000	
(b) Marine Insurance		(39,000)	
(c) Miscellaneous Insurance		-	
Income From Investments			
Interest, Dividend & Rent–Gross		2,97,000	
Other Income (To be specified)			
Total (A)		7,81,000	

Provisions (Other than taxation)			
Depreciation		1,00,000	
Other Expenses –Director's Fee		1,84,000	
Total (B)		2,84,000	
Profit Before Tax		4,97,000	
Provision for Taxation		1,50,000	
Profit After Tax		3,47,000	

Working Notes:

		Fire	*Marine*
		₹	₹
1.	Claims under policies less reinsurance		
	Claims paid during the year	2,30,000	1,84,000
	Add: Outstanding on 31st March, 2014	23,000	34,000
		2,53,000	2,18,000
	Less : Outstanding on 1st April, 2013	63,000	15,000
		1,90,000	2,03,000
2.	Expenses of management		
	Expenses paid during the year	1,40,000	1,00,000
	Add: Outstanding on 31st March, 2014	20,000	10,000
		1,60,000	1,10,000
3.	Premiums less reinsurance		
	Premiums received during the year	10,00,000	7,50,000
	Add: Outstanding on 31st March, 2014	70,000	45,000
		10,70,000	7,95,000
	Less : Reinsurance premiums	60,000	35,000
		10,10,000	7,60,000

4. Reserve for unexpired risks is 50% of net premium for fire insurance and 100% of net premium for marine insurance. Reserve for unexpired risks for fire insurance = ₹ 10,10,000 X 50% = ₹ 5,05,000. Opening Balance in reserves for unexpired risk for fire insurance was ₹ 4,60,000. Hence, additional transfer to reserve for fire insurance in the year will be ₹ 45,000. On similar basis of calculation, the additional transfer to reserve for marine insurance will be ₹ 4,40,000.

5. **Provision for taxation account**

	₹		₹
31.3.2014 To Bank A/c (taxes paid)	1,40,000	1.4.2013 By Balance b/d	1,95,000
31.3.2014 To Balance c/d	2,05,000	31.3.2014 By P & L A/c (Bal Fig)	1,50,000
	3,45,000		3,45,000

13. TOP Bank Limited

Profit and Loss Account for the year ended 31st March, 2014

		Schedule	*Year ended 31.03. 2014*
			(₹ in '000s)
I.	**Income:**		
	Interest earned	13	5923.18
	Other income	14	728.00
	Total		6,651.18
II.	**Expenditure**		
	Interest expended	15	3259.92
	Operating expenses	16	768.46
	Provisions and contingencies (960+210+900)		2,070.00
	Total		6,098.38
IIII.	**Profits/Losses**		
	Net profit for the year		552.80
	Profit brought forward		nil
			552.80
IV.	**Appropriations**		
	Transfer to statutory reserve (25%)		138.20
	Balance carried over to balance sheet		414.60
			552.80

		Year ended 31.3. 2014 (₹ in '000s)
	Schedule 13 – Interest Earned	
I.	Interest/discount on advances/bills (Refer W.N.)	5923.18
		5923.18
	Schedule 14 – Other Income	
I.	Commission, exchange and brokerage	304
II.	Profit on sale of investments	320
III.	Rent received	104
		728
	Schedule 15 – Interest Expended	
I.	Interests paid on deposits	3259.92
	Schedule 16 – Operating Expenses	
I.	Payment to and provisions for employees	320
II.	Rent, taxes and lighting	144
III.	Depreciation on bank's properties	48
IV.	Director's fee, allowances and expenses	48
V.	Auditors' fee	28
VI.	Law (statutory) charges	44
VII.	Postage and telegrams	96.46
VIII.	Preliminary expenses	40
		768.46

Working Note:

	(₹ in '000s)
Interest/discount	5,929.18
Add: Rebate on bills discounted on 31.3. 2013	19.00
Less: Rebate on bills discounted on 31.3. 2014	25.00
	5,923.18

14. Calculation of correct Departmental Profits

	Department P (₹)	*Department S (₹)*	*Department Q (₹)*
Profit after charging Manager's Commission	90,000	60,000	45,000
Add: Manager's Commission (1/9)	10,000	6,667	5,000
	1,00,000	66,667	50,000
Less: Unrealised profit on Stock (WN)	(5,426)	(21,000)	(2,727)
Profit Before Manager's Commission	94,574	45,667	47,273
Less: Manager's Commission 10%	(9,457)	(4,567)	(4,727)
Correct Profit after Manager's Commission	85,117	41,100	42,546

Working Notes:

	Department P (₹)	*Department S (₹)*	*Department Q (₹)*	*Total (₹)*
Unrealized Profit of:				
Department P	-	25/125X18,000 =3,600	15/115X14,000 =1,826	5,426
Department S	20/100X48,000 =9,600	-	30/100X38,000 =11,400	21,000
Department Q	20/120X12,000 =2,000	10/110X8,000 =727		2,727

15. (a) Journal entry in the books of Head Office

Date	*Particulars*	*Dr.*	*Cr.*
		₹	₹
30.4.2014	W.B. Branch Account	Dr. 45,000	
	To A.P. Branch Account		5,000
	To M.P. Branch Account		10,000
	To U.P. Branch Account		30,000
	(Being adjustment entry passed by head office in respect of inter-branch transactions for the month of April, 2014)		

Working Note:

Inter – Branch transactions

		A.P	*M.P.*	*W.B.*	*U.P.*
		₹	₹	₹	₹
A.	**A.P Branch**				
(1)	Received goods	55,000 (Dr.)	30,000 (Cr.)		25,000 (Cr.)
(2)	Sent goods	50,000 (Cr.)		20,000 (Dr.)	30,000 (Dr.)
(3)	Received Bills receivable	10,000 (Dr.)		10,000 (Cr.)	
(4)	Sent acceptance	30,000 (Cr.)	10,000 (Dr.)		20,000 (Dr.)
B.	**M.P. Branch**				
(5)	Received goods	10,000 (Cr.)	30,000 (Dr.)		20,000 (Cr.)
(6)	Sent cash	20,000 (Dr.)	30,000 (Cr.)		10,000 (Dr.)
C.	**W.B. Branch**				
(7)	Received goods			40,000 (Dr.)	40,000 (Cr.)
(8)	Sent cash and acceptances			25,000 (Cr.)	25,000 (Dr.)
D.	**U.P. Branch**				
(9)	Sent cash		10,000(Dr.)	20,000 (Dr.)	30,000 (Cr.)
		5,000 (Cr.)	10,000 (Cr.)	45,000 (Dr.)	30,000 (Cr.)

16. (a) (1) Users of financial statements:

Investors, Employees, Lenders, Supplies/Creditors, Customers, Government & Public

(2) Qualitative Characteristics of Financial Statements:

Understandability, Relevance, Comparability, Reliability & Faithful Representation

(3) Elements of Financial Statements:

Asset, Liability, Equity, Income/Gain and Expense/Loss

(b) Fundamental Accounting Assumptions:

Accrual, Going Concern and Consistency

17. (a) Para 8.3 of AS 4 "Contingencies and Events Occurring after the Balance Sheet Date", states that adjustments to assets and liabilities are not appropriate for events occurring after the balance sheet date, if such events do not relate to conditions existing at the balance sheet date. The destruction of warehouse due to earthquake did not exist on the balance sheet date i.e. 31.3.2014. Therefore, loss occurred due to earthquake is not to be recognised in the financial year 2013-2014.

However, according to para 8.6 of the standard, unusual changes affecting the existence or substratum of the enterprise after the balance sheet date may indicate a need to consider the use of fundamental accounting assumption of going concern in the preparation of the financial statements. As per the information given in the question, the earthquake has caused major destruction; therefore fundamental accounting assumption of going concern is called upon.

Hence, the fact of earthquake together with an estimated loss of ₹ 25 lakhs should be disclosed in the Report of the Directors for the financial year 2013-2014.

(b) As per para 31 of AS 5 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies', the adoption of an accounting policy for events or transactions that differ in substance from previously occurring events or transactions, will not be considered as a change in accounting policy.

(i) Accordingly, introduction of a formal retirement gratuity scheme by an employer in place of ad hoc ex-gratia payments to employees on retirement is not a change in an accounting policy.

(ii) Similarly, the adoption of a new accounting policy for events or transactions which did not occur previously or that were immaterial will not be treated as a change in an accounting policy

18. (a) The financial statements of an integral foreign operation (for example, dependent foreign branches) should be translated using the principles and procedures described in paragraphs 8 to 16 of AS 11 (Revised 2003). The individual items in the financial statements of a foreign operation are translated as if all its transactions had been entered into by the reporting enterprise itself.

Individual items in the financial statements of the foreign operation are translated at the actual rate on the date of transaction. For practical reasons, a rate that approximates the actual rate at the date of transaction is often used, for example, an average rate for a week or a month may be used for all transactions in each foreign currency during the period. The foreign currency monetary items (for example cash, receivables, payables) should be reported using the closing rate at each balance sheet date. Non-monetary items (for example, fixed assets, inventories, investments in equity shares) which are carried in terms of historical cost denominated in a foreign currency should be reported using the exchange date at the date of transaction. Thus the cost and depreciation of the tangible fixed assets is translated using the exchange rate at the date of purchase of the asset if asset is carried at cost. If the fixed asset is carried at fair value, translation should be done using the rate existed on the date of the valuation. The cost of inventories is translated at the exchange rates that existed when the cost of inventory was incurred and realizable value is translated applying exchange rate when realizable value is determined which is generally closing rate.

Exchange difference arising on the translation of the financial statements of integral foreign operation should be charged to profit and loss account. Exchange difference arising on the translation of the financial statement of foreign operation may have tax effect which should be dealt as per AS 22 'Accounting for Taxes on Income'.

Thus, the treatment by the management of translating all assets and liabilities; income and expenditure items in respect of foreign branches at the prevailing rate at the year end and also the treatment of resultant exchange difference is not in consonance with AS 11 (Revised 2003).

(b) **Journal Entries**

Year	*Particulars*		*₹ in lakhs (Dr.)*	*₹ in lakhs (Cr.)*
1	Fixed Asset Account	Dr.	25	
	To Bank Account			25
	(Being fixed asset purchased)			
	Bank Account	Dr.	10	
	To Fixed Asset Account			10
	(Being grant received from the government reduced the cost of fixed asset)			
	Depreciation Account (W.N.1)	Dr.	2	
	To Fixed Asset Account			2
	(Being depreciation charged on Straight Line method (SLM))			
	Profit & Loss Account	Dr.	2	
	To Depreciation Account			2
	(Being depreciation transferred to Profit and Loss Account at the end of year 1)			
2	Fixed Asset Account	Dr.	6	
	To Bank Account			6
	(Being government grant on asset partly refunded which increased the cost of fixed asset)			

	Depreciation Account (W.N.2)	Dr.	3.5	
	To Fixed Asset Account			3.5
	(Being depreciation charged on SLM on revised value of fixed asset prospectively)			
	Profit & Loss Account	Dr.	3.5	
	To Depreciation Account			3.5
	(Being depreciation transferred to Profit and Loss Account at the end of year 2)			

Working Notes:

1. Depreciation for Year 1

	₹ in lakhs
Cost of the Asset	25
Less: Government grant received	(10)
	15
Depreciation [15-5]/5	2

2. Depreciation for Year 2

	₹ in lakhs
Cost of the Asset	25
Less: Government grant received	(10)
	15
Less: Depreciation for the first year [15-5]/5	2
	13
Add: Government grant refundable	6
	19
Depreciation for the second year [19-5]/4	3.5

19. (a) (i) Computation of average accumulated expenses

		₹
₹ 1,60,000 x 12 / 12	=	1,60,000
₹ 2,70,000 x 8/ 12	=	1,80,000
₹ 4,20,000 x 5 / 12	=	1,75,000
₹ 1,50,000 x 1 / 12	=	12,500
		5,27,500

(ii) Calculation of average interest rate other than for specific borrowings

Amount of loan (₹)	*Rate of interest*		*Amount of interest (₹)*
3,00,000	12%	=	36,000
7,00,000	14%	=	98,000
10,00,000			1,34,000
Weighted average rate of interest {(1,34,000/ 10,00,000) x 100}		=	13.40% (approx)

(iii) Interest on average accumulated expenses

		₹
Specific borrowings (₹ 2,00,000 x 11%)	=	22,000
Non-specific borrowings (₹ 3,27,500* x 13.40%)	=	43,885
Amount of interest to be capitalized	=	65,885

(₹ 5,27,500 – ₹ 2,00,000)

(iv) Total expenses to be capitalized for building

	₹
Cost of building ₹ (1,60,000+2,70,000+4,20,000+1,50,000)	10,00,000
Add: Amount of interest to be capitalised	65,885
	10,65,885

(v) Journal Entry

Date	*Particulars*		*Dr. (₹)*	*Cr. (₹)*
31.12.2014	Building account	Dr.	10, 65,885	
	To Bank account			10, 65,885
	(Being amount of cost of building and borrowing cost thereon capitalized)			

(b) (i) Leases are classified based on the extent to which risks and rewards incident to ownership of a leased asset lie with the Lessor or the Lessee.

- Risks include the possibilities of losses from idle capacity or technological obsolescence and of variations in return due to changing economic conditions.

- Rewards may be represented by the expectation of profitable operation over the economic life of the asset and of gain from appreciation in value or realisation of residual value.

As per AS 19 "Accounting for Lease", Lease may be of two types: a) Finance Lease b) Operating Lease.

Finance Lease is a lease which transfers substantially all the risks and rewards incidental to ownership of an asset to the lessee by the lessor but not the legal ownership.

Operating lease is a lease which does not transfers substantially all the risks and rewards incidental to ownership. To be precise, it is a lease other than "Financial Lease".

(ii) According to para 11 of AS 19 "Leases", the lessee should recognise the lease as an asset and a liability at an amount equal to the fair value of the leased asset at the inception of the finance lease. However, if the fair value of the leased asset exceeds the present value of the minimum lease payments from the standpoint of the lessee, the amount recorded as an asset and a liability should be the present value of the minimum lease payments from the standpoint of the lessee. In calculating the present value of the minimum lease payments the discount rate is the interest rate implicit in the lease. Present value of minimum lease payments will be calculated as follows:

Year	*Minimum Lease Payment* ₹	*Internal rate of return*	*Present value* ₹
1	6,25,000	0.8696	5,43,500
2	6,25,000	0.7561	4,72,563
3	6,25,000	0.6575	4,10,937
4	7,50,000*	0.5718	4,28,850
Total	26,25,000		18,55,850

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

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

20. (a) No. of Bonus shares issued as on 1.1.2015

On existing shares (50,00,250 x ½) 25,00,125 shares

On convertible debentures as per SEBI Guidelines on Bonus Issue

(1,00,000 debentures x 10 shares x ½) 5,00,000 shares

Basic Earnings per share for the year 2014-15 =

$$\frac{\text{Net profit for the year ended 31.3.2015}}{\text{Weighted average number of equity share as on 31.3.2015}}$$

$$\frac{₹\ 1,00,25,000}{(50,00,250+25,00,125+5,00,000)} = ₹\ 1.25$$

Adjusted earnings per share for the year 2013-14

$$= \frac{₹\ 75,50,000}{(50,00,250+25,00,125+5,00,000)} = ₹\ 0.94$$

For Diluted EPS

Interest expense for the current year = ₹ 12,00,000

Tax relating to interest expense (30%) =₹ 3,60,000

Adjusted net profit for the current year =₹ 1,00,25,000 + (12,00,000 - 3,60,000) x 3/12

=₹ 1,02,35,000

No. of equity shares resulting from conversion of debentures

= 1,00,000 x 10 shares = 10,00,000

No. of equity shares used to compute diluted earnings per share

= 50,00,250 + 25,00,125 + 5,00,000 + (10,00,000 x 3/12)

= 50,00,250 + 25,00,125 + 5,00,000 + 2,50,000

= 82,50,375 shares

Diluted earnings per share = 1,02,35,000/82,50,375 = ₹ 1.24

Note: As per AS 20, bonus shares issued to existing shareholders and to convertible debenture holders (on conversion of debentures into shares) are an issue without consideration. Therefore, it is treated as if it had occurred prior to the beginning of the year 2013- 14, the earliest period reported.

(b) As per Para 41 of AS 26 "Intangible Assets", expenditure on research should be recognized as an expense when it is incurred. An intangible asset arising from development (or from the development phase of an internal project) should be recognized if, and only if, an enterprise can demonstrate all of the conditions specified in para 44 of the standard. An intangible asset (arising from development) should be derecognised when no future economic benefits are expected from its use according to para 87 of the standard. Therefore, the manager cannot defer the expenditure write off to future years.

Hence, the expenses amounting ₹ 20 lakhs incurred on the research and development project has to be written off in the current year ending 31st March, 2015.

Applicability of Pronouncements/Legislative Amendments/Circulars etc. for November, 2015 – Intermediate (IPC) Examination

Paper 5: Advanced Accounting

Accounting Standards

AS 4 : Contingencies and Events occurring after the Balance Sheet Date

AS 5 : Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies

AS 11 : The Effects of Changes in Foreign Exchange Rates (Revised 2003)

AS 12 : Accounting for Government Grants

AS 16 : Borrowing Costs

AS 19 : Leases

AS 20 : Earnings Per Share

AS 26 : Intangible Assets

AS 29 : Provisions, Contingent Liabilities and Contingent Assets.

Note Regarding Applicability for Paper 1 and Paper 5:

The relevant notified Sections of the Companies Act, 2013 up to 31st March, 2015 and for other legislative amendments including relevant Notifications / Circulars / Rules / Guidelines issued by Regulating Authority up to 30th April, 2015 will be applicable for November, 2015 Examination

Non-Applicability of Ind ASs for November, 2015 Examination:

The Ministry of Corporate Affairs has notified Roadmap for applicability of Indian Accounting Standards (Ind AS) vide Notification No. G.S.R…….(E) dated 16 February, 2015, for compliance by the class of companies specified in the said roadmap. The notification has been uploaded on www.mca.gov.in along with the thirty nine (39) Indian Accounting Standards (Ind AS). **Students may note that these Ind ASs are not applicable for November, 2015 Examination.**

PAPER – 6: AUDITING AND ASSURANCE

PART – I: ACADEMIC UPDATE

(Legislative Amendments as per the Companies Act, 2013 and Rules made thereunder)

1. **Reporting under Companies (Auditor's Report) Order, 2015 [CARO, 2015]:** The Central Government, after consultation with the Institute of Chartered Accountants of India, has issued the Companies (Auditor's Report) Order, 2015, (CARO, 2015) under section 143(11) of the Companies Act, 2013, dated 10th April, 2015. The requirements of the Order are supplemental to the existing provisions of section 143 of the Act regarding the auditor's report.

   The Order is not intended to limit the duties and responsibilities of auditors but only requires a statement to be included in the audit report in respect of the matters specified therein. For example, examination of the system of internal control is one of the basic audit procedures employed by the auditor. The fact that the Order requires a statement regarding the internal control system applicable to purchases of inventory and fixed assets, and sale of goods and services only is no justification for the auditor to conclude that an examination of internal control regarding the other areas of a company's business is not important or not required.

   Applicability of the Order: The CARO, 2015 is an additional reporting requirement Order. The order applies to every company including a foreign company as defined in clause (42) of section 2 of the Companies Act, 2O13.

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

   (i) a banking company as defined in clause (c) of section 5 of the Banking Regulation Act, 1949;

   (ii) an insurance company as defined under the Insurance Act,1938;

   (iii) a company licensed to operate under section 8 of the Companies Act;

   (iv) a One Person Company as defined under clause (62) of section 2 of the Companies Act;

   (v) a small company as defined under clause (85) of section 2 of the Companies Act; and

   (vi) a private limited company with a paid up capital and reserves not more than ₹ 50 lakh and which does not have loan outstanding exceeding ₹ 25 lakh from any bank or financial institution and does not have a turnover exceeding ₹ 5 crore at any point of time during the financial year.

   Matters to be included in the Auditor's Report: Paragraph 3 of the Order requires the auditor to include a statement in the auditor's report on the following matters, namely-

(i) (a) whether the company is maintaining proper records showing full particulars, including quantitative details and situation of fixed assets;

(b) whether these fixed assets have been physically verified by the management at reasonable intervals; whether any material discrepancies were noticed on such verification and if so, whether the same have been properly dealt with in the books of account.

(ii) (a) whether physical verification of inventory has been conducted at reasonable intervals by the management;

(b) are the procedures of physical verification of inventory followed by the management reasonable and adequate in relation to the size of the company and the nature of its business. If not, the inadequacies in such procedures should be reported;

(c) whether the company is maintaining proper records of inventory and whether any material discrepancies were noticed on physical verification and if so, whether the same have been properly dealt with in the books of account.

(iii) whether the company has granted any loans, secured or unsecured to companies, firms or other parties covered in the register maintained under section 189 of the Companies Act. If so,

(a) whether receipt of the principal amount and interest are also regular; and

(b) if overdue amount is more than rupees one lakh, whether reasonable steps have been taken by the company for recovery of the principal and interest.

(iv) is there an adequate internal control system commensurate with the size of the company and the nature of its business, for the purchase of inventory and fixed assets and for the sale of goods and services. Whether there is a continuing failure to correct major weaknesses in internal control system.

(v) in case the company has accepted deposits, whether the directives issued by the Reserve Bank of India and the provisions of sections 73 to 76 or any other relevant provisions of the Companies Act and the rules framed there under, where applicable, have been complied with? If not, the nature of contraventions should be stated; If an order has been passed by Company Law Board or National Company Law Tribunal or Reserve Bank of India or any court or any other tribunal, whether the same has been complied with or not?

(vi) where maintenance of cost records has been specified by the Central Government under sub-section (1) of section 148 of the Companies Act, whether such accounts and records have been made and maintained.

(vii) (a) is the company regular in depositing undisputed statutory dues including provident fund, employees' state insurance, income-tax, sales-tax, wealth tax, service tax, duty of customs, duty of excise, value added tax, cess and any other statutory dues with the appropriate authorities and if not, the extent of the arrears of outstanding statutory dues as at 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 by the auditor.

(b) in case dues of income tax or sales tax or wealth tax or service tax or duty of customs or duty of excise or value added tax or cess 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 constitute a dispute).

(c) whether the amount required to be transferred to investor education and protection fund in accordance with the relevant provisions of the Companies Act, 1956 and rules made thereunder has been transferred to such fund within time.

(viii) whether in case of a company which has been registered for a period not less than five years, its accumulated losses at the end of the financial year are not less than fifty per cent of its net worth and whether it has incurred cash losses in such financial year and in the immediately preceding financial year.

(ix) whether the company has defaulted in repayment of dues to a financial institution or bank or debenture holders? If yes, the period and amount of default to be reported.

(x) whether the company has given any guarantee for loans taken by others from bank or financial institutions, the terms and conditions whereof are prejudicial to the interest of the company.

(xi) whether term loans were applied for the purpose for which the loans were obtained.

(xii) 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.

Reasons to be Stated for Unfavourable or Qualified Answers: Where the answer to any of the questions referred to in paragraph 3 of the Order is unfavourable or qualified, in the auditor's report, the auditor shall also state the reasons for such unfavourable or qualified answer, as the case may be.

Further, where the auditor is unable to express any opinion in answer to a particular question, his report shall indicate such fact together with the reasons why it is not possible for him to give an answer to such question.

Consequential Amendment to the Format of the Auditor's Report of a Company: The Auditing and Assurance Standards Board has issued illustrative formats of the auditor's report on financial statements of a company under the Companies Act, 2013. While reporting on the requirements of CARO, 2015, a reference thereto also needs be added in the main audit report under the "Report on Legal and Other Regulatory Matters" paragraph as follows:

"Report on Other Legal and Regulatory Requirements

As required by the Companies (Auditor's Report) Order, 2015 ("the Order"), issued by the Central Government of India in terms of sub-section (11) of section 143 of the Companies Act, 2013, we give in the Annexure a statement on the matters specified in paragraphs 3 and 4 of the Order, to the extent applicable.

As required by Section 143(3) of the Act, we report that:

……………………….

………………………."

2. **Companies (Cost Records and Audit) Rules, 2014:** The Central Government has notified the Companies (Cost Records and Audit) Rules, 2014 (amended dated 31st December, 2014) which prescribes the classes of companies required to include cost records in their books of account, applicability of cost audit, maintenance of records etc.

   Maintenance of Cost Records: Rule 3 of the Companies (Cost Records and Audit) Rules, 2014 provides the classes of companies, engaged in the production of goods or providing services, required to include cost records in their books of account. These companies include Foreign Companies defined in sub-section (42) of section 2 of the Act, but exclude a company classified as a Micro enterprise or a Small enterprise including as per the turnover criteria provided under Micro, Small and Medium Enterprises Development Act, 2006.

   The said rule has divided the list of companies into regulated sectors and non-regulated sectors. Some of the companies/industry/sector/product/service prescribed under the said rule are given below:

   (A) Regulated Sectors-

   (i) Telecommunication services made available to users by means of any transmission or reception of signs, signals, images etc. (other than broadcasting services) and regulated by the Telecom Regulatory Authority of India.

   (ii) Generation, transmission, distribution and supply of electricity regulated by the relevant regulatory body or authority under the Electricity Act, 2003, other than for captive generation.

   (iii) Petroleum products regulated by the Petroleum and Natural Gas Regulatory Board.

   (iv) Drugs and Pharmaceutical.

   (v) Sugar and industrial alcohol.

(B) Non-Regulated Sectors-

(i) Machinery and mechanical appliances used in defence, space and atomic energy sectors excluding any ancillary item or items.

(ii) Turbo jets and turbo propellers.

(iii) Tyres and Tubes.

(iv) Steel; Cement.

(v) Production, import and supply or trading of following medical devices, such as heart valves; orthopaedic implants; pacemaker (temporary and permanent), etc. The rule excludes the foreign companies having only liaison offices.

As per Rule 5 of the Companies (Cost Records and Audit) Rules, 2014, every company under these rules including all units and branches thereof, shall, in respect of each of its financial year, is required to maintain cost records in **Form CRA-1**. The cost records shall be maintained on regular basis in such manner as to facilitate calculation of per unit cost of production or cost of operations, cost of sales and margin for each of its products and activities for every financial year on monthly or quarterly or half-yearly or annual basis.

Additionally, as per clause (vi) to Paragraph 3 of the CARO, 2015, where maintenance of cost records has been specified by the Government under section 148(1) of the Companies Act, 2013, the auditor has to report whether such accounts and records have been made and maintained.

Applicability of Cost Audit: Rule 4 of the Companies (Cost Records and Audit) Rules, 2014 states the provisions related to the applicability of cost audit depending on the turnover of the company as follows -

(i) Classes of companies specified under item (A) "Regulated Sectors" are required to get its cost records audited if the overall annual turnover of the company from all its products and services during the immediately preceding financial year is ₹ 50 crore or more and the aggregate turnover of the individual product(s) or service(s) for which cost records are required to be maintained under rule 3 is ₹ 25 crore or more.

(ii) Classes of companies specified under item (B) "Non-Regulated Sectors" are required to get its cost records audited if the overall annual turnover of the company from all its products and services during the immediately preceding financial year is ₹ 100 crore or more and the aggregate turnover of the individual product(s) or service(s) for which cost records are required to be maintained under rule 3 is ₹ 35 crore or more.

Appointment of Cost Auditor: Rule 6 of the Companies (Cost Records and Audit) Rules, 2014 requires the companies prescribed under the said Rules to appoint an Auditor within 180 days of the commencement of every financial year. Every referred company shall inform the cost auditor concerned of his or its appointment as such and file a notice of such appointment with the Central Government within a period of 30 days of the Board meeting in which such appointment is made or within a period of 180 days of the commencement of the financial year, whichever is earlier, through electronic mode, in **Form CRA-2**, along with the fee as specified in Companies (Registration Offices and Fees) Rules, 2014.

The cost auditor appointed as such shall continue in such capacity till the expiry of 180 days from the closure of the financial year or till he submits the cost audit report, for the financial year for which he has been appointed.

Casual Vacancy in the Office of a Cost Auditor: Any casual vacancy in the office of a Cost Auditor, whether due to resignation, death or removal, shall be filled by the Board of Directors within 30 days of occurrence of such vacancy and the company shall inform the central government in **Form CRA-2** within 30 days of such appointment of cost auditor.

Submission of Cost Audit Report:

(i) **To the Board of Directors of the Company-** The cost auditor shall submit the cost audit report along with his reservations or qualifications or observations or suggestions, if any, in **Form CRA-3**. He shall forward his report to the Board of Directors of the company within a period of 180 days from the closure of the financial year to which the report relates and the Board of Directors shall consider and examine such report particularly any reservation or qualification contained therein.

(ii) **To the Central Government-** The company shall within 30 days from the date of receipt of a copy of the cost audit report prepared (in pursuance of a direction issued by Central Government) furnish the Central Government with such report along with full information and explanation on every reservation or qualification contained therein in **Form CRA-4** along with fees specified in the Companies (Registration Offices and Fees) Rules, 2014. If, after considering the cost audit report and the, information and explanation furnished by the company as above, the Central Government is of the opinion, that any further information or explanation is necessary, it may call for such further information and explanation and the company shall furnish the same within such time as may be specified by that Government.

Duty to Report on Fraud: The provisions of section 143(12) of the Companies Act, 2013 and the relevant rules on duty to report on fraud shall apply mutatis mutandis to a cost auditor during performance of his functions under section 148 of the Act and these rules.

Cost Audit Rules Not to Apply in Certain Cases: Sub-rule (3) of rule 4 provides that the requirement for cost audit under these rules shall not be applicable to a company which is covered under Rule 3, and,

(i) whose revenue from exports, in foreign exchange, exceeds 75% of its total revenue; or

(ii) which is operating from a special economic zone.

PART – II: QUESTIONS AND ANSWERS

QUESTIONS

1. State with reason (in short) whether the following statements are true or false:

   (i) The remuneration of subsequent auditor appointed under the Companies Act, 2013 shall be fixed by the Board.

   (ii) Sales invoice is an example of external evidence.

   (iii) The risk of not detecting a material misstatement resulting from fraud is higher than the risk of not detecting one resulting from error.

   (iv) Events occurring after the balance sheet date must be disclosed in the financial statements.

   (v) If the auditor of the company 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 Audit Committee.

   (vi) In case of failure of the Board to appoint the first auditor, it shall inform the members of the company.

   (vii) Copies of communication with other auditors, experts and other third parties are part of permanent audit file.

   (viii) The primary objective of an audit is to detect fraud and errors in Financial Statements.

   (ix) Audit procedure and Audit technique are not one and same thing.

   (x) Where a person appointed as an auditor of a company incurs any of the disqualifications after his appointment, he shall vacate his office as such auditor.

Nature of Auditing

2. (a) An audit is independent examination of financial information of any entity, whether profit oriented or not, and irrespective of its size or legal form, when such an examination is conducted with a view to expressing an opinion thereon.

   What the auditor is supposed to do to satisfy himself that nothing contained in the statements will mislead anybody?

   (b) "All those personal qualities that go to make a good businessman contribute to the making of a good auditor." Explain.

3. (a) "Professional judgment is essential to the proper conduct of an audit." Discuss the statement in terms of Standard on Auditing 200.

   (b) As part of obtaining an understanding of the entity and its environment, the auditor shall obtain a general understanding of the legal and regulatory framework applicable to the entity and the industry or sector in which the entity operates and how the entity is complying with that framework.

Explain what the auditor may perform to obtain such general understanding of the legal and regulatory framework applicable to the entity.

4. (a) The field of auditing as a discipline in simple words involves review of various assertions; both in financial as well as in non-financial terms, with a view to prove the veracity of such assertions and expression of opinion by auditor on the same.

   In this context, you are required to explain the relationship between auditing and accounting.

   (b) The auditor shall communicate with those charged with governance significant difficulties, if any, encountered during the audit. State such difficulties with reference to Standard on Auditing 260.

Basic Concepts in Auditing

5. Explain the concept of "True and Fair" view.

6. (a) The auditor of a limited company has given a clean report on the financial statement on the basis of Xerox copies of the books of accounts, vouchers and other records which were taken away by the Income-tax Department in search under section 132 of the I.T. Act, 1961. Comment with respect to reliability of audit evidence obtained while performing the audit function.

   (b) "Risk of material misstatement at the assertion level for classes of transactions, account balances and disclosures need to be considered." Explain stating the different categories of assertions used by the auditor.

7. (a) Explain the test of controls and substantive procedures as audit procedure of obtaining sufficient appropriate audit evidence for forming an audit opinion.

   (b) Under the going concern assumption, an entity is viewed as continuing in business for the foreseeable future. Explain "Going Concern" assumption with reference to SA. State some financial events or conditions that may cast doubt about going concern assumption.

Preparation for an Audit

8. Comment on the following situations/statements:

   (a) Mr Intelligent, a Chartered Accountant, was engaged by BeeCee Ltd. for auditing their accounts. He sent his letter of engagement to the Board of Directors which was accepted by the Company. In the course of audit of the company, Mr. Intelligent was unable to obtain appropriate sufficient audit evidence regarding receivables. The client further requested for a change in the terms of engagement.

(b) The statutory auditor of X Ltd. was unable to confirm the existence and valuation of imported goods lying with the shipper and, therefore, accepted a certificate from the management without obtaining other audit evidence.

9. Write short notes on the following:

(a) Matters that the auditor may consider when obtaining an understanding of the nature of the entity.

(b) Disadvantages of the use of an audit programme.

(c) Surprise checks.

Internal Control

10. (a) The auditor should gather information about the CIS environment that is relevant to the audit plan. Mention such important information which the auditor has to collect.

(b) The internal controls over computer processing, which help to achieve the overall objectives of internal control, include both manual procedures and procedures designed into computer programmes. Such manual and computer controls affect the CIS environment and the specific controls over the accounting applications. Explain those internal controls in a CIS Environment.

11. (a) The management of Gee Aar Ltd. decided to convert its manual accounting system into computerised accounting system from the current financial year. The company also appointed VC & Co., a firm of Chartered Accountants, as auditor for the said financial year. The auditors are told that as the audit is simpler in Computerised Information System (CIS) Environment since Trial Balance always tallies, the fees shall be reduced up to some extent comparative to the industry norms. You are required to analyse the contention of the management with respect to audit in CIS Environment.

(b) Your firm has been appointed as an auditor of Hind College. Before initiating any audit work, you want to analyse the internal control system of the college for collection of tuition fees from the students. Mention the points you would consider for such analysis.

Vouching & Verification of Assets and Liabilities

12. (a) Anu Co. Ltd. invested ₹ 50 lakhs in cumulative fixed deposits of Radha Bank Ltd. on 31.12.2014. The deposits carry interest @ 8.52% per annum compoundable quarterly and amount of interest is added to the principal and is due and payable on the maturity date which is 5 years from the date of investments.

For the year ended 31st March, 2015, the company did not book any revenue of interest on the ground that interest amount is not available at their disposal till maturity date of investment. Comment.

(b) PK Ltd. maintains its stock records up to date with timely entries passed for all receipts and issues. The company has hired a professional security agency, which monitors and implements a close vigilance over the operations of the company. As such, the company had dispensed with the practice of taking stock of their inventories at the year-end as in their opinion the exercise is redundant, time consuming and intrusion to normal functioning of the operations. Comment as an auditor.

13. How will you verify/vouch the following:

    (a) Credit sales

    (b) Bank Overdraft

    (c) Goods lying with Third Party

    (d) Goods sent out on Sale or Return Basis.

14. Janta Ltd. has made a contribution of ₹ 7.8 lacs during the financial year ended 31st March, 2015 to Samaj Seva Party, a political party, for running a teaching institute situated in the rural area, where most of the workers of the company reside. It is admitted that the benefit of the institute is mostly for the children of the workers of the company. The average net profit of the company during the three immediately preceding financial years was ₹ 100 lakhs. Comment.

The Company Audit

15. (a) M/s R & Co., a firm of Chartered Accountants, was appointed as statutory auditors of Ramesh Company Ltd. Ramesh Company Ltd. holds 51% shares in Suresh Company Ltd. Mr. R, one of the partners of M/s R & Co., owed ₹ 1,500 as on the date of appointment to Suresh Company Ltd. for goods purchased in normal course of business. Comment.

    (b) XYZ Company Ltd. removed its auditor appointed under section 139 of the Companies Act, 2013 before the expiry of his term without obtaining prior approval of the Central Government. Explain the procedure to be followed for removing auditor before the expiry of his term.

16. (a) M/s ASD & Associates, a firm of Chartered Accountants, has three partners Mr. A, Mr. S and Ms. D. The firm is already having audit of 45 companies. The firm is offered 20 public company audits. Advise whether M/s ASD & Associates will exceed the ceiling prescribed under section 141(3)(g) of the Companies Act, 2013 by accepting the above audit assignments assuming none of the partners hold any audits in their personal capacity or as partners of other firms.

    (b) ABC Ltd. appointed CA Prem as an auditor of the company for the current financial year. Further the company offered him the services of investment banking, rendering of outsourced financial services and management services which was also approved by the Board of Directors. State the services which the auditor is restrained from rendering and then advise accordingly.

17. (a) State the matters to be specified in Auditor's Report in terms of provisions of section 143(3) of the Companies Act, 2013.

(b) What are the various types of companies covered under Companies (Auditor's Report) Order, 2015?

18. (a) State the procedures to be followed for verification of issue of sweat equity shares.

(b) How an auditor can audit 'allotment of debentures'?

Special Audits

19. (a) What procedure may be adopted by an auditor while auditing leasing transactions entered into by the leasing company?

(b) What are the special steps involved in conducting the audit of a University?

20. Explain in detail the duties of Comptroller and Auditor General of India as envisaged under the Comptroller & Auditor General's (Duties, Powers and Conditions of Service) Act, 1971.

SUGGESTED ANSWERS / HINTS

1. **(i)** **Incorrect:** According to section 142 of the Companies Act, 2013, the remuneration of subsequent auditor of a company shall be fixed in its general meeting or in such manner as may be determined therein.

(ii) **Incorrect:** External evidence is the evidence that originates outside the client's organisation. Since sales invoice originates within the organisation being audited, therefore, it is an example of internal evidence and not external evidence.

(iii) **Correct:** The risk of not detecting a material misstatement resulting from fraud is higher than the risk of not detecting one resulting from error. This is because fraud may involve sophisticated and carefully organized schemes designed to conceal it.

(iv) **Incorrect:** As per AS-4 on "Contingencies and Events Occurring After the Balance Sheet Date", events occurring after the balance sheet date which do not affect the figures stated in the financial statements would not normally require disclosure in the financial statements although they may be of such significance that they may require a disclosure in the report of the approving authority to enable users of financial statements to make proper evaluations and decisions.

(v) **Incorrect:** As per section 143(12) 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.

(vi) **Correct**: According to section 139(6) of the Companies Act, 2013, in the case of failure of the Board to appoint the auditor, it shall inform the members of the company.

(vii) **Incorrect:** Copies of communication with other auditors, experts and other third parties are part of current audit file. Permanent audit file normally includes information concerning the legal and organisational structure of the entity, copies of audited financial statements for previous years, copies of management letters, etc.

(viii) **Incorrect:** Detection of fraud and errors in the financial statements is not the primary objective of audit. The primary objective of an audit is to obtain reasonable assurance about whether the financial statements are free from material misstatements thereby enabling the auditor to express an opinion on the financial statements.

(ix) **Correct:** The two terms, procedure and technique are often used interchangeably. However, a distinction does exist. Procedure may comprise a number of techniques and represents the broad frame of the manner of handling audit work and the technique stands for the methods employed for carrying out the procedure.

(x) **Correct:** As per section 141(4) of the Companies Act, 2013, where a person appointed as an auditor of a company incurs any of the disqualifications after his appointment, he shall vacate his office as such auditor and such vacation shall be deemed to be a casual vacancy in the office of the auditor.

2. (a) **Independent Examination of Financial Information:** An audit is independent examination of financial information of any entity, whether profit oriented or not, and irrespective of its size or legal form, when such an examination is conducted with a view to expressing an opinion thereon. The person conducting this process should perform his work with knowledge of the use of the accounting statements and should take particular care to ensure that nothing contained in the statements will ordinarily mislead anybody. This he can do honestly by satisfying himself that-

(i) the accounts have been drawn up with reference to entries in the books of account;

(ii) the entries in the books of account are adequately supported by underlying papers and documents and by other evidence;

(iii) none of the entries in the books of account has been omitted in the process of compilation and nothing which is not in the books of account has found place in the statements;

(iv) the information conveyed by the statements is clear and unambiguous;

(v) the financial statement amounts are properly classified, described and disclosed in conformity with accounting standards; and

(vi) the statement of accounts taken as an integrated whole, present a true and fair picture of the operational results and of the assets and liabilities.

(b) Qualities of an Auditor: The qualities required, according to Dicksee, are tact, caution, firmness, good temper, integrity, discretion, industry, judgement, patience, clear headedness and reliability. In short, all those personal qualities required to make a good businessman contribute to the making of a good auditor. In addition, he must have the shine of culture for attaining a great height. He must have the highest degree of integrity backed by adequate independence. In fact, Code of ethics mentions integrity, objectivity and independence as one of the fundamental principles of professional ethics.

He must have a thorough knowledge of the general principles of law which govern matters with which he is likely to be in intimate contact. The Companies Act, 2013 and the Partnership Act, 1932 need special mention but mercantile law, specially the law relating to contracts, is no less important. Needless to say, where undertakings are governed by a special statute, its knowledge will be imperative; in addition, a sound knowledge of the law and practice of taxation is unavoidable.

He must pursue an intensive programme of theoretical education in subjects like financial and management accounting, general management, business and corporate laws, computers and information systems, taxation, economics, etc. Both practical training and theoretical education are equally necessary for the development of professional competence of an auditor for undertaking any kind of audit assignment.

The auditor should be equipped not only with a sufficient knowledge of the way in which business generally is conducted but also with an understanding of the special features peculiar to a particular business whose accounts are under audit. The auditor, who holds a position of trust, must have the basic human qualities apart from the technical requirement of professional training and education.

He is called upon constantly to critically review financial statements and it is obviously useless for him to attempt that task unless his own knowledge is that of an expert. An exhaustive knowledge of accounting in all its branches is the *sine qua non* of the practice of auditing. He must know thoroughly all accounting principles and techniques.

Lord Justice Lindley in the course of the judgment in the famous *London & General Bank case* had succinctly summed up the overall view of what an auditor should be as regards the personal qualities. He said, “an auditor must be honest that is, he must not certify what he does not believe to be true and must take reasonable care and skill before he believes that what he certifies is true”.

3. (a) **Professional Judgment:** As per SA 200 "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", professional judgment is essential to the proper conduct of an audit. This is because interpretation of relevant ethical requirements and the SAs and the informed decisions required throughout the audit cannot be made without the application of relevant knowledge and experience to the facts and circumstances. Professional judgment is necessary in particular regarding decisions about-

   (i) Materiality and audit risk.

   (ii) The nature, timing, and extent of audit procedures used to meet the requirements of the SAs and gather audit evidence.

   (iii) Evaluating whether sufficient appropriate audit evidence has been obtained, and whether more needs to be done to achieve the objectives of the SAs and thereby, the overall objectives of the auditor.

   (iv) The evaluation of management's judgments in applying the entity's applicable financial reporting framework.

   (v) The drawing of conclusions based on the audit evidence obtained, for example, assessing the reasonableness of the estimates made by management in preparing the financial statements.

(b) **Obtaining General Understanding of the Legal and Regulatory Framework:** According to SA 250 "Consideration of Laws and Regulations in an Audit of Financial Statements", to obtain a general understanding of the legal and regulatory framework, and how the entity complies with that framework, the auditor may-

   (i) Use the auditor's existing understanding of the entity's industry, regulatory and other external factors;

   (ii) Update the understanding of those laws and regulations that directly determine the reported amounts and disclosures in the financial statements;

   (iii) Inquire of management as to other laws or regulations that may be expected to have a fundamental effect on the operations of the entity;

   (iv) Inquire of management concerning the entity's policies and procedures regarding compliance with laws and regulations; and

   (v) Inquire of management regarding the policies or procedures adopted for identifying, evaluating and accounting for litigation claims.

4. (a) **Relationship of Auditing with Other Disciplines:** The field of auditing as a discipline in simple words involves review of various assertions; both in financial as well as in non-financial terms, with a view to prove the veracity of such assertions and expression of opinion by auditor on the same. Thus, it is quite logical and natural that the function of audit can be performed if and only if the person also

possesses a good knowledge about the fields in respect of which he is conducting such a review.

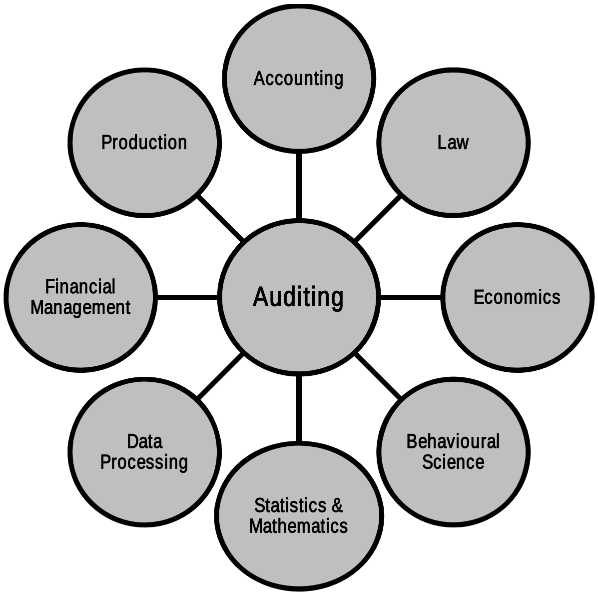


Diagram showing the relationship of Auditing with other Disciplines

Auditing and Accounting: It has been pointed out earlier that both accounting and auditing are closely related with each other as auditing reviews the financial statements which are nothing but a result of the overall accounting process. It naturally calls on the part of the auditor to have a thorough and sound knowledge of generally accepted principles of accounting before he can review the financial statements. In fact, auditing as a discipline is also closely related with various other disciplines as there is lot of linkages in the work which is done by an auditor in his day-to-day activities. To begin with, it may be noted that the discipline of auditing itself is a logical construct and everything done in auditing must be bound by the rules of logic. Ethical precepts are the foundations on which the foundation of the entire accounting profession rests. The knowledge of language is also considered essential in the field of auditing as the auditor shall be required to communicate, both in writing as well as orally, in day-to-day work.

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

(i) Significant delays in management providing required information.

(ii) An unnecessarily brief time within which to complete the audit.

(iii) Extensive unexpected effort required to obtain sufficient appropriate audit evidence.

(iv) The unavailability of expected information.

(v) Restrictions imposed on the auditor by management.

(vi) Management's unwillingness to make or extend its assessment of the entity's ability to continue as a going concern when requested.

(vii) In some circumstances, such difficulties may constitute a scope limitation that leads to a modification of the auditor's opinion.

5. **Concept of "True and Fair":** The concept of "true and fair" is a fundamental concept in auditing. The phrase "true and fair" in the auditor's report signifies that the auditor is required to express his opinion as to whether the state of affairs and the results of the entity as ascertained by him in the course of his audit are truly and fairly represented in the accounts under audit.

   This requires that the auditor should examine the accounts with a view to verifying that all assets and liabilities, incomes and expenses are stated at the amounts which are in accordance with accounting principles and policies, and no material item has been omitted.

   The importance of the concept of true and fair view can also be understood and appreciated from the fact that sections 128, 129 and 143 of the Companies Act, 2013 also discuss this concept in relation to account books, financial statements and reporting on financial statements respectively.

   Section 128(1) of the said Act provides that every company shall prepare and keep at its registered office books of account and other relevant books and papers and financial statement for every financial year which give a true and fair view of the state of the affairs of the company, including that of its branch office or offices, if any. The company shall be in a position to explain the transactions effected both at the registered office and its branches. Such books of accounts shall be kept on accrual basis and according to the double entry system of accounting.

   Section 129(1) of the Companies Act, 2013 provides that the financial statements shall give a true and fair view of the state of affairs of the company or companies, comply with the accounting standards notified under section 133 of the Companies Act, 2013, (in which the Central Government may prescribe the standards of accounting or any addendum thereto, as recommended by the Institute of Chartered Accountants of India, constituted under section 3 of the Chartered Accountants Act, 1949, in consultation with and after examination of the recommendations made by the National Financial Reporting Authority) and shall be in the form or forms as may be provided for different class or classes of companies in Schedule III to the said Act.

The term "financial statement" shall include any notes annexed to or forming part of such financial statement, giving information required to be given and allowed to be given in the form of such notes under the said Act.

It may be noted that nothing contained in sub-section (1) of section 129 shall apply to any insurance or banking company or any company engaged in the generation or supply of electricity, or to any other class of company for which a form of financial statement has been specified in or under the Act governing such class of company.

However, the financial statements shall not be treated as not disclosing a true and fair view of the state of affairs of the company, merely by reason of the fact that they do not disclose-

(a) in the case of an insurance company, any matters which are not required to be disclosed by the Insurance Act, 1938, or the Insurance Regulatory and Development Authority Act, 1999;

(b) in the case of a banking company, any matters which are not required to be disclosed by the Banking Regulation Act, 1949;

(c) in the case of a company engaged in the generation or supply of electricity, any matters which are not required to be disclosed by the Electricity Act, 2003;

(d) in the case of a company governed by any other law for the time being in force, any matters which are not required to be disclosed by that law.

It may be noted that where the financial statements of a company do not comply with the accounting standards referred to in sub-section (1), the company shall disclose in its financial statements, the deviation from the accounting standards, the reasons for such deviation and the financial effects, if any, arising out of such deviation.

Further, according to section 143(2) of the said Act, the auditor is required to make a report to the members of the company indicating that, to the best of his information and knowledge, the financial statements give a true and fair view of the state of the company's affairs as at the end of its financial year and profit or loss and cash flow for the year and such other matters as may be prescribed.

SA 700 "Forming an Opinion and Reporting on Financial Statements", requires the auditor to form an opinion on the financial statements based on an evaluation of the conclusions drawn from the audit evidence obtained; and express clearly that opinion through a written report that also describes the basis for the opinion. The auditor is required to express his opinion on the financial statements that it gives a true and fair view in conformity with the accounting principles generally accepted in India (a) in the case of the Balance Sheet, of the state of affairs of the Company as at March 31, 20XX; (b) in the case of the Statement of Profit and Loss, of the profit/ loss for the year ended on that date; and (c) in the case of the Cash Flow Statement, of the cash flows for the year ended on that date.

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

(i) The reliability of audit evidence is increased when it is obtained from independent sources outside the entity.

(ii) The reliability of audit evidence that is generated internally is increased when the related controls, including those over its preparation and maintenance, imposed by the entity are effective.

(iii) Audit evidence obtained directly by the auditor (for example, observation of the application of a control) is more reliable than audit evidence obtained indirectly or by inference (for example, inquiry about the application of a control).

(iv) Audit evidence in documentary form, whether paper, electronic, or other medium, is more reliable than evidence obtained orally (for example, a contemporaneously written record of a meeting is more reliable than a subsequent oral representation of the matters discussed).

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

Applying the above, the degree of reliance which can be placed by the auditor on the documentary audit evidence available in the present case will be considerably increased if the xerox copies of account books and vouchers are certified to be true copies by the Income Tax Department. If the tax authorities refuse to certify the same, the auditor should get the certificate to this effect from the management of the company.

The auditor should use procedure like confirmation of balances from third parties, inspection of tangible assets, etc. and obtain evidence which corroborates the documentary evidence available. In any case, the auditor has to satisfy himself that he has obtained sufficient and appropriate audit evidence to support the figures contained in the financial statements and formulate his opinion accordingly. Under such circumstances, the auditor should have appropriately modified his report and bring this fact to the attention of shareholders. In case he was satisfied, a simple paragraph of information was enough but in case the auditor failed to establish the reliability of evidence available, he would be required to a disclaimer of opinion.

(b) **Risk of Material Misstatement at the Assertion Level:** According to SA 315 "Identifying and Assessing the Risk of Material Misstatement Through Understanding the Entity and its Environment", risks of material misstatement at the assertion level for classes of transactions, account balances, and disclosures need to be considered because such consideration directly assists in determining the nature, timing, and extent of further audit procedures at the assertion level necessary to obtain sufficient appropriate audit evidence. In identifying and assessing risks of material misstatement at the assertion level, the auditor may conclude that the identified risks relate more pervasively to the financial statements as a whole and potentially affect many assertions.

Assertions used by the auditor to consider the different types of potential misstatements that may occur fall into the following three categories and may take the following forms-

(1) Assertions about classes of transactions and events for the period under audit:

(i) Occurrence—transactions and events that have been recorded have occurred and pertain to the entity.

(ii) Completeness—all transactions and events that should have been recorded have been recorded.

(iii) Accuracy—amounts and other data relating to recorded transactions and events have been recorded appropriately.

(iv) Cut-off—transactions and events have been recorded in the correct accounting period.

(v) Classification—transactions and events have been recorded in the proper accounts.

(2) Assertions about account balances at the period end:

(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.

(3) Assertions about presentation and disclosure:

(i) Occurrence and rights and obligations—disclosed events, transactions, and other matters have occurred and pertain to the entity.

(ii) Completeness—all disclosures that should have been included in the financial statements have been included.

(iii) Classification and understandability—financial information is appropriately presented and described, and disclosures are clearly expressed.

(iv) Accuracy and valuation—financial and other information are disclosed fairly and at appropriate amounts.

7. (a) **Testing of Evidence to Form Audit Opinion:** Auditor should obtain sufficient and appropriate audit evidences and test them before framing an opinion about the assertions the financial statements reveal. For this, the auditor checks evidences through (i) Test of Controls and (ii) Substantive Procedure.

According to SA 330 "The Auditor's Responses to Assessed Risks", 'test of controls' means an audit procedure designed to evaluate the operating effectiveness of controls in preventing, or detecting and correcting, material misstatements at the assertion level.

The auditor shall design and perform tests of controls to obtain sufficient appropriate audit evidence as to the operating effectiveness of relevant controls when:

(i) The auditor's assessment of risks of material misstatement at the assertion level includes an expectation that the controls are operating effectively (i.e., the auditor intends to rely on the operating effectiveness of controls in determining the nature, timing and extent of substantive procedures); or

(ii) Substantive procedures alone cannot provide sufficient appropriate audit evidence at the assertion level.

SA 330 further explains the 'substantive procedure' as an audit procedure designed to detect material misstatements at the assertion level. Substantive procedures comprise:

(i) Tests of details (of classes of transactions, account balances, and disclosures), and

(ii) Substantive analytical procedures.

Irrespective of the assessed risks of material misstatement, the auditor shall design and perform substantive procedures for each material class of transactions, account balance, and disclosure.

The auditor shall consider whether external confirmation procedures are to be performed as substantive audit procedures.

(b) **Going Concern Assumption:** SA 570, "Going Concern" deals with the auditor's responsibility in the audit of financial statements with respect to management's use of the going concern assumption in the preparation and presentation of the financial statements.

Under the going concern assumption, an entity is viewed as continuing in business for the foreseeable future. General purpose financial statements are prepared on a going concern basis, unless management either intends to liquidate the entity or to cease operations, or has no realistic alternative but to do so. Special purpose financial statements may or may not be prepared in accordance with a financial reporting framework for which the going concern basis is relevant. When the use of the going concern assumption is appropriate, assets and liabilities are recorded on the basis that the entity will be able to realise its assets and discharge its liabilities in the normal course of business.

Financial events or conditions that may cast doubt about Going Concern assumption: Following are the examples of events or conditions that, individually or collectively, may cast significant doubt about the going concern assumption-

(i) Net liability or net current liability position.

(ii) Fixed-term borrowings approaching maturity without realistic prospects of renewal or repayment; or excessive reliance on short-term borrowings to finance long-term assets.

(iii) Indications of withdrawal of financial support by trade payables.

(iv) Negative operating cash flows indicated by historical or prospective financial statements.

(v) Adverse key financial ratios.

(vi) Substantial operating losses or significant deterioration in the value of assets used to generate cash flows.

(vii) Arrears or discontinuance of dividends.

(viii) Inability to pay trade payables on due dates.

(ix) Inability to comply with the terms of loan agreements.

(x) Change from credit to cash-on-delivery transactions with suppliers.

(xi) Inability to obtain financing for essential new product development or other essential investments.

8. (a) **Change in Terms of Engagement:** According to SA 210 "Agreeing the Terms of Audit Engagements", an auditor who is required to change the engagement which requires lower level of assurance before the completion of engagement should consider the appropriateness of doing so. But when the terms of engagement are changed, both the auditor and the client should agree on the new terms. However,

the auditor should not agree to a change in terms where there is no reasonable justification for doing so.

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

(i) Withdraw from the audit engagement where possible under applicable law or regulation; and

(ii) Determine whether there is any obligation, either contractual or otherwise, to report the circumstances to other parties, such as those charged with governance, owners or regulators.

In the instant case, Mr. Intelligent was unable to obtain sufficient evidence regarding receivables. The client requested him for a change in the terms of the agreement to avoid qualified/adverse opinion. Hence, there is no reasonable justification for change in the terms of engagement.

Thus, Mr. Intelligent should not agree for change in the terms of engagement letter. He may withdraw from the engagement if possible under law; and determine any obligation to report accordingly.

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

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

In the instant case, the inventory of imported material lying with the shipper can be easily verified with purchase order, invoice, bill of entry, custom document, etc.

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

9. (a) **Matters that the Auditor may consider when obtaining an understanding of the nature of the entity:** As per SA 315 “Identifying and Assessing the Risk of Material Misstatement through understanding the Entity and its Environment”, following are some of the examples of matters that the auditor may consider when obtaining an understanding of the nature of the entity-

(i) Business operations – such as:

- Nature of revenue sources, products or services, and markets, including involvement in electronic commerce such as internet sales and marketing activities.
- Conduct of operations (for example, stages and methods of production, or activities exposed to environmental risks).
- Alliances, joint ventures, and outsourcing activities.
- Geographic dispersion and industry segmentation.
- Location of production facilities, warehouses, and offices, and location and quantities of inventories.
- Key customers and important suppliers of goods and services, employment arrangements.
- Research and development activities and expenditures.
- Transactions with related parties.

(ii) Investments and investment activities – such as:

- Planned or recently executed acquisitions or divestitures.
- Investments and dispositions of securities and loans.
- Capital investment activities.
- Investments in non-consolidated entities, including partnerships, joint ventures and special-purpose entities.

(iii) Financing and financing activities – such as:

- Major subsidiaries and associated entities, including consolidated and non-consolidated structures.
- Debt structure and related terms, including off-balance-sheet financing arrangements and leasing arrangements.
- Beneficial owners (local, foreign, business reputation and experience) and related parties.
- Use of derivative financial instruments.

(iv) Financial reporting – such as:

- Accounting principles and industry - specific practices, including industry - specific significant categories (for example, loans and investments for banks, or research and development for pharmaceuticals).
- Revenue recognition practices.
- Accounting for fair values.
- Foreign currency assets, liabilities and transactions.
- Accounting for unusual or complex transactions including those in

controversial or emerging areas (for example, accounting for stock-based compensation).

(b) **Disadvantages of the use of an Audit Programme:** There are some disadvantages in the use of audit programmes but most of these can be removed by taking some steps which otherwise also contribute to the making of a good audit. The disadvantages are-

(i) The work may become mechanical and particular parts of the programme may be carried out without any understanding of the object of such parts in the whole audit scheme.

(ii) The programme often tends to become rigid and inflexible following set grooves; the business may change in its operation of conduct, but the old programme may still be carried on. Changes in staff or internal control may render precaution necessary at points different from those originally decided upon.

(iii) Inefficient assistants may take shelter behind the programme i.e. defend deficiencies in their work on the ground that no instruction in the matter is contained therein.

(iv) A hard and fast audit programme may kill the initiative of efficient and enterprising assistants.

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

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

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

10. (a) **Information to be gathered to prepare an Audit Plan in CIS Environment:** The auditor should gather information about the CIS environment that is relevant to the audit plan, including information as to-

(i) How the CIS function is organized and the extent of concentration or distribution of computer processing throughout the entity.

(ii) The computer hardware and software used by the entity.

(iii) Each significant application processed by the computer, the nature of the processing (e.g. batch, on-line), and data retention policies.

(iv) Planned implementation of new applications or revisions to existing applications.

(v) When considering his overall plan the auditor should consider matters, such as:

  (1) Determining the degree of reliance, if any, he expects to be able to place on the CIS controls in his overall evaluation of internal control.

  (2) Planning how, where and when the CIS function will be reviewed including scheduling the works of CIS experts, as applicable.

  (3) Planning auditing procedures using computer-assisted audit techniques.

(b) Internal Controls in a CIS Environment: The internal controls over computer processing, which help to achieve the overall objectives of internal control, include both manual procedures and procedures designed into computer programmes. Such manual and computer controls affect the CIS environment (general CIS controls) and the specific controls over the accounting applications (CIS application controls).

General CIS Controls: The purpose of general CIS controls is to establish a framework of overall control over the CIS activities and to provide a reasonable level of assurance that the overall objectives of internal control are achieved. These controls may include-

(1) Organisation and management controls are designed to establish an organizational framework over CIS activities, including:

  (i) Policies and procedures relating to control functions.

  (ii) Appropriate segregation of incompatible functions.

(2) Application systems development and maintenance controls are designed to establish control over:

  (i) Testing, conversion, implementation and documentation of new or revised systems.

  (ii) Changes to application systems.

  (iii) Access to systems documentation.

  (iv) Acquisition of application systems from third parties.

(3) Computer operation controls are designed to control the operation of the systems and to provide reasonable assurance that:

(i) The systems are used for authorised purposes only.

(ii) Access to computer operations is restricted to authorised personnel.

(iii) Only authorised programs are used.

(iv) Processing errors are detected and corrected.

(4) Systems software controls include:

(i) Authorisation, approval, testing, implementation and documentation of new systems software and systems software modifications.

(ii) Restriction of access to systems software and documentation to authorised personnel.

(5) Data entry and program controls are designed to provide reasonable assurance that:

(i) An authorisation structure is established over transactions being entered into the system.

(ii) Access to data and programs is restricted to authorised personnel.

(iii) Offsite back-up of data and computer programmes.

(iv) Recovery procedures for use in the event of theft, loss or international or accidental destruction.

(v) Provision for offsite processing in the event of disaster.

CIS Application Controls: The purpose of CIS application controls is to establish specific control procedures over the accounting applications to provide reasonable assurance that all transactions are authorised and recorded, and are processed completely, accurately and on a timely basis. These include-

(1) Controls over input are designed to provide reasonable assurance that:

(i) Transactions are properly authorised before being processed by the computer.

(ii) Transactions are accurately converted into machine readable form and recorded in the computer data files.

(iii) Transactions are not lost, added, duplicated or improperly changed.

(iv) Incorrect transactions are rejected, corrected and if necessary, resubmitted on a timely basis.

(2) Controls over processing and computer data files are designed to provide reasonable assurance that:

(i) Transactions, including system generated transactions, are properly processed by the computer.

(ii) Transactions are not lost, added, duplicated or improperly changed.

(iii) Processing errors are identified and corrected on a timely basis.

(3) Controls over output are designed to provide reasonable assurance that:

(i) Results of processing are accurate.

(ii) Access to output is restricted to authorised personnel.

(iii) Output is provided to appropriate authorised personnel on a timely basis.

11. (a) Audit in a Computerised Information System (CIS) Environment: Though it is true that in CIS environment the trial balance always tallies, the same can not imply that the job of an auditor becomes simpler. There can still be some accounting errors like omission of certain entries, compensating errors, duplication of entries, errors of commission in the form of wrong head of accounts etc. Possibility of "Window Dressing" and/or "Creation of Secret Reserves" can be possible in CIS environment also in spite of tallied trial balance. At present, due to complex business environment the importance of trial balance cannot be judged only upto the arithmetical accuracy but the nature of transactions recorded and its classification in the books should be focused.

The emergence of new forms of financial instruments like options and futures, derivatives, off balance sheet financing etc have given rise to further complexities in recording and disclosure of transactions. In an audit, besides the tallying of a trial balance, there are other issue also like estimation of provision for depreciation, estimation of tax liability, valuation of inventories, obtaining audit evidence, ensuring compliance with various laws, regulations and standards, verification of existence and valuation of assets and liabilities, reporting requirement as per statute etc. which still requires judgement to be exercised by the auditor.

The CIS environment has its own complexities and requires lot of controls, safeguards and application which requires specialised knowledge and skill for proper implementation.

Responsibility of expressing an audit opinion and objectives of an audit are not changed in the audit in CIS environment. Compliance with various laws and standards are still to be verified, ensured and reported.

Therefore, it can be said that simply because of CIS environment and tallying of the trial balance, the audit can't be said to have become simpler. Thus, the contention of management of Gee Aar Ltd., as given in the question, is not acceptable.

(b) Internal Control points for Collection of Tuition Fees: While analysing internal control system of Hind College regarding collection of tuition fees from students, the following points may be considered-

(i) There must be a clear cut tuition fee structure approved by the college council.

(ii) The challan or paying in slip should contain necessary fields for identifying the roll number of the student, class, and period for which fees is paid etc. The slips should have such number of counterfoils to cross check the remittance.

(iii) The paying in slip when filled by the students should be checked for its correctness as to applicable amount etc. b y one clerk and the amount should be entered in a scroll. He must initial the slip which authorises the cashier to accept the fees as per slip.

(iv) The cashier scroll and the authorising officer/s scroll should be checked by an officer daily.

(v) All remittance should be banked each day. No amount should be allowed to be spared for meeting any type of expense.

(vi) Alternatively, the fees may be directly remitted into bank and banker's daily remittance slip should be scrutinised by college officers.

(vii) Arrears list should be periodically prepared from the students rolls. Any concession, remission of tuition fees should have approval of competent authority.

(viii) Delayed remittance should carry fines or compensating charges for delay.

(ix) When students are readmitted after removal for non-payment of fees, the admission should carry the permission of competent authority.

12. (a) **Recognition of Interest on Deposits:** Accounting Standard 9 on Revenue Recognition requires that the revenue arising from interest should be recognised on a time proportion basis taking into account the amount outstanding and the rate applicable. Such revenues should only be recognised when no significant uncertainty as to measurability or collectability exists.

Further, according to section 128 of the Companies Act, 2013, books are to be maintained on accrual basis. Again, accrual method of accounting is a fundamental assumption of accounting policies.

In the given case, though the interest becomes due for payment only at maturity date, it accrues each quarter. Interest accrued but not due should be shown under current assets in the balance sheet as per Schedule III Part I requirement of the Companies Act, 2013.

As such, the profits and current assets are understated, the true and fair view of the accounts are thus vitiated.

On considerations of materiality of the item, the auditor may appropriately decide to qualify the audit report.

(b) **Verification of Inventories – Auditor's Duties:** The audit procedures to be performed by an auditor to obtain sufficient appropriate audit evidence in relation to inventories have been recommended in the Guidance Note on Audit of Inventories issued by ICAI. On the basis of his evaluation of the effectiveness of the internal controls, the auditor should carry out appropriate substantive procedures in relation to inventories. These substantive procedures include examination of records, attendance at inventory-taking, examination of valuation and disclosure of inventories, carrying out analytical procedures, and obtaining confirmations from third parties and representations from the management.

In view of above, an auditor should insist on the company to do physical verification of inventory. Verification must be done at least yearly, if not more frequently within a year. Dispensing with physical verification altogether is unacceptable. It is not enough that the company had installed good control procedures. It must be tested, for example, in case of inventory, physically verifying the same as to see that no discrepancy exists. Pilferage, misappropriation is not the only cause for discrepancies. Inherent product qualities like shrinkage, evaporation, handling loss, etc. may also account for discrepancies. The auditor should require the management to conduct physical verification by or near the year end. If the management does not accept to the auditor's view the auditor may appropriately make modification in his audit report.

Additionally, as per clause (ii) of Para 3 of Companies (Auditor's Report) Order, 2015 [CARO 2015], the auditor has to report on whether physical verification of inventory has been conducted at reasonable intervals by the management; are the procedures of physical verification of inventory followed by the management reasonable and adequate in relation to the size of the company and the nature of its business. If not, the inadequacies in such procedures should be reported. It also requires the auditor to report on whether the company is maintaining proper records of inventory and whether any material discrepancies noticed on physical verification have been properly dealt with in the books of account.

13. (a) Verification of the Credit Sales: The credit sales should be verified by reference to copies of invoices issued to customers and, in the process, attention should be paid to the following matters-

(i) that each item of sales relates to the period of account under audit;

(ii) that the goods are those that are normally dealt in by the concern;

(iii) that the sale price has been correctly arrived at and the copy of the requisition slip issued by the Sales Department and the copy of the Despatch Note showing the date and mode of despatch of goods are attached with the invoice;

(iv) that the amount of the invoice has been adjusted in an appropriate account; and

(v) that the sale has been authorised by a responsible official and in token thereof he has initialed the invoice; also that any alteration in the invoice has been attested by the same person.

(b) Bank Overdraft

(i) The auditor should ensure that the facility of overdraft is authorised by the Board's resolution/partner's resolution.

(ii) Pursue the agreement with the bank and see whether the overdraft is clean or against hypothecation or pledge of company's property.

(iii) Verify the register of charges and ensure that the charge has been registered with Registrar of Companies.

(iv) Verify the rate of interest and other terms and conditions from the agreement.

(v) Verify the amount of overdraft from the books of accounts and compare it with the passbook.

(vi) If the overdraft is against hypothecation of assets like inventories, a certificate from the bank should be obtained.

(vii) If the overdraft is against hypothecation of assets or pledge of company's property, see that overdraft is properly shown under 'secured loans' and nature of security has been properly disclosed.

(c) Goods lying with Third Party

(i) The auditor should check that the materiality of the item under this caption included in inventories.

(ii) He should obtain confirmation of the amount of goods lying with them. The confirmation may be directly obtained by auditor or be produced by client depending upon the situation.

(iii) He should inquire into the necessity of sub-contractor retaining the inventory. He should ensure the process that they do are related to the business requirement and there is no ground for suspicion on this score.

(iv) The goods lying with them for the very long period would merit auditor's special attention for making provision.

(v) The records, voucher/slips for the regulating the movement of inventory into and out of entity for sub-contracting work be reviewed by vouching for few transaction for ensuring existence and working of internal control system for them.

(vi) The excise gate pass, entry in such records, information in returns, be also cross-verified.

(vii) The valuation of inventories should be correctly made for including material cost on appropriate inventory valuation formulae and also for inclusion of proportionate processing charges for the work in process with the contractors.

(viii) The provision should be created for work done, billed for processing and also for incidence of any applicable levy like service tax payable.

(d) Goods Sent Out on Sale or Return Basis

(i) Check whether a separate memoranda record of goods sent out on sale or return basis is maintained. The party accounts are debited only after the goods have been sold and the sales account is credited.

(ii) See that price of such goods is unloaded from the sales account and the trade receivable's record. Refer to the memoranda record to confirm that on the receipt of acceptance from each party, his account has been debited and the sales account correspondingly credited.

(iii) Ensure that the goods in respect of which the period of approval has expired at the close of the year either have been received back subsequently or customers' accounts have been debited.

(iv) Confirm that the inventory of goods sent out on approval, the period of approval in respect of which had not expired till the close of the year lying with the party, has been included in the closing inventory.

14. Restrictions regarding Political Contribution: Section 182 of the Companies Act, 2013 deals with prohibitions and restrictions regarding political contributions. According to this section, a government company or any other company which has been in existence for less than three financial years cannot contribute any amount directly or indirectly to any political party. In other cases, aggregate contribution in any financial year should not exceed 7½ % of average net profit during the three immediately preceding financial years.

In the given case, Janta Ltd. has made a contribution of ₹ 7.8 lacs to Samaj Seva Party, a political party. The average net profit of the company during the three immediately preceding financial years is ₹ 100 lakhs and the 7½ % of this works out to ₹ 7.5 lacs.

As the company has contributed ₹ 7.8 lacs, there is a violation of the provisions of section 182 of the Companies Act, 2013 although the children of its workers are benefited. Therefore, the auditor would have to qualify his report accordingly.

15. (a) Indebtness to the Subsidiary Company: As per Section 141(3)(d)(ii) of the Companies Act, 2013, a person who, or his relative or partner is indebted to the company, or its subsidiary, or its holding or associate company, or a subsidiary of its holding company, for an amount exceeding ₹ 5,00,000, then he is not qualified for appointment as an auditor of a company.

Where an auditor purchases goods or services from a company audited by him or its subsidiary, or its holding or associate company, or a subsidiary of its holding company, whether in normal course of business, he is definitely indebted to the company and if the amount outstanding exceeds ₹ 5,00,000, he is disqualified for appointment as an auditor of the company. In such a case, he becomes indebted to the company and consequently he has deemed to have vacated his office.

In the given case, M/s R & Co., a firm of Chartered Accountants, was appointed as statutory auditors of Ramesh Company Ltd. where the company holds 51% shares in Suresh Company Ltd. Mr. R, one of the partners of M/s R & Co. owed ₹ 1,500 as on the date of appointment to Suresh Company Ltd. for goods purchased.

Accordingly, the partner, Mr. R, is not disqualified to be appointed as auditor of the company as he is indebted to the company for an amount not exceeding ₹ 5,00,000.

Due to this, M/s R & Co. is not disqualified to be appointed as an auditor of Ramesh Company Ltd.

(b) **Removal of Auditor Before Expiry:** 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-

(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.

In the instant case, the auditor appointed under section 139 of the Companies Act, 2013 was removed by the company before the expiry of his term without obtaining approval of the Central Government.

Therefore, it may be concluded that the action of the company for removal of the auditor before expiry of term is not justified and auditor may be removed from his office only by following the above mentioned procedure.

16. (a) **Ceiling on Number of Audits:** Before appointment is given to any auditor, the company must obtain a certificate from him to the effect that the appointment, if made, will not result in an excess holding of company audit by the auditor concerned over the limit laid down in section 141(3)(g) of the Companies Act, 2013,

which prescribes that a person shall not be eligible for appointment as an auditor of a company who is in full time employment elsewhere or a person or a partner of a firm holding appointment as its auditor, if such person or partner is at the date of such appointment or reappointment holding appointment as auditor of more than twenty companies.

In the case of a firm of auditors, it has been further provided that 'specified number of companies' shall be construed as the number of companies specified for every partner of the firm who is not in full time employment elsewhere.

In the given case, M/s ASD & Associates is already having audit of 45 companies and the individual partners do not hold any audits in their personal capacity or as partners of other firms. Therefore, the total number of company audits that can be accepted by M/s ASD & Associates is 60. But, the firm is already having audit of 45 companies. Thus, the firm can accept the audit of 15 public companies only, which is well within the limit, specified by section 141(3)(g) of the Companies Act, 2013.

(b) Services not to be rendered by the Auditor: Section 144 of the Companies Act, 2013 prescribes certain services not to be rendered by the auditor. An auditor appointed under this Act shall provide to the company only such other services as are approved by the Board of Directors or the audit committee, as the case may be, but which shall not include any of the following services (whether such services are rendered directly or indirectly to the company or its holding company or subsidiary company), namely-

(i) accounting and book keeping services;

(ii) internal audit;

(iii) design and implementation of any financial information system;

(iv) actuarial services;

(v) investment advisory services;

(vi) investment banking services;

(vii) rendering of outsourced financial services;

(viii) management services; and

(ix) any other kind of services as may be prescribed.

Further, section 141(3)(i) of the Companies Act, 2013 also disqualifies a person for appointment as an auditor of a company who is engaged as on the date of appointment in consulting and specialized services as provided in section 144.

In the given case, CA Prem was appointed as an auditor of ABC Ltd. He was offered additional services of investment banking, rendering of outsourced financial services and management services which was also approved by the Board of

Directors. The auditor is advised not to accept the services as these services are specifically covered in the services not to be rendered by him as an auditor as per section 144 of the Companies Act, 2013.

17. (a) **Matters to be Specified in Auditor's Report:** As per sub-section (3) of section 143 of the Companies Act, 2013, the auditor's report shall state –

(i) whether he has sought and obtained all the information and explanations which to the best of his knowledge and belief were necessary for the purpose of his audit and if not, the details thereof and the effect of such information on the financial statements;

(ii) whether, in his opinion, proper books of account as required by law have been kept by the company so far as appears from his examination of those books and proper returns adequate for the purposes of his audit have been received from branches not visited by him;

(iii) whether the report on the accounts of any branch office of the company audited under sub-section (8) by a person other than the company's auditors has been sent to him under the proviso to that sub-section and the manner in which he has dealt with it in preparing his report;

(iv) whether the company's Balance Sheet and Statement of Profit and Loss dealt with in the report are in agreement with the books of account and returns;

(v) whether, in his opinion, the financial statements comply with the accounting standards;

(vi) the observations or comments of the auditors on financial transactions or matters which have any adverse effect on the functioning of the company;

(vii) whether any direct is disqualified from being appointed as a director under sub-section (2) of the section 164;

(viii) any qualification, reservation or adverse remark relating to the maintenance of accounts and other matters connected therewith;

(ix) whether the company has adequate internal financial controls system in place and the operating effectiveness of such controls;

(x) such other matters as may be prescribed.

Further, Rule 11 of the Companies (Audit and Auditors) Rules, 2014 prescribes the other matters to be included in auditor's report. The auditor's report shall also include their views and comments on the following matters, namely-

(i) whether the company has disclosed the impact, if any, of pending litigations on its financial position in its financial statement;

(ii) whether the company has made provision, as required under any law or accounting standards, for material foreseeable losses, if any, on long term contracts including derivative contracts;

(iii) whether there has been any delay in transferring amounts, required to be transferred, to the Investor Education and Protection Fund by the company.

(b) Types of Companies covered under CARO, 2015: The Companies (Auditor's Report) Order, 2015 is an additional reporting requirement Order which has been issued by the Central Government in consultation with the Institute of Chartered Accountants of India under section 143(11) of the Companies Act, 2013. The order applies to every company including a foreign company as defined in clause (42) of section 2 of the Companies Act, 2O13. However, the Order specifically exempts the following class of companies-

(i) a banking company as defined in clause (c) of section 5 of the Banking Regulation Act, 1949;

(ii) an insurance company as defined under the Insurance Act,1938;

(iii) a company licensed to operate under section 8 of the Companies Act;

(iv) a One Person Company as defined under clause (62) of section 2 of the Companies Act;

(v) a small company as defined under clause (85) of section 2 of the Companies Act; and

(vi) a private limited company with a paid up capital and reserves not more than ₹ 50 lakh and which does not have loan outstanding exceeding ₹ 25 lakh from any bank or financial institution and does not have a turnover exceeding ₹ 5 crore at any point of time during the financial year.

18. (a) 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".

"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 right in the nature of intellectual property rights or value additions, by whatever name called.

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.

(b) Allotment of Debentures: Following are the steps to be taken by an auditor while doing the audit of allotment of debentures-

(i) Verify that the Prospectus or the Statement in lieu of Prospectus had been duly filed with the Registrar before the date of allotment.

(ii) Check the applications for debentures with the Application and Allotment Book to verify that the name, address of the applicants and the number of debentures applied for are correctly recorded.

(iii) Verify the allotment of debentures by reference to the Directors' Minute Book.

(iv) Vouch the amounts collected as are entered in the Cash Book with the counterfoils of receipts issued to the applicants; also trace the amounts into the Application and Allotment Book.

(v) Check postings of allotments of debentures and the amounts received in respect thereof from the Application and Allotment Book, into the Debentures Register.

(vi) Verify the entries on the counterfoils of debentures issued with the Debentures Register.

(vii) Extract balances in the Debentures Register in respect of amounts paid by the debenture holders and agree their total with the balance in the Debentures Account in the General Ledger.

(viii) Examine a copy of the Debenture Trust Deed and note the conditions including creation of Debenture Redemption Reserve contained therein as to issue and repayment.

(ix) If the debentures are covered by a mortgage or charge, it should be verified that the charge has been correctly recorded in the Register of Mortgages and Charges and that it has also been registered with the Registrar of Companies. Further, that the charge is clearly disclosed in the Balance Sheet.

(x) Compliance with SEBI Guidelines and section 71 of the Companies Act, 2013, should also be seen.

(xi) Where debentures have been issued as fully paid up to vendors as a part of the purchase consideration, the contract in this regard should be referred to.

19. (a) In respect of leasing transaction entered into by the leasing company, the following procedures may be adopted by the auditor:

(i) The object clause of leasing company to see that the goods like capital goods, consumer durables etc. in respect of which the company can undertake such activities. Further, to ensure that whether company can undertake financing activities or not.

(ii) Whether there exists a procedure to ascertain the credit analysis of lessee like lessee's ability to meet the commitment under lease, past credit record, capital strength, availability of collateral security, etc.

(iii) The lease agreement should be examined and the following points may be noted:

(1) the description of the lessor, the lessee, the equipment and the location where the equipment is to be installed. (The stipulation that the equipment shall not be removed from the described location except for repairs. For the sake of identification, the lessor may also require plates or markings to be attached to the equipment).

(2) the amount of tenure of lease, dates of payment, late charges, deposits or advances etc. should be noted.

(3) whether the equipment shall be returned to the lessor on termination of the agreement and the cost shall be borne by the lessee.

(4) whether the agreement prohibits the lessee from assigning the subletting the equipment and authorises the lessor to do so.

(iv) Examine the lease proposal form submitted by the lessee requesting the lessor to provide him the equipment on lease.

(v) Ensure that the invoice is retained safely as the lease is a long-term contract.

(vi) Examine the acceptance letter obtained from the lessee indicating that the equipment has been received in order and is acceptable to the lessee.

(vii) See the Board resolution authorising a particular director to execute the lease agreement has been passed by the lessee.

(viii) See that the copies of the insurance policies have been obtained by the lessor for his records.

(b) **Audit of a University:** The special steps involved in the audit of a University are the following-

(i) In the case of a university, refer to the Act of Legislature and the Regulations framed thereunder.

(ii) Read through the minutes of the meetings of the Managing Committee or Governing Body, noting resolutions affecting accounts to see that these have been duly complied with, specially the decisions as regards the operation of bank accounts and sanctioning of expenditure.

(iii) Check names entered in the Students' Fee Register for each month or term, with the respective class registers, showing names of students on rolls and test amount of fees charged; and verify that there operates a system of internal check which ensures that demands against the students are properly raised.

(iv) Check fees received by comparing counterfoils of receipts granted with entries in the cash book and tracing the collections in the Fee Register to confirm that the revenue from this source has been duly accounted for.

(v) Total up the various columns of the Fees Register for each month or term to ascertain that fees paid in advance have been carried forward and the arrears that are irrecoverable have been written off under the sanction of an appropriate authority.

(vi) Check admission fees with admission slips signed by the head of the institution and confirm that the amount had been credited to a Capital Fund, unless the Managing Committee has taken a decision to the contrary.

(vii) See that free studentship and concessions have been granted by a person authorised to do so, having regard to the prescribed Rules.

(viii) Confirm that fines for late payment or absence, etc., have either been collected or remitted under proper authority.

(ix) Confirm that hostel dues were recovered before students' accounts were closed and their deposits of caution money refunded.

(x) Verify rental income from landed property with the rent rolls, etc.

(xi) Vouch income from endowments and legacies, as well as interest and dividends from investment; also inspect the securities in respect of investments held.

(xii) Verify any Government or local authority grant with the relevant papers of grant. If any expense has been disallowed for purposes of grant, ascertain the reasons and compliance thereof.

(xiii) Report any old heavy arrears on account of fees, dormitory rents, etc, to the Managing Committee.

(xiv) Confirm that caution money and other deposits paid by students on admission have been shown as liability in the balance sheet and not transferred to revenue.

(xv) See that the investments representing endowment funds for prizes are kept separate and any income in excess of the prizes has been accumulated and invested along with the corpus.

(xvi) Verify that the Provident Fund money of the staff has been invested in appropriate securities.

(xvii) Vouch donations, if any, with the list published with the annual report. If some donations were meant for any specific purpose, see that the money was utilised for the purpose.

(xviii) Vouch all capital expenditure in the usual way and verify the same with the sanction for the Committee as contained in the minute book.

(xix) Vouch in the usual manner all establishment expenses and enquire into any unduly heavy expenditure under any head.

(xx) See that increase in the salaries of the staff have been sanctioned and minuted by the Committee.

(xxi) Ascertain that the system ordering inspection on receipt and issue of provisions, foodstuffs, clothing and other equipment is efficient and all bills are duly authorised and passed before payment.

(xxii) Verify the inventories of furniture, stationery, clothing, provision and all equipment, etc. These should be checked by reference to Inventory Register and values applied to various items should be test checked.

(xxiii) Confirm that the refund of taxes deducted from the income from investment (interest on securities, etc.) has been claimed and recovered since the institutions are generally exempted from the payment of income-tax.

(xxiv) Verify the annual statements of accounts and while doing so see that separate statements of account have been prepared as regards Poor Boys Fund, Games Fund, Hostel and Provident Fund of Staff, etc.

20. **Duties of C&AG:** The Comptroller & Auditor General's (Duties, Powers and Conditions of Service) Act, 1971 lays down duties of the C&AG as under-

(i) **Compile and submit Accounts of Union and States -** The C&AG shall be responsible for compiling the accounts of the Union and of each State from the initial and subsidiary accounts rendered to the audit and accounts offices under his control by treasuries, offices or departments responsible for the keeping of such account.

(ii) **General Provisions Relating to Audit -** It shall be the duty of the C&AG –

(a) to audit and report on all expenditure from the Consolidated Fund of India and of each State and of each Union Territory having a Legislative Assembly and to ascertain whether the moneys shown in the accounts as having been disbursed were legally available for and applicable to the service or purpose to which they have been applied or charged and whether the expenditure conforms to the authority which governs it;

(b) to audit and report all transactions of the Union and of the States relating to Contingency Funds and Public Accounts;

(c) to audit and report on all trading, manufacturing profit and loss accounts and balance-sheets and other subsidiary accounts kept in any department of the Union or of a State.

(iii) **Audit of Receipts and Expenditure -** Where any body or authority is substantially financed by grants or loans from the Consolidated Fund of India or of any State or of any Union Territory having a Legislative Assembly, the Comptroller and Auditor General shall, subject to the provisions of any law for the time being in force applicable to the body or authority, as the case may be, audit all receipts and expenditure of that body or authority and to report on the receipts and expenditure audited by him.

(iv) **Audit of Grants or Loans -** Where any grant or loan is given for any specific purpose from the Consolidated Fund of India or of any State or of any Union Territory having a Legislative Assembly to any authority or body, not being a foreign State or international organisation, the Comptroller and Auditor General shall scrutinise the procedures by which the sanctioning authority satisfies itself as to the fulfillment of the conditions subject to which such grants or loans were given and shall for this purpose have right of access, after giving reasonable previous notice, to the books and accounts of that authority or body.

(v) **Audit of Receipts of Union or States -** It shall be the duty of the Comptroller and Auditor General to audit all receipts which are payable into the Consolidated Fund of India and of each State and of each Union Territory having a Legislative Assembly and to satisfy himself that the rules and procedures in that behalf are designed to secure an effective check on the assessment, collection and proper allocation of revenue and are being duly observed and to make this purpose such examination of the accounts as he thinks fit and report thereon.

(vi) **Audit of Accounts of Stores and Inventory -** The Comptroller and Auditor General shall have authority to audit and report on the accounts of stores and inventory kept in any office or department of the Union or of a State.

(vii) **Audit of Government Companies and Corporations -** The duties and powers of the Comptroller and Auditor General in relation to the audit of the accounts of government companies shall be performed and exercised by him in accordance with the provisions of the Companies Act, 2013. The comptroller and Auditor-General of India shall appoint the auditor under sub-section (5) or sub-section (7) of section 139 (i.e. appointment of First Auditor or Subsequent Auditor) and direct such auditor the manner in which the accounts of the Government company are required to be audited and thereupon the auditor so appointed shall submit a copy of the audit report to the Comptroller and Auditor-General of India which, among other things, include the directions, if any, issued by the Comptroller and Auditor-General of India, the action taken thereon and its impact on the accounts and financial statement of the company.

Applicability of Pronouncements/Legislative Amendments/Circulars etc. for November, 2015 – Intermediate (IPC) Examination

Paper 5: Advanced Accounting

Accounting Standards

AS 4	:	Contingencies and Events occurring after the Balance Sheet Date
AS 5	:	Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies
AS 11	:	The Effects of Changes in Foreign Exchange Rates (Revised 2003)
AS 12	:	Accounting for Government Grants
AS 16	:	Borrowing Costs
AS 19	:	Leases
AS 20	:	Earnings Per Share
AS 26	:	Intangible Assets
AS 29	:	Provisions, Contingent Liabilities and Contingent Assets.

Note Regarding Applicability for Paper 1 and Paper 5:

The relevant notified Sections of the Companies Act, 2013 up to 31st March, 2015 and for other legislative amendments including relevant Notifications / Circulars / Rules / Guidelines issued by Regulating Authority up to 30th April, 2015 will be applicable for November, 2015 Examination

Non-Applicability of Ind ASs for November, 2015 Examination:

The Ministry of Corporate Affairs has notified Roadmap for applicability of Indian Accounting Standards (Ind AS) vide Notification No. G.S.R…….(E) dated 16 February, 2015, for compliance by the class of companies specified in the said roadmap. The notification has been uploaded on www.mca.gov.in along with the thirty nine (39) Indian Accounting Standards (Ind AS). **Students may note that these Ind ASs are not applicable for November, 2015 Examination.**

PAPER – 7: INFORMATION TECHNOLOGY AND STRATEGIC MANAGEMENT

SECTION – A: INFORMATION TECHNOLOGY

QUESTIONS

1. Define the following terms briefly:
   - (i) Mobile Software
   - (ii) Entity Relationship Diagram
   - (iii) Input Devices
   - (iv) Network Access Control
   - (v) Router
   - (vi) Resilience
   - (vii) Information
   - (viii) Strategic-Level Systems
   - (ix) Personal Identification Number
   - (x) Validity in Controls
2. Differentiate between the following:
   - (i) Centralized Computing and Decentralized Computing
   - (ii) Half Duplex Mode and Full Duplex Mode
   - (iii) Circuit Switching and Packet Switching
   - (iv) Concurrent Audit and General Audit
   - (v) Quality Assurance Management Controls and Security Management Controls
   - (vi) Presentation Layer and Session Layer of OSI Model
   - (vii) Infrastructure as a Service (IaaS) and Software as a Service (SaaS)
   - (viii) Batch Processing and Online Processing
   - (ix) Random Access Memory (RAM) and Read Only Memory (ROM)
   - (x) Plaintext and Ciphertext
3. Write short note on the following:
   - (i) Business Process Reengineering (BPR)
   - (ii) One-to-Many Relationship in E-R Diagram
   - (iii) System Designing Phase in SDLC
   - (iv) Electronic Funds Transfer (EFT)
   - (v) Repeater
   - (vi) Leased Application

(vii) Quality Assurance Management under Managerial Controls

(viii) Smart Cards

(ix) Inference Engine in Expert Systems

(x) Operating System

Data Processing Cycle

4. Discuss the steps involved in Data Processing Cycle.

Network Virtualization

5. In reference to Network Virtualization, describe major applications of the concepts of the virtualization.

Network Topology

6. Discuss Ring and Mesh network. List also their advantages and disadvantages in detail.

Transaction Processing System (TPS)

7. Discuss pre-requisites of ACID Test for any Transaction Processing System.

Business Process Management Systems (BPMS)

8. XYZ Limited is planning to implement Business Process Management System (BPMS). The Management asked you to briefly explain some benefits of BPMS to help them to take a decision on BPMS.

Auditing in IT Environment

9. Discuss Audit Objectives in a computerized environment.

Flowcharts

10. Discuss advantages and limitations of using Flowchart.

Cloud Computing

11. Discuss Cloud Computing architecture.

Network Protocols

12. Discuss Network Protocols in detail.

Network Security Techniques

13. Discuss different tools/techniques to protect information and systems against compromise, intrusion, or misuse.

Business Intelligence Tools

14. Discuss various Business Intelligence Tools.

Supply Chain Management (SCM)

15. Discuss the components of Supply Chain Management.

SUGGESTED ANSWERS / HINTS

1. (i) **Mobile Software:** Mobile Software is the actual program that runs on the mobile hardware. It deals with the characteristics and requirements of mobile applications and is the engine of that mobile device. In other terms, it is the operating system of that appliance. It is the essential component that makes the mobile device operates.

(ii) **Entity Relationship Diagram:** An Entity-Relationship (ER) diagram is a data modeling technique that creates a graphical representation of the entities, and the relationships between entities, within an information system. ER diagrams repeatedly bring into play symbols to symbolize dissimilar types of information.

(iii) **Input Devices:** Input devices are devices through which we interact with the systems and include devices like Keyboard, Mouse and other pointing devices, Scanners & Bar Code, MICR readers, Webcams, Microphone and Stylus/Touch Screen. Keyboard helps us with text based input, Mouse helps us in position based input, Scanners & Webcams help in image based input and Microphone helps us in voice based input.

(iv) **Network Access Control:** Network Access Control (NAC) products enforce security policy by granting only security policy–compliant devices access to network assets. They handle access authentication and authorization functions and can even control the data that specific users' access, based on their ability to recognize users, their devices and their network roles.

(v) **Router:** Router is a communications processor that interconnects networks based on different rules or *protocols*, so that a telecommunications message can be routed to its destination.

(vi) **Resilience:** It refers to the ability of a network to recover from any kind of error like connection failure, loss of data etc.

(vii) **Information:** It is necessary for businesses to put in place procedures to ensure data which is a raw fact have been processed so that they are meaningful, known as Information. Some examples of information include aggregating which summarizes data by such means as taking an average value of a group of numbers. Sorting organizes data so that items are placed in a particular order, for example listing orders by delivery date etc.

(viii) **Strategic-Level Systems:** These are the systems for strategic managers to track and deal with strategic issues, assisting in long-range planning. A principle area is tracking changes in the external conditions (market sector, employment levels, share prices, *etc*.) and matching these with the internal conditions of the organization.

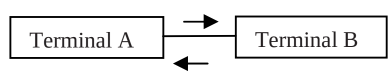
(ix) **Personal Identification Number:** The Personal Identification Number is similar to a password assigned to a user by an institution based on the user characteristics and encrypted using a cryptographic algorithm. The application generates a random number stored in its database independent of user identification details or a customer selected number.

(x) **Validity in Controls:** This ensures that all recorded transactions fairly represent the economic events that actually occurred, are lawful in nature, and have been executed in accordance with management's general authorization.

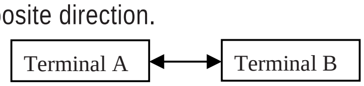
2. (i) **Centralized Computing:** Centralized computing is computing done at a central location, using terminals that are attached to a central computer. The computer itself may control all the peripherals directly (if they are physically connected to the central computer), or they may be attached via a terminal server. It offers greater security over decentralized systems because all of the processing is controlled in a central location. In addition, if one terminal breaks down, the user can simply go to another terminal and log in again, and all of their files will still be accessible. Depending on the system, they may even be able to resume their session from the point they were at before, as if nothing had happened.

Decentralized Computing: Decentralized computing is the allocation of resources, both hardware and software, to each individual workstation, or office location. In contrast, centralized computing exists when the majority of functions are carried out, or obtained from a remote centralized location. A collection of decentralized computers systems are components of a larger computer network, held together by local stations of equal importance and capability. These systems are capable of running independently of each other. Decentralized systems enable file sharing and all computers can share peripherals such as printers and scanners as well as modems, allowing all the computers in the network to connect to the internet.

(ii) **Half-Duplex Mode:** In Half-Duplex mode**,** (sometimes called an alternating connection or semi-duplex) the data flows in one direction or the other, but not both at the same time. This type of connection makes it possible to have bidirectional communications using the full capacity of the line. For example: Walkie Talkie. In this, the entire capacity of a channel is taken over by whichever of the two devices is transmitting at the time.



Full-Duplex Mode: In Full-Duplex mode, the data flow in both directions simultaneously. Each end of the line can thus transmit and receive at the same time, which means that the bandwidth is divided in two for each direction of data transmission if the same transmission medium is used for both directions of transmission. For example: Mobile Phones. In this, signals going in either direction share the capacity of the link wither by containing two separate physical links (one for sending and the other for receiving) or by dividing the capacity of the channel between signals travelling in opposite direction.



(iii) **Circuit Switching:** A **Circuit Switching** network is one that establishes a fixed bandwidth circuit (or channel) between nodes and terminals before the users may communicate, as if the nodes were physically connected with an electrical circuit. The route is dedicated and exclusive, and released only when the communication session terminates. Circuit switching is what most of us encounter on our home phones. A single circuit is used for the entire duration of the call. Applications which use circuit switching go through three phases: **Establish a Circuit, Transfer of data** and **Disconnect the Circuit**.

Packet Switching: It is a sophisticated means of maximizing transmission capacity of networks. **Packet switching** refers to protocols in which messages are broken up into small transmission units called packets, before they are sent. Each packet is transmitted individually across the net. The packets may even follow different routes to the destination. Since there is no fixed path, different packets can follow different path and thus they may reach to destination out of order.

(iv) **Concurrent Audit:** In this, Auditors are members of the system development team. They assist the team in improving the quality of systems development for the specific system they are building and implementing.

General Audit: In this, Auditors evaluate systems development controls overall. They seek to determine whether they can reduce the extent of substantive testing needed to form an audit opinion about management's assertions relating to the financial statements in systems effectiveness and efficiency.

(v) **Quality Assurance Management Controls:** Organizations are increasingly producing safety-critical systems and users are becoming more demanding in terms of the quality of the software they employ to undertake their work. Organizations are undertaking more ambitious information systems projects that require more stringent quality requirements and are becoming more concerned about their liabilities if they produce and sell defective software.

Security Management Controls: Information security administrators are responsible for ensuring that information systems assets are secure. Assets are secure when the expected losses that will occur over some time are at an acceptable level.

(vi) **Presentation Layer or Layer 6 of OSI Model:** This layer at times referred as **Syntax Layer** also, is usually a part of an operating system, that converts incoming and outgoing data from one presentation format to another (for example, from a text stream into a popup window with the newly arrived text). The presentation service data units are then encapsulated into Session Protocol Data Units, and moved down the stack. It further controls on screen display of data, transforms data to a standard application interface. Encryption, data compression can also be undertaken at this layer level.

Session Layer or Layer 5 of OSI Model: This layer sets up, coordinates, and terminates conversations, exchanges, and dialogs between the applications at each end. It deals with session and connection coordination. It provides for full-duplex, half-duplex, or simplex operation, and establishes check pointing, adjournment, termination, and restart procedures. The OSI model made this layer responsible for "graceful close" of sessions also.

(vii) Infrastructure as a Service (IaaS): Infrastructure as a Service (IaaS) delivers computer infrastructure on an outsourced basis to support enterprise operations. Typically, IaaS provides hardware, storage, servers and data centre space or network components; it may also include software.

Software as a Service (SaaS): Software as a Service (SaaS) features a complete application offered as a service on-demand. A service provider hosts the application at its data centre over the Internet and customer accesses it via a standard Web browser. For example - Google Apps.

(viii) Batch Processing: It is defined as a processing of large set of data in a specific way, automatically, without needing any user intervention. The data is first collected, during a work day, for example, and then batch-processed, so all the collected data is processed in one go. This could happen at the end of the work day, for example, when computing capacities are not needed for other tasks. It is possible to perform repetitive tasks on a large number of pieces of data rapidly without needing the user to monitor it. Batched jobs can take a long time to process. Batch processing is used in producing bills, stock control, producing monthly credit card statements, etc.

Online Processing: Data is processed immediately while it is entered, the user usually only has to wait a short time for a response. (Example: games, word processing, booking systems). Interactive or online processing requires a user to supply an input. Interactive or online processing enables the user to input data and get the results of the processing of that data immediately.

(ix) The differences between Random Access Memory (RAM) and Read Only Memory (ROM) are given below:

Random Access Memory (RAM)	Read Only Memory (ROM)
RAM is a volatile memory and when the computer is turned off, RAM loses its data. When the computer is turned on again, operating system and other files are once again loaded into RAM usually from the hard disk.	Unlike RAM, ROM is non-volatile. The contents of ROM remain even after the computer is switched off.
This is Read Write memory wherein information can be read as well as modified.	Originally, the ROM used to be read-only; however, the new

	versions of ROM allow limited rewriting making it possible to upgrade firmware such as the BIOS by using installation software.

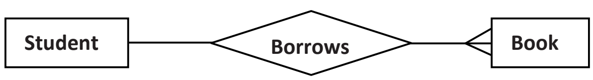
(x) **Plaintext -** It is the message that is to be encrypted. It is transformed by a function that is parameterized by a key.

CipherText - It is the output of the encryption process that is transmitted often by a messenger or radio.

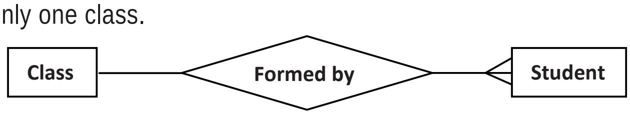
3. (i) **Business Process Reengineering (BPR): Business Process Reengineering (BPR)** is based on the understanding that the products and services a company offers to the market are provided through business processes, and a radical redesign of these processes is the road to success. BPR is defined as the "fundamental rethinking and radical redesign of processes to achieve dramatic improvement, in critical, contemporary measures of performance such as cost, quality, service and speed". BPR is the main method by which organizations become more efficient and modern. It transforms an organization in ways that directly affect its performance.

(ii) **One-to-Many Relationship (1:N) in E-R Diagram –** A One-to-Many relationship is shown on the diagram by a line connecting the two entities with a "crow's foot" symbol denoting the 'many' end of the relationship.

Example: A student may borrow some books from the library. A book in the library may be borrowed by at most a student.



A class is formed by a group of atleast one student. Each student is allocated to one and only one class.



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

(iv) **Electronic Funds Transfer (EFT):** Electronic Funds Transfer (EFT) represents the way the business can receive direct deposit of all payments from the financial institution to the company bank account. Once the user "Signs Up", money comes to him directly and sooner than ever before. Some examples of EFT systems in operation are Automated Teller Machines (ATMs), Point-of-Sale (PoS) Transactions, Preauthorized and Telephone Transfers.

(v) **Repeater:** Repeater is a communication processor that boosts or amplifies the signal before passing it to the next section of cable in a network.

(vi) **Leased Application:** It is a new method for getting applications that are being used today, i.e. leased applications, where user pays fixed rent for using the application for agreed terms. Many specialized vendors provide users with option to get their job done by paying monthly rent; this is referred to as outsourcing.

(vii) **Quality Assurance Management under Managerial Controls:** It is responsible for ensuring information systems development; implementation, operation, and maintenance conform to established quality standards.

(viii) **Smart Cards:** Smart cards are any pocket sized card with embedded integrated circuits. Smart cards can provide identification authentications, data storage and application processing. Smart cards may serve as a credit or ATM cards, Fuel cards, mobile phone SIMs, access-control cards, public transport or public phone payment cards etc. on the card. Contact cards, Contactless cards and Combi/Hybrid Cards are the three types of Smart Cards.

(ix) **Inference Engine in Expert Systems:** This program contains the logic and reasoning mechanisms that simulate the expert logic process and deliver advice. It uses data obtained from both the knowledge base and the user to make associations and inferences, form its conclusions, and recommend a course of action.

(x) **Operating System:** An Operating System (OS) is a set of computer programs that manages computer hardware resources and acts as an interface with computer applications programs. The operating system is a vital component of the system software in a computer system. Application programs usually require an operating system to function that provides a convenient environment to users for executing their programs. Computer hardware with operating system can thus be viewed as an extended machine which is more powerful and easy to use. Some prominent Operating systems used nowadays are Windows 7, Windows 8, Linux, UNIX, etc.

4. The Data Processing Cycle consists of following basic steps with alerts, controls and feedback at each step:

- **Data input** - Involves the activities like capturing the data, implementing control procedures, recording in journals, posting to ledgers and preparation of reports.
- **Data storage** - Involves organizing the data in master file or reference file of an automated system for easy and efficient access.

- **Data processing** - Involves addition, deletion and updating of the data in the transaction file, master file or reference file.
- **Information output** - Involves generation of documents and managerial reports in printable or electronic form for addressing queries, to control operational activities and help the management in decision making.

5. Major applications of the concepts of the Virtualization are given as follows:

- ♦ **Server Consolidation:** Virtual machines are used to consolidate many physical servers into fewer servers, which in turn host virtual machines. Each physical server is reflected as a virtual machine "guest" residing on a virtual machine host system. This is also known as “Physical-to-Virtual” or 'P2V' transformation.
- ♦ **Disaster Recovery:** Virtual machines can be used as "hot standby" environments for physical production servers. This changes the classical "backup-and-restore" philosophy, by providing backup images that can "boot" into live virtual machines, capable of taking over workload for a production server experiencing an outage.
- ♦ **Testing and Training:** Hardware virtualization can give root access to a virtual machine. This can be very useful such as in kernel development and operating system courses.
- ♦ **Portable Applications:** Portable applications are needed when running an application from a removable drive, without installing it on the system's main disk drive. Virtualization can be used to encapsulate the application with a redirection layer that stores temporary files, windows registry entries and other state information in the application's installation directory and not within the system's permanent file system.
- ♦ **Portable Workspaces:** Recent technologies have used virtualization to create portable workspaces on devices like iPods and USB memory sticks.

6. **Ring Network:** A Ring Network is much like a bus network, except the length of wire, cable, or optical fibre connects to form a loop. The characteristics of a ring network are:

- Local computer processors are tied together sequentially in a ring with each device being connected to two other devices.
- A ring network has a decentralized approach.
- When one computer needs data from another computer, the data is passed along the ring.
- Considered more reliable and less costly than star networks because if one computer fails, the other computers in the ring can continue to process their own work and communicate with each other.

Advantages of Ring Network include the following:

- Ring networks do not require a central computer to control activity nor does it need a file server.
- Each computer connected to the network can communicate directly with the other computers in the network by using the common communication channel, and each computer does its own independent applications processing.
- The ring network is not as susceptible to breakdowns as the star network, because when one computer in the ring fails, it does not necessarily affect the processing or communications capabilities of the other computers in the ring.
- Ring networks offer high performance for a small number of workstations or for larger networks where each station has a similar workload.
- Ring networks can span longer distances than other types of networks.
- Ring networks are easily extendable.

Disadvantages of Ring Network are as follows:

- Relatively expensive and difficult to install.
- Failure of one computer on the network can affect the whole network.
- It is difficult to troubleshoot a ring network.
- Adding or removing computers can disrupt the network.

Mesh Network: In this structure, there is random connection of nodes using communication links. A mesh network may be fully connected or connected with only partial links. In fully interconnected topology, each node is connected by a dedicated point to point link to every node. The reliability is very high as there are always alternate paths available if direct link between two nodes is down or dysfunctional. Fully connected networks are not very common because of the high cost. Only military installations, which need high degree of redundancy, may have such networks, that too with a small number of nodes.

Advantages of Mesh Network are as under:

- Yields the greatest amount of redundancy in the event that if one of the nodes fails, the network traffic can be redirected to another node.
- Network problems are easier to diagnose.

Disadvantage of Mesh Network is its high cost of installation and maintenance (more cable is required than any other configuration).

7. In order to qualify as a Transaction Processing System (TPS), transactions made by the system must pass the ACID Test. The ACID Test refers to the following four prerequisites as discussed below:

- **Atomicity:** This means that a transaction is either completed in full or not at all. TPS systems ensure that transactions take place in their entirety. For example, if funds are transferred from one account to another, this only counts as a bona-fide transaction if both the withdrawal and deposit take place. If one account is debited and the other is not credited, it does not qualify as a transaction.
- **Consistency:** TPS systems exist within a set of operating rules (or integrity constraints). If an integrity constraint states that all transactions in a database must have a positive value, any transaction with a negative value would be refused.
- **Isolation:** Transactions must appear to take place in seclusion. For example, when a fund transfer is made between two accounts the debiting of one and the crediting of another must appear to take place simultaneously. The funds cannot be credited to an account before they are debited from another.
- **Durability:** Once transactions are completed they cannot be undone. To ensure that this is the case even if the TPS suffers failure, a log will be created to document all completed transactions.

These four conditions ensure that TPS systems carry out their transactions in a methodical, standardized and reliable manner. So Transactions must be ongoing.

8. Some benefits of Business Process Management Systems (BPMS) are as follows:

(a) **Automating repetitive business processes:** Processes such as report creation and distribution or the monitoring of or reporting on company's Key Performance Indicators (KPI) reduces the manual operational costs and helps employees to concentrate on activities that are important to the success of business.

(b) **BPMS works by 'loosely coupling' with a company's existing applications:** This enables it to monitor, extract, format and distribute information to systems and people; in line with business events or rules.

(c) **Operational Savings:** BPM focuses on optimization of processes. The processes that are repetitive are optimized and lead to reduced expenses which translate to immediate cost savings. By automating a task, ROI of BPM that requires six hours of manual intervention, one can expect to cut that time to half. Thus, three hours multiplied by the number of times the process is completed in a cycle will yield significant cost saving.

(d) **Reduction in the administration involved in Compliance and ISO Activities:** Be it a quality assurance initiative such as the ISO standards, a financial audit law, or an IT systems best-practice implementation, companies worldwide are seeing the need to manage compliance as part of their everyday business activities. The BPM is ideally suited to help support companies in their quest for process improvement and compliance/governance certification. It gives full control over process and document change, clarity of inherent risks, and ease with which process knowledge is communicated across the company.

(e) **Freeing-up of employee time:** While the euphuism "time is money" is often over-used, it is very relevant to this topic, because in business, for each additional hour it takes to complete a manual business process, there is a hard cost associated with employee time as well as soft costs associated with losing business or lowered productivity. Another area where time comes into play is in opportunity costs.

9. The general objectives of auditing in a computerized environment are as follows:

- **Existence:** Verify that the assets, liabilities, ownership, and/or activities are real;
- **Authorization:** Verify that events have occurred in accordance with management`s intent;
- **Valuation:** Verify that the accounting values fairly present items worth;
- **Cutoff:** Verify that the transaction is re-coded in the proper accounting period;
- **Compliance:** Verify that the processing is in compliance with governmental laws and regulations, generally accepted accounting procedures, and the organization`s policies and procedures;
- **Operational:** Verify that the program, area, or activity is performed economically, efficient, and effectively;
- Assisting management in finding ways to implementing internal control recommendations;
- Participating in specifying and designing computer control and other features for systems to be installed;
- Determining whether efficient use is made of the organization's Computer resources; and
- Determining whether Computer system used accomplishes the business objectives and goals.

10. Advantages of using Flowchart are as follows:

(i) **Quicker grasp of relationships** – Before any application can be solved, it must be understood, the relationship between various elements of the application must be identified. The programmer can chart a lengthy procedure more easily with the help of a flowchart than by describing it by means of written notes.

(ii) **Effective Analysis** – The flowchart becomes a blue print of a system that can be broken down into detailed parts for study. Problems may be identified and new approaches may be suggested by flowcharts.

(iii) **Communication** – Flowcharts aid in communicating the facts of a business problem to those whose skills are needed for arriving at the solution.

(iv) **Documentation** – Flowcharts serve as a good documentation which aid greatly in future program conversions. In the event of staff changes, they serve as training function by helping new employees in understanding the existing programs.

(v) **Efficient coding** – Flowcharts act as a guide during the system analysis and program preparation phase. Instructions coded in a programming language may be checked against the flowchart to ensure that no steps are omitted.

(vi) **Orderly check out of problem** – Flowcharts serve as an important tool during program debugging. They help in detecting, locating and removing mistakes.

(vii) **Efficient program maintenance** – The maintenance of operating programs is facilitated by flowcharts. The charts help the programmer to concentrate attention on that part of the information flow which is to be modified.

Limitations of using Flowchart are as follows:

(i) **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.

(ii) **Modification** – If modifications to a flowchart are required, it may require complete re-drawing.

(iii) **Reproduction** – Reproduction of flowcharts is often a problem because the symbols used in flowcharts cannot be typed.

(iv) **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.

(v) **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.

11. **Cloud Computing Architecture: Cloud Computing Architecture** refers to the components and subcomponents that typically consist of a front end platform (fat client, thin client, mobile device), back end platforms (servers, storage), a cloud based delivery, and a network (Internet, Intranet, Intercloud). Combined, these components make up cloud computing architecture. Cloud architecture typically involves multiple cloud components communicating with each other over a tight or loose coupling of cloud resources, services, middleware, and software components.

A cloud computing architecture consists of two parts - **Front End** and a **Back End** that connect to each other through a network, usually the Internet. The front end is the side the computer user, or client, sees. The back end is the “cloud” section of the system.

- **Front End:** The **Front End** of the cloud computing system comprises of the client’s devices (or it may be a computer network) and some applications are needed for accessing the cloud computing system. All the cloud computing systems do not give the same interface to users. For example-Web services like electronic mail programs use some existing web browsers such as Firefox, Microsoft's internet explorer or Apple's Safari. Other types of systems have some unique applications which provide network access to its clients.

- **Back End:** Back End refers to some physical peripherals. In cloud computing, the back end is cloud itself which may encompass various computer machines, data storage systems and servers. Groups of these clouds make a whole cloud computing system. Theoretically, a cloud computing system can include practically any type of web application program such as video games to applications for data processing, software development and entertainment residing on its individual dedicated server for services. There are some set of rules, generally called as **Protocols** which are followed by this server and it uses a special type of software known termed as **Middleware** that allow computers that are connected on networks to communicate with each other. If any cloud computing service provider has many customers, then there's likely to be very high demand for huge storage space. Many companies that are service providers need hundreds of storage devices.

12. Network Protocols: Protocols are software that performs a variety of actions necessary for data transmission between computers. Stated more precisely, protocols are a set of rules for inter-computer communication that have been agreed upon and implemented by many vendors, users and standards bodies to ensure that the information being exchanged between the two parties is received and interpreted correctly. Ideally, a protocol standard allows heterogeneous computers to talk to each other.

At the most basic level, protocols define the physical aspects of communication, such as how the system components will be interfaced and at what voltage levels will be transmitted.

At higher levels, protocols define the way that data will be transferred, such as the establishment and termination of "sessions" between computers and the synchronization of those transmissions. At still higher levels, protocols can standardize the way data itself is encoded and compressed for transmission.

A protocol defines the following three aspects of digital communication.

(a) **Syntax:** The format of data being exchanged, character set used, type of error correction used, type of encoding scheme (e.g., signal levels) being used.

(b) **Semantics:** Type and order of messages used to ensure reliable and error free information transfer.

(c) **Timing:** Defines data rate selection and correct timing for various events during data transfer.

At the sending computer, protocols –

(i) Break data down into packets;

(ii) Add destination address to the packet; and

(iii) Prepares data for transmission through Network Interface Card (NIC)

At the receiving computer, protocols –

(i) Take data packets off the cable;

(ii) Bring packets into computer through Network Interface Card (NIC;

(iii) Strip the packets off any transmitting information;

(iv) Copy data from packet to a buffer for reassembly; and

(v) Pass the reassembled data to the application.

13. Different tools/technologies are now available to protect information and systems against compromise, intrusion, or misuse. Some of them are as follows:

(i) Intrusion Detection System (IDS): An Intrusion Detection System is a device or software application that monitors network or system activities for malicious activities or policy violations and produces reports to a Management Station. The goal of intrusion detection is to monitor network assets to detect anomalous behaviour and misuse. Network Intrusion Detection System (NID) and Host-based Intrusion Detection (HID) Systems are two primary Intrusion Detection Systems.

(ii) Firewall: Firewall is a device that forms a barrier between a secure and an open environment when the latter environment is usually considered hostile, for example, the Internet. It acts as a system or combination of systems that enforces a boundary between more than one networks. Access controls are common form of controls encountered in the boundary subsystem by restricting the use of system resources to authorized users, limiting the actions authorized users can take with these resources and ensuring that the users obtain only authentic system resources.

(iii) Network Access Control: Network Access Control (NAC) products enforce security policy by granting only security policy–compliant devices access to network assets. They handle access authentication and authorization functions and can even control the data that specific users' access, based on their ability to recognize users, their devices and their network roles.

(iv) Anti – Malware: Anti-malware network tools help administrators identify block and remove malware. They enable the IT department to tailor its anti-malware policies to identify known and unknown malware sources. Malware is always on the lookout for network vulnerabilities - in security defences, operating systems, browsers, applications and popular targets such as Adobe Flash, Acrobat and Reader - that they can exploit to fully access a victim's network. Best practices call for a multipronged defence that might also include IP blacklisting, data loss prevention

(DLP) tools, anti-virus and anti-spyware software, web browsing policies, egress filtering, and outbound-traffic proxies.

(v) Site Blocking: It is a software-based approach that prohibits access to certain Web sites that are deemed inappropriate by management. For example, sites that contain explicit objectionable material can be blocked to prevent employee's from accessing these sites from company Internet servers. In addition to blocking sites, companies can also log activities and determine the amount of time spent on the Internet and identify the sites visited.

14. Business Intelligence tools are a type of software that is designed to retrieve, analyze and report data. BI is basically just getting important business information to decision makers when they need it – in a way that they can actually use it. Business Intelligence tools are standalone tools or suites of tools that are targeted to a specific industry that implement a particular BI technique.

Business Intelligence tools are software programs and features that are used to complete detailed data analysis. There are different types of business intelligence tools which a business may need in order to achieve business objectives. Some of the key Business Intelligence tools are given as follows:

- **Simple Reporting and Querying:** This involves using the data warehouse to get response to the query: "Tell me what happened." The objective of a BI implementation is to turn operational data into meaningful knowledge. This requires that BI must be connected with the enterprise data and all the necessary data is available in one place, in one common format. Data warehousing (DW) provides the perfect architecture to combine all the data dispersed throughout the enterprise in different applications in a variety of formats, on a range of hardware, which could be anywhere to be cleaned up, summarized, converted and integrated into one common format and available centrally for further processing. There are reporting tools used to arrange information into a readable format and distribute it to the people who need it.
- **Business Analysis:** This involves using the data to get response to the query: "Tell me what happened and why." Business analysis refers to presenting visualizing data in a multidimensional manner. Query and report data is presented in row after row of two dimensional data. Typically, the first dimension is the headings for the data columns and the second dimension is the actual data listed below those column headings. Business analysis allows the user to plot data in row and column coordinates to further understand the intersecting points. ETL (Extract, Transform, Load) tools bring in data from outside sources, transform it to meet business specified operational needs, and then load the results into the company database. Metadata tools gather and analyze metadata, helping to increase data quality.

- **Dashboards**: This involves using the information gathered from the data warehouse and making it available to users as snapshots of many different things with the objective of getting response to the query: "Tell me a lot of things, but without too much effort". Dashboards are flexible tools that can be bent into as many different shapes as per user requirements. It includes a collection of graphs, reports, and KPIs that can help monitor such business activities as progress on a specific initiative.
- **Scorecards:** This involves providing a visual representation of the enterprise strategy by taking critical metrics and mapping them to strategic goals throughout the enterprise. Scorecards offer a rich, visual gauge to display the performance of specific initiatives, business units, or the enterprise as a whole and the individual goals in the context of larger enterprise strategy. Scorecards distil information into a small number of metrics and targets and provide users with an at a glance perspective of information. A scorecard has a graphical list of specific, attainable strategic milestones, combined with metrics that serve as benchmarks. Specific measures on how well the company has actually performed specified activities are linked in the scorecard with graphical display highlighting the status of each goal.
- **Data Mining or Statistical Analysis:** This involves using statistical, artificial intelligence, and related techniques to mine through large volumes of data and providing knowledge without users even having to ask specific questions. The objective is to provide interesting and useful information to users by design even without their querying. Data Mining involves data analysis for discovering useful patterns that are "hidden" in large volume of diverse data. For Example: Market segmentation - identify common characteristics of customers who buy same products. OLAP (Online Analytical Processing) is a multi-dimensional analytical tool typically used in data mining, that gathers and process vast amounts of information into useful packets.

15. The main elements of a Supply Chain Management (SCM) are as follows:

(i) **Procurement/Purchasing** - begins with the purchasing of parts, components, or services. Procurement must ensure that the right items are delivered in the exact quantities at the correct location on the specified time schedule at minimal cost. This means that procurement must concern itself with the determination of who should supply the parts, the components, or the services. It must address the question of assurance that these suppliers will deliver as promised. The key issue in procurement is how one goes about selecting and maintaining a supplier, which can be approached from two directions. The first concentrates on how a firm might evaluate a potential supplier whereas the second is how a firm evaluates those businesses that are already suppliers to an operation.

(ii) **Operations** - The second major element of supply chain management system is operations. Having received raw materials, parts, components, assemblies, or services from suppliers, the firm must transform them and produce the products or the services that meet the needs of its consumers. It must conduct this transformation in an efficient and effective manner for the benefit of the supply chain management system.

(iii) **Distribution** - The third element of the supply chain management system is distribution. Distribution involves several activities—transportation (logistics), warehousing, and customer relationship management (CRM). The first and most obvious is logistics—the transportation of goods across the entire supply chain.

(iv) **Integration** - The last element of supply chain management is the need for integration. It is critical that all participants in the service chain recognize the entirety of the service chain. The impact of the failure to adopt a system-wide perspective—that is, examining the totality of the chain can significantly increase costs and destroy value.

SECTION – B: STRATEGIC MANAGEMENT

Correct/Incorrect with reasoning

1. State with reasons which of the following statements are correct/incorrect:
   - (a) Portfolio analysis involves comparison of various functional areas of business.
   - (b) Strategic management is a bundle of tricks and magic.
   - (c) A strategic group consists of rival firms with similar competitive approaches and positions in the market.
   - (d) SWOT analysis presents a comparative account.
   - (e) Focus strategies are most effective with consumers having similar preferences.
   - (f) TQM is a people-focused management system that aims employees' satisfaction.
   - (g) IT can bring efficiency and effectiveness in the functioning of businesses.
   - (h) A corporate culture is always identical in organizations located in same geographical area.
   - (i) Demarketing is used to eliminate the competitors' market share.
   - (j) Balance scorecard is a combination of Human resource and marketing functions.

Differences between the two concepts

2. Distinguish between the following:
   - (a) Economic environment and Socio-cultural environment.
   - (b) Synchro Marketing and Demarketing.
   - (c) Divestment strategy and Liquidation strategy.
   - (d) Logistic Management and Supply Chain Management.

Short notes

3. Write short notes on the following:
   - (a) Implementation steps in BPR.
   - (b) Reasons necessary for globalization of companies.
   - (c) Objectives of SWOT analysis.
   - (d) Retrenchment Strategy.

Brief answers

4. Briefly answer the following questions:
   - (a) Briefly explain Experience Curve.

(b) Define Competitive Advantage.

(c) Explain Strategic Vision.

(d) Define Network structure.

Descriptive Answers

Chapter 1-Business Environment

5. "A business enterprise is a sub-system of the larger environmental system." Discuss the relationship between the organization and its business environment.

6. Explain briefly different strategic approaches for Globalization by a company.

Chapter 2-Business Policy and Strategic Management

7. Distinguish between the Three Levels of Strategy Formulation.

8. What is Strategic Decision Making? Briefly explain the major dimensions of strategic decisions.

Chapter 3-Strategic Analysis

9. ABC Ltd., the pharmaceutical company wants to grow its business. Draw Ansoff's Product Market Growth Matrix to advise them of the available options.

10. How would you argue that strategic analysis is the starting point for strategic thinking?

Chapter 4-Strategic Planning

11. What do you understand by 'Strategy'? Explain the four generic strategies as discussed by Glueck and Jauch.

12. Many organizations in order to achieve quick growth use strategies such as mergers and acquisitions. Explain. Discuss various types of mergers.

Chapter 5-Formulation of Functional Strategy

13. What are the issues that need to be addressed to formulate an effective logistics strategy in a business firm?

14. How Research and Development (R&D) personnel can play an integral part in strategy implementation?

Chapter 6-Strategic Implementation and Control

15. "Successful strategy formulation does not guarantee successful strategy implementation." Discuss.

16. How is 'Strategic Business Unit' beneficial for improving the competitive advantage of a firm?

Chapter 7-Reaching Strategic Edge

17 Explain the role of strategic management in Medical Organizations.

18. How would you explain the managerial significance of Six Sigma in today's business world?

SUGGESTED ANSWERS

1. (a) **Incorrect:** Portfolio analysis can be defined as a set of techniques that help strategists in taking strategic decisions with regard to individual products or businesses in a firm's portfolio. It is primarily used for competitive analysis and corporate strategic planning in a multiproduct and multi-business firm.

   (b) **Incorrect:** No, Strategic management is not a bundle of tricks and magic. It is much more serious affair. It involves systematic and analytical thinking and action. Although, the success or failure of a strategy is dependent on several extraneous factors, it can not be stated that a strategy is a trick or magic. Formation of strategy requires careful planning and requires strong conceptual, analytical, and visionary skills.

   (c) **Correct:** A strategic group consists of those rival firms that have similar competitive approaches and positions in the market. Organisations in the same strategic group can resemble one another in any of the several ways: they may have comparable product-line breadth, sell in the same price/quality range, emphasize the same distribution channels, use essentially the same product attributes to appeal to similar types of buyers, depend on identical technological approaches, or offer buyers similar services and technical assistance.

   (d) **Correct:** SWOT analysis presents the information about both external and internal environment in a structured form where it is possible to compare external opportunities and threats with internal strengths and weaknesses. This helps in matching external and internal environments so that a strategist can come out with suitable strategy by developing certain patterns of relationship. The patterns are combinations say, high opportunities and high strengths, high opportunities and low strengths, high threats and high strengths, high threats and low strengths.

   (e) **Incorrect:** Focus strategies are most effective when consumers have distinctive preferences or requirements and when rival firms are not attempting to specialize in the same target segment. An organization using a focus strategy may concentrate on a particular group of customers, geographic markets, or on particular product-line segments in order to serve a well-defined but narrow market better than competitors who serve a broader market.

   (f) **Incorrect:** TQM or Total Quality Management is a people-focused management system that aims at continual increase in customer satisfaction at continually lower real cost. There is a sustained management commitment to quality and everyone in the organisation and the supply chain is responsible for preventing rather than detecting defects.

(g) **Correct:** Information technology is playing a significant role in changing the business processes. A reengineered business process, characterized by IT-assisted speed, accuracy, adaptability and integration of data and service points, is focused on meeting the customer needs and expectations quickly and adequately, thereby enhancing his/her satisfaction level. With the help of tools of information technology organizations can modify their processes to make them automatic, simpler, time saving. Thus IT can bring efficiency and effectiveness in the functioning of business.

(h) **Incorrect:** Every company has its own organisational culture. Each has its own business philosophy and principles, its own ways of approaching to the problems and making decisions, its own work climate, work ethics, etc. Therefore, corporate culture need not be identical in all organisations in a geographical area. However, every organisation over a period of time inherits and percolates down its own specific work ethos and approaches.

(i) **Incorrect:** Demarketing is a marketing strategy to reduce demand temporarily or permanently-the aim is not to destroy demand, but only to reduce or shift it. This happens when the demand is too much to handle. For example, buses are overloaded in the morning and evening, roads are busy for most of times, zoological parks are over-crowded on Saturdays, Sundays and holidays. Here demarketing can be applied to regulate demand.

(j) **Incorrect**: Balance scorecard is a combination of strategic and financial objectives. It measure company performance, requires setting both financial and strategic objectives and tracking their achievement. Unless a company is in deep financial difficulty, such that its very survival is threatened, company managers are well advised to put more emphasis on achieving strategic objectives than on achieving financial objectives whenever a trade-off has to be made.

2. (a) The economic environment refers to the nature and direction of the economy in which a company competes or may compete. It includes general economic situation in the region and the nation, conditions in resource markets which influence the supply of inputs to the enterprise, their costs, quality, availability and reliability of supplies.

Economic environment determines the strength and size of the market. The purchasing power in an economy depends on current income, prices, savings, circulation of money, debt and credit availability. Income distribution pattern determines the marketing possibilities. The important point to consider is to find out the effect of economic prospect and inflation on the operations of the firms. Strategists must scan, monitor, forecast, and assess a number of key economic factors for both domestic and key international markets.

Socio-Cultural Environment influences almost all enterprises in a similar manner. It primarily affects strategic management process within the organization in the areas of mission & objectives setting and decisions related to products & markets.

Socio-cultural environment is a complex combination of factors such as social traditions, values and beliefs, changing lifestyle patterns &materialism, level and standards of literacy and education, awareness & consciousness of rights and work ethics of members of society, the ethical standards and state of society, the extent of social stratification, conflict and cohesiveness, social concerns such as corruption, environmental pollution etc.

(b) **Synchro-marketing:** When the demand for any product is irregular due to season, some parts of the day, or on hour basis, causing idle capacity or overworked capacities, synchro-marketing can be used to find ways to alter the same pattern of demand through flexible pricing, promotion, and other incentives. For example, products such as movie tickets can be sold at lower price over week days to generate demand.

Demarketing: Marketing strategies to reduce demand temporarily or permanently- the aim is not to destroy demand, but only to reduce or shift it. This happens when there is overfull demand. For example, buses are overloaded in the morning and evening, roads are busy for most of times, zoological parks are over-crowded on Saturdays, Sundays and holidays. Here demarketing can be applied to regulate demand.

(c) **Divestment Strategy:** Divestment strategy involves the sale or liquidation of a portion of business, or a major division, profit centre or SBU. Divestment is usually a part of rehabilitation or restructuring plan and is adopted when a turnaround has been attempted but has proved to be unsuccessful. The option of a turnaround may even be ignored if it is obvious that divestment is the only answer.

Liquidation Strategy: Liquidation as a form of retrenchment strategy is considered as the most extreme and unattractive. It involves closing down a firm and selling its assets. It is considered as the last resort because it leads to serious consequences such as loss of employment for workers and other employees, termination of opportunities a firm could pursue, and the stigma of failure.

(d) Supply chain management is an extension of logistic management. However, there are differences between the two. Logistical activities typically include management of inbound and outbound goods, transportation, warehousing, handling of material, fulfillment of orders, inventory management and supply/demand planning. Although these activities also form part of supply chain management, the latter is much broader. Logistic management can be termed as one of its part that is related to planning, implementing, and controlling the movement and storage of goods, services and related information between the point of origin and the point of consumption.

Supply chain management is an integrating function of all the major business activities and business processes within and across organisations. Supply Chain Management is a systems view of the linkages in the chain consisting of different channel partners – suppliers, intermediaries, third-party service providers and customers. Different elements in the chain work together in a collaborative and coordinated manner. Often it is used as a tool of business transformation and involves delivering the right product at the right time to the right place and at the right price.

3. **(a)** Companies begin business process re-engineering by creating a plan of action based on the gap between the current and proposed processes, technologies and structures. Steps usually followed to implement BPR are as follows:

(i) **Determining objectives and framework:** Objectives are the desired end results of the redesign process which the management and organization attempts to achieve. It helps in building a comprehensive foundation for the reengineering process.

(ii) **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.

(iii) **Study the existing process:** The existing processes will provide an important base for the redesigners.

(iv) **Formulate a redesign process plan:** Formulation of redesign plan is the real crux of the reengineering efforts. Customer focused redesign concepts are identified and formulated.

(v) **Implement the redesign:** Implementation of the redesigned process and application of other knowledge gained from the previous steps is key to achieve dramatic improvements.

(b) Reasons necessary for Globalization of companies are as follows:

- The rapid shrinking of time and distance across the globe resulting in faster communication, speedier transportation, growing financial flows and rapid technological changes.
- Domestic market is not large enough to absorb whatever is produced. Some European companies have gone global for this reason.
- Justification of foreign investment keeping in view the size of foreign market.
- Securing a reliable and cheaper source of raw-materials. Some companies, by contrast, have often ventured overseas to protect old markets or to seek new ones. For example cheap labour in India lure foreign investors.

- Reducing the high transportation costs by setting up overseas plants that ultimately leads to reducing the higher ratio of the unit cost to the selling price per unit.

(c) In SWOT analysis 'strengths' and 'opportunities' are positive considerations and 'weaknesses' and 'threats' are negative considerations. The basic objectives of conducting SWOT analysis are:

- To exploit the strengths of the company to achieve its objectives.
- To identify the shortcomings in the company's present skills and resources and to take necessary corrective steps so that the overall interest of the organisation is protected.
- To focus on profit making opportunities in the business environment and for identifying threats.
- To highlight areas within the company, which are strong and might be exploited more and weaknesses, where some defensive planning might be required to prevent the company from downfall.

(d) Retrenchment strategy implies substantial reduction in the scope of organization's activity. A business organization can redefine its business by divesting a major product line or market. While retrenching, organizations might set objectives below the past level of objectives. It is essentially a defensive strategy adopted as a reaction to operating problems stemming from either internal mismanagement, unanticipated actions by competitors or hostile and unfavourable changes in the business environmental conditions. With a retrenchment strategy the endeavour of management is to raise the level of enterprise achievements focusing on improvements in the functional performance and cutting down operations with negative cash flows.

4. (a) Experience curve is similar to learning curve which explains the efficiency gained by workers through repetitive productive work. Experience curve is based on the commonly observed phenomenon that unit costs decline as a firm accumulates experience in terms of a cumulative volume of production. The implication is that larger firms in an industry would tend to have lower unit costs as compared to those of smaller organizations, thereby gaining a competitive cost advantage. Experience curve results from a variety of factors such as learning effects, economies of scale, product redesign and technological improvements in production.

The concept of experience curve is relevant for a number of areas in strategic management. For instance, experience curve is considered a barrier for new firms contemplating entry in an industry. It is also used to build market share and discourage competition.

(b) Competitive advantage is the position of a firm to maintain and sustain a favorable market position when compared to the competitors. Competitive advantage is ability to offer buyers something different and thereby providing more value for the money. It is the result of a successful strategy. This position gets translated into higher market share, higher profits when compared to those that are obtained by competitors operating in the same industry. Competitive advantage may also be in the form of low cost relationship in the industry or being unique in the industry along dimensions that are widely valued by the customers in particular and the society at large.

(c) A strategic vision delineates organisation's aspirations for the business, providing a panoramic view of the position where the organisation is going. A strategic vision points an organization in a particular direction, charts a strategic path for it to follow in preparing for the future, and moulds organizational identity. A Strategic vision is a road map of a company's future – providing specifics about technology and customer focus, the geographic and product markets to be pursued, the capabilities it plans to develop, and the kind of company that management is trying to create.

(d) Network structure is a newer and somewhat more radical organizational design. The network structure could be termed as 'non-structure' as it virtually eliminates in-house business functions and outsource many of them. A corporation organized in this manner is a virtual organization because it is composed of a series of project groups or collaborations linked by constantly changing non-hierarchical, cobweb-like networks.

5. A business does not function in isolation, rather, it acts as a sub-system of its environment consisting of society, economy, laws, competitors and so on. Business draws certain inputs from environment in the form of resources and information and transforms them into outputs. The relationship between the organization and its environment may be discussed in terms of interactions between them that can be broadly outlined as below:

Exchange of information: The organization scans the external environmental variables, their behaviour and changes, generates important information and uses it for its planning, decision-making and control purposes.

On the other hand, the organization itself transmits information to several external agencies either voluntarily, inadvertently or legally.

Exchange of resources: The organization receives inputs — finance, materials, manpower, equipment etc., from the external environment. It sustains itself by employing the above inputs for involving or producing output of products and services.

The organization is also dependent on the external environment for disposal of its output of products and services to a wide range of clientele.

Exchange of influence and power: The external environment holds considerable power over the organization both by virtue of its being more inclusive as also by virtue of its command over resources, information and other inputs. The external environment is also in a position to impose its will over the organization. Governmental control, competitors, customers, suppliers, investors etc., exercise considerable power and influence over the organization.

In turn, the organization itself is sometimes in a position to wield power and influence over the external environment by virtue of its command over resources and information.

6. International economic dynamics accompanied by geographical changes have changed the paradigm of global business. A firm / company who wishes to go global will be guided by the following three types of strategies:

(i) **Multi-domestic strategy:** A multi-domestic strategy focuses on competition within each country in which the firm operates. This Strategy is adopted when a company tries to achieve a high level of local responsiveness by matching their products and services offerings to national conditions prevailing in the countries they operate in. The organization attempts to extensively customize their products and services according to the local conditions of different countries.

(ii) **Global strategy:** A global strategy assumes more standardization of products across country boundaries. Under this strategy, the company tries to focus on a low cost structure by leveraging their expertise in providing certain products and services and concentrating the production of these standard products and services at a few favourable locations around the world. Competitive strategy is centralized and controlled by the home office.

(iii) **Transnational strategy:** Many large multinational firms, particularly those with many diverse products, may use a multi-domestic strategy with some product lines and a global strategy with others. A transnational strategy seeks to combine aspects of both multi-domestic and global strategies. Thus there is emphasizes on both local responsiveness and global integration and coordination. Although the transnational strategy is difficult to implement, environmental trends are causing multinational firms to consider the needs for both global efficiencies and local responsiveness.

When a firm adopts one or more of the above strategies, the firm would have to take decisions on the manner in which it would commence international operations. The decision as to how to enter a foreign market can have a significant impact on the results. Expansion into foreign markets can be achieved through following options:

- Exporting.
- Licensing/ Franchising.
- Joint Venture.
- Foreign Direct Investment.

7. A typical large organization is a multidivisional organisation that competes in several different businesses. It has separate self-contained divisions to manage each of these. There are three levels of strategy in management of business - corporate, business, and functional.

The corporate level of management consists of the chief executive officer and other top level executives. These individuals occupy the apex of decision making within the organization. The role of corporate-level managers is to oversee the development of strategies for the whole organization. This role includes defining the mission and goals of the organization, determining what businesses it should be in, allocating resources among the different businesses and so on rests at the Corporate Level.

The development of strategies for individual business areas is the responsibility of the general managers in these different businesses or business level managers. A business unit is a self-contained division with its own functions - for example, finance, production, and marketing. The strategic role of business-level manager, head of the division, is to translate the general statements of direction and intent that come from the corporate level into concrete strategies for individual businesses.

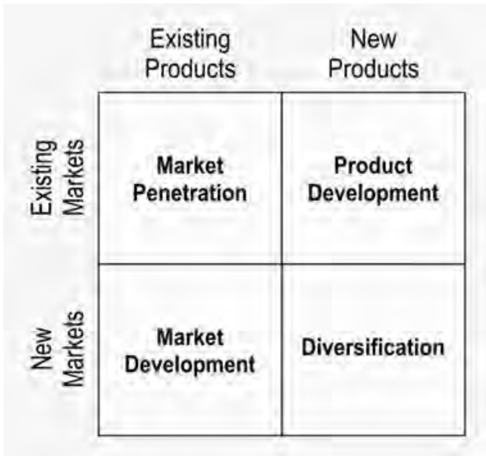
Functional-level managers are responsible for the specific business functions or operations such as human resources, purchasing, product development, customer service, and so on. Thus, a functional manager's sphere of responsibility is generally confined to one organizational activity, whereas general managers oversee the operation of a whole company or division.

8. Decision making is a managerial process and a function of choosing a particular course of action out of several alternative courses for the purpose of accomplishment of the organizational goals. Strategic decisions are different in nature than all other decisions which are taken at various levels of the organization during their day-to-day working. The major dimensions of strategic decisions are given below:

- Strategic issues require top-management decisions: Strategic issues involve thinking in totality of the organizations and also there is lot of risk involved.
- Strategic issues involve the allocation of large amounts of company resources: It may require huge financial investment to venture into a new area of business or the organization may require huge manpower with new set of skills in them.
- Strategic issues are likely to have a significant impact on the long term prosperity of the firm: Generally the results of strategic implementation are seen on a long term basis and not immediately.
- Strategic issues are future oriented: Strategic thinking involves predicting the future environmental conditions and how to orient for the changed conditions.
- Strategic issues usually have major multifunctional or multi-business consequences: As they involve organization in totality they affect different sections of the organization with varying degree.
- Strategic issues necessitate consideration of factors in the firm’s external environment: Strategic focus in organization involves orienting its internal environment to the changes of external environment.

9. The Ansoff's product market growth matrix (proposed by Igor Ansoff) is an useful tool that helps businesses decide their product and market growth strategy. With the use of this matrix, a business can get a fair idea about how its growth depends upon its markets in new or existing products in both new and existing markets.

The Ansoff's product market growth matrix is as follows:



Ansoff's Product Market Growth Matrix

Based on the matrix, ABC Ltd. may segregate its different products. Being in pharmaceuticals, development of new products is result of extensive research and involves huge costs. There are also social dimensions that may influence the decision of the company. It can adopt penetration, product development, market development or diversification simultaneously for its different products.

Market penetration refers to a growth strategy where the business focuses on selling existing products into existing markets. It is achieved by making more sales to present customers without changing products in any major way. Market development refers to a growth strategy where the business seeks to sell its existing products into new markets. It is a strategy for company growth by identifying and developing new markets for the existing products of the company. Product development is refers to a growth strategy where business aims to introduce new products into existing markets. It is a strategy for company growth by offering modified or new products to current markets. Diversification refers to a growth strategy where a business markets new products in new markets. It is a strategy by starting up or acquiring businesses outside the company's current products and markets.

As market conditions change overtime, the company may shift product-market growth strategies. For example, when its present market is fully saturated a company may have no choice other than to pursue new market.

10. The external analysis process focuses on scanning of environment in which all organizations work as sub-systems. The scanning of external environment leads to the identification of opportunities and threats & opening the organizations to the external world. While the internal analysis leads to the study of strengths and weakness which will decide to what extent each company is going to capitalize the opportunities and threats.

Moreover, strategic thinking judges about the nature of strategy and proceeds to flow directly from analysis of a company's external environment and internal situation. The analytical sequence starts from strategic appraisal of the company's external and internal situations and to evaluate alternatives for implanting the strategy choices. Accurate diagnosis of the company's situation is necessary. Managerial preparation for deciding a sound long term direction is done by setting appraisal alternate and creating a winning strategy.

Understanding of the strategic aspects of a company's external and internal environment, the changes are greatly influenced that how managers will lay out a strategic game plan. Thus, it is a major prospect for building competitive advantage and that is likely to boost company performance.

11. Businesses have to respond to a dynamic and often hostile environment in 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.

12. Many organizations in order to achieve quick growth, expand or diversify use strategies such as mergers and acquisitions. This also helps in deploying surplus funds.

Merger and Acquisition Strategy

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

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

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

Types of Mergers

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

2. **Vertical merger:** It is a merger of two organizations that are operating in the same industry but at different stages of production or distribution system. This often leads to increased synergies with the merging firms. If an organization takes over its supplier/producers of raw material, then it leads to backward integration. On the other hand, forward integration happens when an organization decides to take over its buyer organizations or distribution channels. Vertical merger results in operating and financial economies. Vertical mergers help to create an advantageous position by restricting the supply of inputs or by providing them at a higher cost to other players.

3. **Co-generic merger:** In co-generic merger two or more merging organizations are associated in some way or the other related to the production processes, business markets, or basic required technologies. Such merger include the extension of the product line or acquiring components that are required in the daily operations. It offers great opportunities to businesses to diversify around a common set of resources and strategic requirements. For example, an organization manufacturing refrigerators can diversify by merging with another organization having business in kitchen appliances.

4. **Conglomerate merger:** Conglomerate mergers are the combination of organizations that are unrelated to each other. There are no linkages with respect to customer groups, customer functions and technologies being used. There are no important common factors between the organizations in production, marketing, research and development and technology. In practice, however, there is some degree of overlap in one or more of these factors.

13. Management of logistics is a process which integrates the flow of supplies into and out of an organization to achieve a level of service which ensures that the right materials are available at the right place, at the right time, of the right quality, and at the right cost.

To have an effective logistics strategy, the organization has to ponder the following issues and formulate strategy comfortable with their issues:

- The sources of raw materials and components needed for production of goods.
- To ascertain the number of manufacturing units, their location etc to decide about transport facility.

- Products being produced at different manufacturing location.
- To decide about the different modes of transportation facilities.
- What is the nature of distribution facilities?
- What is the nature of materials handling equipment possessed? Is it ideal?
- What is the method for deploying inventory in the logistics network?
- Should the business organization own the transport vehicles?

14. Research and development (R&D) personnel can play an integral part in strategy implementation. These individuals are generally charged with developing new products and improving old products in a way that will allow effective strategy implementation. R&D employees and managers perform tasks that include transferring complex technology, adjusting processes to local raw materials, adapting processes to local markets, and altering products to particular tastes and specifications.

Technological improvements that affect consumer and industrial products and services shorten product life cycles. Companies in virtually, every industry are relying on the development of new products and services to fuel profitability and growth. Surveys suggest that the most successful organizations use an R&D strategy that ties external opportunities to internal strengths and is linked with objectives. Well formulated R&D policies match market opportunities with internal capabilities. R&D policies can enhance strategy implementation efforts to:

- ♦ Emphasize product or process improvements.
- ♦ Stress basic or applied research.
- ♦ Be leaders or followers in R&D.
- ♦ Develop robotics or manual-type processes.
- ♦ Spend a high, average, or low amount of money on R&D.
- ♦ Perform R&D within the firm or to contract R&D to outside firms.
- ♦ Use university researchers or private sector researchers.

15. Successful strategy formulation does not guarantee successful strategy implementation. It is always more difficult to do something (strategy implementation) than to say you are going to do it (strategy formulation)! Although inextricably linked, strategy implementation is fundamentally different from strategy formulation.

Strategy implementation is different from strategy formulation. Strategy formulation is an intellectual process but strategy implementation is an operational process. Strategy formulation is positioning forces before the action which focuses on effectiveness whereas strategy implementation is managing forces during the action which focuses on efficiency. Strategy formulation requires good intuitive and analytical skills and coordination among a few individuals but strategy implementation requires special motivation and leadership skills and combination among many individuals. So the strategy implementation is more difficult than strategy formulation.

16. A Strategic Business Unit (SBU) is a grouping of related businesses that can be taken up for strategic planning distinct from the rest of the businesses. Products/businesses within an SBU receive same strategic planning treatment and priorities. Products/businesses that are related from the standpoint of “function” are assembled together as a distinct SBU.

Strategic Business Unit (SBU) is beneficial for improving the competitive advantage of a firm in the following ways:

- A scientific method of grouping the businesses of a multi-business corporation which helps the firm in strategic planning.
- An improvement over the territorial grouping of businesses and strategic planning based on territorial units.
- An SBU is a grouping of related businesses that can be taken up for strategic planning distinct from the rest of the businesses. Products/businesses within an SBU receive same strategic planning treatment and priorities.
- Products/businesses that are related from the standpoint of "function" are assembled together as a distinct SBU.
- Unrelated products/businesses in any group are separated. If they could be assigned to any other SBU applying the criterion of functional relation, they are assigned accordingly; otherwise they are made into separate SBUs.
- Grouping the businesses on SBU lines helps the firm in strategic planning by removing the vagueness and confusion generally seen in grouping businesses.
- Each SBU is a separate business from the strategic planning standpoint. In the basic factors, viz., mission, objectives, competition and strategy-one SBU will be distinct from another.
- Each SBU will have its own distinct set of competitors and its own distinct strategy.
- Each SBU will have a CEO, so it can be managed separately for profit performance and will have better controlling.

17. Medical organisations such as hospitals are often not-for-profit organisations. At the same time there is existence of medical organisations that have commercial interest. Whether they run for profit or are in charitable nature, the tools and techniques of strategic management are equally important. The role of strategic management can be expressed as follows.

Medical organisations need to follow the process of strategic management. They work under complex and turbulent environment with changes in macroeconomic factors covering economic, social, legal, technological factors. They need to set their mission, look for strategic alternatives and implement their chosen strategies, etc. In fact, all the steps in the process of strategic management are relevant for them. Medical organisations may also have survival and growth strategies. Hospitals may diversify to form chain of pathological labs or open pharmaceutical shops. Strategic management can also help in providing better services to the patients.

Like any organisation, medical organisations also compete with each other. Strategic management helps to function and succeed within the competitive pressures.

Thus the role of strategic management in medical organizations is similar to any other organisation. In fact, Hospitals are creating new strategies today with advances in the diagnosis and treatment methods. Hospitals are bringing services to the patient as much as bringing the patient to the hospital. Pathological laboratories have started collecting door-to-door samples. Providing day-treatment facilities, electronic monitoring at home, user-friendly ambulatory services, and laboratory testing.

18. Six sigma means maintenance of the desired quality in processes and end products. It takes a systematic and integrated effort towards improving quality and reducing cost besides meeting and improving the organizational goals related to quality, cost, scheduling, manpower, new products and so on. It works continuously towards revising the current standards and establishing higher ones.

Conclusively, six sigma starts with a dream or vision to have the goal of near perfect products and services and superb customer satisfaction. Managers and leaders should accept the challenge to keep the organization adaptable with the changing environment.

Six sigma is often related to Motorola, the company that has invented it. It pointed out that modern technology was so complex that old ideas about acceptable quality levels are no longer acceptable. The success of Motorola effectively changed the focus of quality worldwide. Many corporate giants like Xerox, Boeing, GE, Kodak etc followed Motorola's lead. In India also Tata's, WIPRO and Bharti's and others are effectively reaping the benefits of six-sigma.

With the help of improved technology and other tools, Management is able to enhance the quality of their products and therefore meets the human unending demand for better quality products and services. Six Sigma helps the management to not only restrict itself in satisfying the existing desires of customers or to put boundary on quality by limiting it to current information and perspective of customers rather, it also helps to be futuristic i.e., in addition to meeting customer's present expectations it should also be able to improve them.