

REVISION TEST PAPERS

INTERMEDIATE (IPC) COURSE

(UNDER OLD SCHEME)

GROUP – II

MAY, 2019



BOARD OF STUDIES

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA

(Set up by an Act of Parliament)

New Delhi

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REVISION TEST PAPER, MAY 2019 – OBJECTIVE & APPROACH

(Students are advised to go through the following paragraphs carefully to derive maximum benefit out of this RTP)

I Objective of Revision Test Paper

Revision Test Papers are one among the many educational inputs provided by the Board of Studies (BOS) to its students. Popularly referred to as RTP by the students, it is one of the very old publications of the BOS whose significance and relevance from the examination perspective has stood the test of time.

RTPs provide glimpses of not only the desirable ways in which examination questions are to be answered but also of the professional quality and standard of the answers expected of students in the examination. Further, aspirants can assess their level of preparation for the examination by answering various questions given in the RTP and can also update themselves with the latest developments in the various subjects relevant from the examination point of view.

The primary objectives of the RTP are:

- To help students get an insight of their preparedness for the forthcoming examination;
- To provide an opportunity for a student to find all the latest developments relevant for the forthcoming examination at one place;
- To supplement earlier studies;
- To enhance the confidence level of the students adequately; and
- To leverage the preparation of the students by giving guidance on how to approach the examinations.

RTPs contain the following:

- (i) Planning and preparing for examination
- (ii) Subject-wise guidance – An overview
- (iii) Updates applicable for a particular exam in the relevant subjects
- (iv) Topic-wise questions and detailed answers thereof in respect of each paper
- (v) Relevant publications/announcement applicable for the particular examination

Students must bear in mind that the RTP contains a variety of questions based on different sections of the syllabi and thus a comprehensive study of the entire syllabus is a pre-requisite before answering the questions of the RTP. In other words, in order to derive maximum benefit out of the RTPs, it is advised that before proceeding to solve the

questions given in the RTP, students ought to have thoroughly read the Study Materials, solved the questions given in the Practice Manual and gone through the Suggested Answers of the earlier examinations. It is important to remember that there can be large number of other complex questions which are not covered in the RTP. In fact, questions contained herein are only illustrative in nature.

The topics on which the questions are set herein have been carefully selected and meticulous attention has been paid in framing different types of questions. Detailed answers are provided to enable the students to do a self-assessment and have a focused approach for effective preparation.

Students are welcome to send their suggestions for fine tuning the RTP to the Director, Board of Studies, The Institute of Chartered Accountants of India, A-29, Sector-62, Noida 201 309 (Uttar Pradesh). RTP is also available on the Institute's website www.icai.org under the BOS knowledge portal in students section for downloading.

II. Planning and preparing for examination

Ideally, when you receive the RTP, you should have completed the entire syllabus of all the subjects at least once. RTP is an effective tool to revise and refresh your concepts and knowledge gained through the first round of study of the whole course. When the RTP reaches your hand, your study plan should have been completed as under:

❖ *Study Materials*

You must have finished reading the relevant Study Materials of all the subjects. Make sure you go through the Study Material as they cover the syllabus comprehensively.

❖ *Other Educational Inputs*

In case of papers on Taxation, you must have carefully perused the Supplementary Study paper containing the latest amendments made through the relevant Finance Act and notifications and circulars issued from time to time which are applicable for the forthcoming examinations.

❖ *Practice Manuals*

Practice Manuals are an excellent medium of understanding the practical aspects of the various provisions learnt through the Study Materials. Solving the Practice Manual at least once before proceeding to the RTP will ensure that you have a grasp of the application and computational aspect of the syllabus as well.

❖ *Suggested Answers*

Giving an honest attempt to solve the previous attempts suggested answers on your own, will give you a flavour of the pattern of question paper and type of questions which are being asked in the examination.

After completing the above process, you should go through the Updates provided in the RTP and then proceed to solve the questions given in the RTP on your own. RTPs are provided to you to check your preparation standards and hence it must be solved on your own in a time-bound manner.

The stratagem and the fine points requiring careful consideration in respect of preparation for the CA examinations are explained in comprehensive details in BOS' publication "How to face CA Examinations? A Matrix of Winning Strategies". The publication may be referred to when you start preparing for a subject.

Examination tips

How well a student fares in the examination depends upon the level and depth of his preparation. However, there are certain important points which can help a student better his performance in the examination. These useful tips are given below:

- Reach the examination hall well in time.
- As soon as you get the question paper, read it carefully and thoroughly. You are given separate 15 minutes for reading the question paper.
- Plan your time so that appropriate time is awarded for each question. Keep sometime for checking the paper as well.
- First impression is the last impression. The question which you can answer in the best manner should be attempted first.
- Always attempt to do all questions. Therefore, it is important that you must finish each question within allocated time.
- Read the question carefully more than once before starting the answer to understand very clearly as to what is required.
- Answer all parts of a question one after the other; do not answer different parts of the same question at different places.
- Write in a neat and legible hand-writing.
- Always be concise and write to the point and do not try to fill pages unnecessarily.
- There must be logical expression of the answer.
- In case a question is not clear, you may state your assumptions and then answer the question.
- Check your answers carefully and underline important points before leaving the examination hall.

III. Subject-wise Guidance – An Overview

PAPER 5: ADVANCED ACCOUNTING

The Revisionary Test Paper (RTP) of Advanced Accounting is divided into two parts viz Part I - Relevant Announcements, Amendments and Notifications for May, 2019 examination and Part II –Questions and Answers.

It may be noted that the July, 2015 edition of the Study Material and April, 2016 edition of Practice Manual is relevant for May, 2019 Examination.

Part I of the Revisionary Test Paper consists of the 'Relevant Amendments and Notifications - applicable and not applicable' for May, 2019 examination. The purpose of this information in the RTP is to apprise the students with the latest developments applicable for May, 2019 examination. The brief summary of the same has been given as under:

A. Applicable for May, 2019 examination:

- I Amendments in Schedule III (Division I) to the Companies Act, 2013
- II Amendment in AS 11 "The Effects of Changes in Foreign Exchange Rates"
- III Amendments made by MCA in the Companies (Accounting Standards) Rules, 2006
- IV Provisions of the Companies Act, 2013 related with Liquidation of Companies
- V Maintenance of Statutory Liquidity Ratio (SLR)
- VI Maintenance of Cash Reserve Ratio (CRR)
- VII Provisions of the Insurance Act (amended by Insurance Amendment Act)

B. Not applicable for May, 2019 examination:

Ind ASs issued by the Ministry of Corporate Affairs.

Part II of the Revisionary Test Paper consists of twenty questions together with their answers. First fifteen questions are based on different topics discussed in the study material. Last 4 questions of this RTP are based on Accounting Standards. For easy reference the topic / accounting standard number on which the question is based has been quoted at the top of each question. The details of topics, on which questions in the RTP are based, are as under:

Question No.	Topic
1	Dissolution of partnership firm
2	Conversion of Partnership firms into a company
3	Sale of Partnership Firm to a Company
4	LLP

5	Employee Stock Option Plans
6	Buy Back of Securities
7	Redemption of Debentures
8	Underwriting of Shares
9	Amalgamation of companies
10	Internal Reconstruction of a Company
11	Liquidation of a Company
12	Financial Statements of Insurance Companies
13	Financial Statements of Banking Companies
14	Departmental Accounts
15	Branch Accounting
16	Framework for preparation and presentation of Financial Statements
17 to 20	Accounting Standards

Answers to the questions have been given in detail along with the working notes for easy understanding and comprehending the steps in solving the problems. The answers to the questions have been presented in the manner which is expected from the students in the examination. The students are expected to solve the questions under examination conditions and then compare their solutions with the solutions given in the Revisionary Test Paper and further strategize their preparation for scoring more marks in the examination.

PAPER – 6: AUDITING AND ASSURANCE

RTP is a tool to refresh your knowledge which you have acquired while doing your conceptual study from Study Material, Practice Manual and other modes of knowledge like student journal, bare acts etc.

The Revisionary Test Paper (RTP) of Auditing and Assurance for May, 2019 carries twenty descriptive questions along with 10 MCQs and their answers. These questions have been taken from the entire syllabus which is divided into nine chapters along with engagement and quality control standards, etc. discussed in the study material.

The various Chapters/topics as mentioned above are Standards on Auditing, Nature of Auditing, Basic Concepts in Auditing, Preparation for an Audit, Internal Control, Vouching, Verification of Assets and Liabilities, Company Audit and Special Audits. The chapter's name is also clearly indicated before each question. The questions in the RTP have been arranged in the same sequence as prescribed in the study material to facilitate easy revision by the students. An attempt has been made to cover the syllabus comprehensively by giving questions from each and every topic.

This RTP of Auditing and Assurance has been divided into two parts viz Part I – Legislative Amendments / Notifications / Circulars / Rules / Guidelines issued by Regulating Authority relevant for May, 2019 examination and Part II – Questions and Answers.

The relevant notified sections of the Companies Act, 2013 and other legislative amendments including relevant Notifications / Circulars / Rules / Guidelines issued by Regulating Authorities up to 31st October, 2018 are applicable for May, 2019 Examination. The questions have been answered in this RTP keeping in view latest amendments as per above mentioned dates.

PAPER – 7: INFORMATION TECHNOLOGY AND STRATEGIC MANAGEMENT

Section – A: Information Technology

The Revision Test Paper on Information Technology describes the comprehensive view of the syllabus with special emphasis on CA examination at Intermediate (IPC) level. The topic-wise questions and answers are given so that student could test his/her preparation level for the examination. The RTP is based on the existing study material that is already provided to the student. It also includes latest development in the field of Information Technology that is required to know by the students. Full answer to each question is given so that students would be benefited without searching the answers from various sources.

Total 15 questions have been given out of which first 5 question numbered 1 to 5 are Multiple Choice Questions (MCQ) based on each chapter. Each MCQ has four options out of which only one option is correct. Remaining 10 questions numbered 6 to 15 are descriptive questions given topic-wise. Questions have been selected from various chapters/topics uniformly keeping in view the complete coverage of the syllabus from all the chapters. The questions provide an insight to the students on their understanding of the fundamental concepts of Business Process Management & IT; Information Systems and IT Fundamentals; Telecommunication and Networks; Business Information Systems and Business Process Automation through Application software.

Section – B: Strategic Management

The Revision Test Paper in the subject of Strategic Management for the May, 2019 examination contains 18 questions. The nature and kind of questions have been kept similar to the previous examinations. Broadly, the questions included are of two categories - short answer type questions and long answer type questions. The first four questions are in the nature of short answer type questions. Each question is further subdivided into different parts which extensively covers different chapter of the syllabus.

In the first short answer type question, multiple choice questions are given with four alternatives and the student has to opt the correct option. In the second question, student has to distinguish between two concepts. Afterwards, third question is based on the short notes and finally, in the fourth question short answer type questions are asked.

Subsequently, 14 long answer type questions have been included which covers all the seven chapters of the syllabus. Chapter names have been mentioned before questions.

The students should take up this Revision Test Paper as a tool to check their preparedness in the subject. To properly self assess the preparation in the subject, students must attempt the questions on their own. Mere reading will not be helpful. Compare your answers with the suggested answers and hints given to assess the present status and identify what else can be done to improve your answers. Work hard and perform well in the examination.

PAPER – 5: ADVANCED ACCOUNTING

PART – I: ANNOUNCEMENTS STATING APPLICABILITY & NON-APPLICABILITY For MAY, 2019 EXAMINATION

A. Applicable for May, 2019 Examination

I. **Amendments in Schedule III (Division I) to the Companies Act, 2013**

In exercise of the powers conferred by sub-section (1) of section 467 of the Companies Act, 2013), the Central Government made the following amendments in Division I of the Schedule III with effect from the date of publication of this notification in the Official Gazette:

- (A) under the heading “II Assets”, under sub-heading “Non-current assets”, for the words “Fixed assets”, the words “Property, Plant and Equipment” shall be substituted;
- (B) in the “Notes”, under the heading “General Instructions for preparation of Balance Sheet”, in paragraph 6,-
 - (I) under the heading “B. Reserves and Surplus”, in item (i), in sub- item (c), the word “Reserve” shall be omitted;
 - (II) in clause W., for the words “fixed assets”, the words “Property, Plant and Equipment” shall be substituted.

II. **Amendment in AS 11 “The Effects of Changes in Foreign Exchange Rates”**

In exercise of the powers conferred by clause (a) of sub-section (1) of section 642 of the Companies Act, 1956, the Central Government, in consultation with National Advisory Committee on Accounting Standards, hereby made the amendment in the Companies (Accounting Standards) Rules, 2006, in the "ANNEXURE", under the heading "ACCOUNTING STANDARDS" under "AS 11 on The Effects of Changes in Foreign Exchange Rates", for the paragraph 32, the following paragraph shall be substituted, namely :-

"32. An enterprise may dispose of its interest in a non-integral foreign operation through sale, liquidation, repayment of share capital, or abandonment of all, or part of, that operation. The payment of a dividend forms part of a disposal only when it constitutes a return of the investment. Remittance from a non-integral foreign operation by way of repatriation of accumulated profits does not form part of a disposal unless it constitutes return of the investment. In the case of a partial disposal, only the proportionate share of the related accumulated exchange differences is included in the gain or loss. A write-down of the carrying amount of a non-integral foreign operation does not constitute a partial disposal. Accordingly, no part of the deferred foreign exchange gain or loss is recognised at the time of a write-down".

III. Amendments made by MCA in the Companies (Accounting Standards) Rules, 2006

Amendments made by MCA on 30.3.2016 in the Companies (Accounting Standards) Rules, 2006 have been made applicable for May, 2019 examination.

MCA has issued Companies (Accounting Standards) Amendment Rules, 2016 to amend Companies (Accounting Standards) Rules, 2006 by incorporating the references of the Companies Act, 2013, wherever applicable. Also, the Accounting Standard (AS) 2, AS 4, AS 10, AS 13, AS 14, AS 21 and AS 29 as specified in these Rules will substitute the corresponding Accounting Standards with the same number as specified in Companies (Accounting Standards) Rules, 2006.

Following table summarizes the changes made by the Companies (Accounting Standards) Amendment Rules, 2016 vis a vis the Companies (Accounting Standards) Rules, 2006 in the accounting standards relevant for Paper 5:

Name of the standard	Para no.	As per the Companies (Accounting Standards) Rules, 2006	As per the Companies (Accounting Standards) Amendment Rules, 2016	Implication
AS 4	Footnote to AS 4	Pursuant to AS 29, Provisions, Contingent Liabilities and Contingent Assets, becoming mandatory in respect of accounting periods commencing on or after 1-4-2004, all paragraphs of this Standard that deal with contingencies (viz paragraphs 1(a), 2, 3.1, 4 (4.1 to 4.4), 5 (5.1 to 5.6), 6, 7 (7.1 to 7.3), 9.1 (relevant portion), 9.2, 10, 11, 12 and 16) stand withdrawn except to the extent they deal with impairment of assets not covered by other	All paragraphs of this Standard that deal with contingencies are applicable only to the extent not covered by other Accounting Standards prescribed by the Central Government. For example, the impairment of financial assets such as impairment of receivables (commonly known as provision for bad and doubtful debts) is governed by this Standard.	Footnote has been modified.

		Indian Accounting Standards. For example, impairment of receivables (commonly referred to as the provision for bad and doubtful debts), would continue to be covered by AS 4.		
	8.5	There are events which, although they take place after the balance sheet date, are sometimes reflected in the financial statements because of statutory requirements or because of their special nature. Such items include the amount of dividend proposed or declared by the enterprise after the balance sheet date in respect of the period covered by the financial statements.	There are events which, although take place after the balance sheet date, are sometimes reflected in the financial statements because of statutory requirements or because of their special nature. For example, if dividends are declared after the balance sheet date but before the financial statements are approved for issue, the dividends are not recognized as a liability at the balance sheet date because no obligation exists at that time unless a statute requires otherwise. Such dividends are disclosed in the notes.	No liability for proposed dividends must be created now. Such proposed dividends are to be disclosed in the notes.

	14	Dividends stated to be in respect of the period covered by the financial statements, which are proposed or declared by the enterprise after the balance sheet date but before approval of the financial statements, should be adjusted.	If an enterprise declares dividends to shareholders after the balance sheet date, the enterprise should not recognize those dividends as a liability at the balance sheet date unless a statute requires otherwise. Such dividends should be disclosed in notes.	No liability for proposed dividends should be created now. Such proposed dividends are to be disclosed in the notes.
AS 14	3(a)	Amalgamation means an amalgamation pursuant to the provisions of the Companies Act, 1956 or any other statute which may be applicable to companies.	Amalgamation means an amalgamation pursuant to the provisions of the Companies Act, 2013 or any other statute which may be applicable to companies and includes 'merger'.	Definition of Amalgamation has been made broader by specifically including 'merger'.
	18 and 39	In such cases the statutory reserves are recorded in the financial statements of the transferee company by a corresponding debit to a suitable account head (e.g., 'Amalgamation Adjustment Account') which is disclosed as a part of 'miscellaneous expenditure' or other	In such cases the statutory reserves are recorded in the financial statements of the transferee company by a corresponding debit to a suitable account head (e.g., 'Amalgamation Adjustment Reserve') which is presented as a	Corresponding debit on account of statutory reserve in case of amalgamation in the nature of purchase is termed as 'Amalgamation Adjustment Reserve' and is now to be

		similar category in the balance sheet. When the identity of the statutory reserves is no longer required to be maintained, both the reserves and the aforesaid account are reversed.	separate line item. When the identity of the statutory reserves is no longer required to be maintained, both the reserves and the aforesaid account are reversed.	presented as a separate line item since there is not sub-heading like 'miscellaneous expenditure' in Schedule III to the Companies Act, 2013
AS 29	35 (An extract)	The amount of a provision should not be discounted to its present value.	The amount of a provision should not be discounted to its present value except in case of decommissioning, restoration and similar liabilities that are recognized as cost of Property, Plant and Equipment. The discount rate (or rates) should be a pre-tax rate (or rates) that reflect(s) current market assessments of the time value of money and the risks specific to the liability. The discount rate(s) should not reflect risks for which future cash flow estimates have been adjusted. Periodic unwinding of	Now discounting of provision for decommissioning, restoration and similar liabilities should be done as per the pre-tax discount rate as mentioned therein.

			discount should be recognized in the statement of profit and loss.	
	73		<p><u>Transitional Provisions</u> All the existing provisions for decommissioning, restoration and similar liabilities (see paragraph 35) should be discounted prospectively, with the corresponding effect to the related item of property, plant and equipment.</p>	Discounting of above existing provisions and similar liabilities should be prospectively, with the corresponding effect to the related item of property, plant and equipment.

IV. Provisions of the Companies Act, 2013 related with Liquidation of Companies

As per Section 2 (94A) of the Companies Act, 2013, winding up means winding up under this Act. As per section 270, the provision of Part I should apply to the winding up of a company by the Tribunal under this Act.

Circumstances in which Company may be wound up by Tribunal [Section 271]

- (a) The company has resolved that the company be wound up by the Tribunal.
- (b) The company has acted against the interests of the sovereignty and integrity of India, the security of the State, friendly relations with foreign States, public order, decency or morality
- (c) The Registrar or any other person authorized by the Central Government by notification under this Act can make an application to tribunal. The Tribunal is of the opinion that the affairs of the company have been conducted in a fraudulent manner or the company was formed for fraudulent and unlawful purpose or the persons concerned in the formation or management of its affairs have been guilty of fraud, misfeasance or misconduct in connection therewith and that it is proper that the company be wound up.
- (d) The company has made a default in filing with the Registrar its financial statements or annual returns for immediately preceding 5 consecutive financial years.
- (e) The Tribunal is of the opinion that it is just and equitable that the company should be wound up.

A company may file petition for winding up under section 272 of the Companies Act, 2013. Petition for winding up to Tribunal can be made by the company, any contributory or contributories, the registrar, any person authorized by Central Govt. in that behalf or if case affairs of the company have been conducted in a Fraudulent manner, by the Central Government or a State Government.

Petition by Contributory

A contributory should be entitled to present a petition for the winding up of a company. Shares in respect of which he is a contributory were either originally allotted to him or have been held by him for at least 6 months during the 18 months immediately before the commencement of the winding up and registered in his name or have transferred to him through the death of a former holder.

Petition by Registrar

The Registrar should be entitled to present a petition for winding up under section 271, except on the grounds specified in section 271 (a) or (e). The Registrar should obtain the previous sanction of the Central Government to the presentation of a petition. The Central Government should not accord its sanction unless the company has been given a reasonable opportunity of making representations.

Petition by Company

A petition presented by the company for winding up before the Tribunal should be admitted only if accompanied by a statement of affairs in such form and in such manner as may be prescribed.

A copy of the petition made under this section should also be filed with the Registrar and the Registrar should, without prejudice to any other provisions, submit his views to the Tribunal within 60 days of receipt of such petition.

A company may be wound up voluntarily [Section 304¹]:

- (a) if the company in general meeting passes a resolution requiring the company to be wound up voluntarily as a result of the expiry of the period for its duration, if any, fixed by its articles or on the occurrence of any event in respect of which the articles provide that the company should be dissolved; or
- (b) if the company passes a special resolution that the company be wound up.

Liquidators' Statement of Account

In case of Compulsory wound-up, the Company Liquidator should keep proper books in such manner, as may be prescribed, in which he should cause entries or minutes to be made of proceedings at meetings and of such other matters as may be prescribed.

¹Applicable until 31 March 2017; with effect from 1 April 2017, Section 59 of the Insolvency and Bankruptcy Code, 2016 is applicable.

Any creditor or contributory may, subject to the control of the Tribunal, inspect any such books, personally or through his agent.

While preparing the liquidator's statement of account, receipts are shown in the following order:

- (a) Amount realized from assets are included in the prescribed order.
- (b) In case of assets specifically pledged in favour of creditors, only the surplus from it, if any, is entered as 'surplus from securities'.
- (c) In case of partly paid up shares, the equity shareholders should be called up to pay necessary amount (not exceeding the amount of uncalled capital) if creditors' claims/claims of preference shareholders can't be satisfied with the available amount. Preference shareholders would be called upon to contribute (not exceeding the amount as yet uncalled on the shares) for paying of creditors.
- (d) Amounts received from calls to contributories made at the time of winding up are shown on the Receipts side.
- (e) Receipts per Trading Account are also included on the Receipts side.
- (f) Payments made to redeem securities and cost of execution and payments per Trading Account are deducted from total receipts.

Payments are made and shown in the following order:

- (a) Legal charges;
- (b) Liquidator's expenses;
- (c) Debenture holders (including interest up to the date of winding up if the company is insolvent and to the date of payment if it is solvent);
- (d) Creditors:
 - (i) Preferential (in actual practice, preferential creditors are paid before debenture holders having a floating charge);
 - (ii) Unsecured creditors;
- (e) Preferential shareholders (Arrears of dividends on cumulative preference shares should be paid up to the date of commencement of winding up); and
- (f) Equity shareholders.

Commencement of Winding Up by Tribunal [Section 357]

Where, before the presentation of a petition for the winding up of a company by the Tribunal, a resolution has been passed by the company for voluntary winding up, the winding up of the company should be deemed to have commenced at the time of the passing of the resolution, and unless the Tribunal, on proof of fraud or mistake, thinks fit to direct otherwise, all proceedings taken in the voluntary winding up should be deemed to have been validly taken.

In any other case, the winding up of a company by the Tribunal should be deemed to commence at the time of the presentation of the petition for the winding up.

Exclusion of Certain Time in Computing Period of Limitation [Section 358]

Notwithstanding anything in the Limitation Act, 1963, or in any other law for the time being in force, in computing the period of limitation specified for any suit or application in the name and on behalf of a company which is being wound up by the Tribunal, the period from the date of commencement of the winding up of the company to a period of one year immediately following the date of the winding up order should be excluded.

Statement of Affairs

In case of winding up by Tribunal, Section 272(5) of the Companies Act, 2013 provides that a petition presented by the company for winding up before the Tribunal shall be admitted only if accompanied by a statement of affairs in such form and in such manner as may be prescribed.

In accordance with Section 274(1), where a petition for winding up is filed before the Tribunal by any person other than the company, the Tribunal shall, if satisfied that a prima facie case for winding up of the company is made out, by an order direct the company to file its objections along with a statement of its affairs within thirty days of the order in such form and in such manner as may be prescribed. The Tribunal may allow a further period of thirty days in a situation of contingency or special circumstances.

The broad lines on which the Statement of Affairs is prepared are the following —

- (1) Include assets on which there is no fixed charge at the value they are expected to realize. Students should note to include calls in arrear but not uncalled capital.
- (2) Include assets on which there is a fixed charge. The amount expected to be realized would be compared with the amount due to the creditor concerned. Any **surplus** is to be extended to the other column. A **deficit** (the amount owed to the creditor exceeding the amount realizable from the asset) is to be added to unsecured creditors.
- (3) The total of assets in point (1) and any surplus from assets mentioned in point (2) is available for all the creditors (except secured creditors already covered by specifically mortgaged assets).
- (4) From the total assets available, the following should be deducted one by one:-
 - (i) Preferential creditors,
 - (ii) Debentures having a floating charge, and
 - (iii) Unsecured creditors.

If a minus balance emerges, there would be deficiency as regards creditors, otherwise there would be a surplus.

- (5) The amount of total paid-up capital (giving details of each class of shares) should be added and the figure emerging will be deficiency (or surplus) as regards members.

Note: Statement of affairs should accompany eight lists:

- List A Full particulars of every description of property not specifically pledged and included in any other list are to be set forth in this list.
- List B Assets specifically pledged and creditors fully or partly secured.
- List C Preferential creditors for rates, taxes, salaries, wages and otherwise.
- List D List of debenture holders secured by a floating charge.
- List E Unsecured creditors.
- List F List of preference shareholders.
- List G List of equity shareholders.
- List H Deficiency or surplus account.

Deficiency Account

The official liquidator will specify a date for period (minimum three years) beginning with the date on which information is supplied for preparation of an account to explain the deficiency or surplus. On that date either assets would exceed capital plus liabilities, that is, there would be a reserve or there would be a deficit or debit balance in the Profit and Loss Account. The Deficiency account is divided into two parts:

1. The first part starts with the deficit (on the given date) and contains every item that increases deficiency (or reduces surplus such as losses, dividends etc.).
2. The second part starts with the surplus on the given date and includes all profits.

If the total of the first exceeds that of the second, there would be a deficiency to the extent of the difference, and if the total of the second part exceeds that of the first, there would be a surplus.

Overriding Preferential Payments [Section 326]: In the winding up of a company under this Act, the following debts should be paid in priority to all other debts:

- a. workmen's dues; and
- b. where a secured creditor has realized a secured asset, so much of the debts due to such secured creditor as could not be realized by him or the amount of the workmen's portion in his security (if payable under the law), whichever is less, pari- passu with the workmen's dues:

Explanation: For the purposes of this section, and section 327 -

- a) **Workmen**, in relation to a company, means the employees of the company, being workmen within the meaning of Section 2 (s) of the Industrial Disputes Act, 1947;
- b) **Workmen's dues**, in relation to a company, means the aggregate of the following sums due from the company to its workmen, namely:

- (i) All wages or salary including wages payable;
- (ii) all accrued holiday remuneration becoming payable to any workman
- (iii) unless the company is being wound up voluntarily merely for the purposes of reconstruction or amalgamation with another company or unless the company has, at the commencement of the winding up, under such a contract with insurers as is mentioned in section 14 of the Workmen's Compensation Act, 1923 (19 of 1923), rights capable of being transferred to and vested in the workmen, all amount due in respect of any compensation or liability for compensation under the said Act in respect of the death or disablement of any workman of the company,
- (iv) all sums due to any workman from provident fund, pension fund, gratuity fund or any other fund maintained by the company.

The following payment should be made in priority to secured creditors:

- (i) All wages or salary including wages payable;
 - (ii) all accrued holiday remuneration becoming payable to any workman
 - (iii) If the above payments are payable for a period of 2 years preceding the winding up order then the same shall be paid in priority to all other debts (including debts due to secured creditors), within a period of 30 days of sale of assets and shall be subject to such charge over the security of secured creditors.
- c) **Workmen's portion**, in relation to the security of any secured creditor of a company, means the amount which bears to the value of the security the same proportion as the amount of the workmen's dues bears to the aggregate of the amount of workmen's dues and the amount of the debts due to the secured creditors.

Preferential Creditors

In a winding up there should be paid in priority to all other debts subject to the provisions of section 326.

Preferential Creditors are as follows:

- a. **Government Taxes:** All revenues, taxes, cess and rates due from the company to the Central Government or a State Government or to a local authority at the relevant date, and having become due and payable within the twelve months immediately before that date;
- b. **Salary and Wages:** All wages or salary including wages payable for time or piece work and salary earned wholly or in part by way of commission of any employee in respect of services rendered to the company and due for a period not exceeding four months within the 12 months immediately before the relevant date, subject to the condition that the amount payable under this clause to any workman should not exceed such amount as may be notified;

- c. **Holiday Remuneration:** All accrued holiday remuneration becoming payable to any employee, or in the case of his death, to any other person claiming under him, on the termination of his employment before, or by the winding up order, or, as the case may be, the dissolution of the company;
- d. **Contribution under ESI Act:** Unless the company is being wound up voluntarily merely for the purposes of reconstruction or amalgamation with another company, all amount due in respect of contributions payable during the period of twelve months immediately before the relevant date by the company as the employer of persons under the Employees' State Insurance Act, 1948 or any other law for the time being in force;
- e. **Compensation in respect of death or disablement:** Unless the company has, at the commencement of winding up, under such a contract with any insurer as is mentioned in section 14 of the Workmen's Compensation Act, 1923, rights capable of being transferred to and vested in the workmen, all amount due in respect of any compensation or liability for compensation under the said Act in respect of the death or disablement of any employee of the company. Where any compensation under the said Act is a weekly payment, the amount payable under this clause should be taken to be the amount of the lump sum for which such weekly payment could, if redeemable, be redeemed, if the employer has made an application under that Act;
- f. **PF, Pension Fund or Gratuity Fund:** All sums due to any employee from the provident fund, the pension fund, the gratuity fund or any other fund for the welfare of the employees, maintained by the company; and
- g. **Expenses of Investigation:** The expenses of any investigation held in pursuance of sections 213 and 216, in so far as they are payable by the company.

Where any advance payment has been made to any employee of a company on account of wages or salary or accrued holiday remuneration himself by some person for that purpose. The person by whom the money was advanced should have a right of priority in respect of the money so advanced and paid-up to the amount. The sum in respect of which the employee or other person in his right would have been entitled to priority in the winding up has been reduced by reason of the payment having been made.

The debts enumerated in this section should—

- h. rank equally among themselves and be paid in full, unless the assets are insufficient to meet them, in which case they should abate in equal proportions; and
- i. so far as the assets of the company available for payment to general creditors are insufficient to meet them, have priority over the claims of holders of debentures under any floating charge created by the company, and be paid accordingly out of any property comprised in or subject to that charge.

The debts under this section should be discharged forthwith so far as the assets are sufficient to meet them, subject to the retention of such sums as may be necessary for the costs and expenses of the winding up.

In the event of a landlord or other person distraining or having distrained on any goods or effects of the company within three months immediately before the date of a winding up order, the debts to which priority is given under this section should be a first charge on the goods or effects so distrained on or the proceeds of the sale thereof. Provided that, in respect of any money paid under any such charge, the landlord or other person should have the same rights of priority as the person to whom the payment is made. Any remuneration in respect of a period of holiday or of absence from work on medical grounds through sickness or other good cause should be deemed to be wages in respect of services rendered to the company during that period.

Explanations: For the purposes of this section,

- **Accrued Holiday Remuneration includes**, in relation to any person, all sums which, by virtue either of his contract of employment or of any enactment including any order made or direction given thereunder, are payable on account of the remuneration which would, in the ordinary course, have become payable to him in respect of a period of holiday, had his employment with the company continued until he became entitled to be allowed the holiday;
- **Employee** does not include a workman; and
- **Relevant Date** means in the case of a company being wound up by the Tribunal, the date of appointment or first appointment of a provisional liquidator, or if no such appointment was made, the date of the winding up order, unless, in either case, the company had commenced to be wound up voluntarily before that date under the Insolvency and Bankruptcy Code, 2016.

Effect of Floating Charge [Section 332]

Where a company is being wound up, a floating charge on the undertaking or property of the company created within the 12 months immediately preceding the commencement of the winding up, should be invalid unless it is proved that the company immediately after the creation of the charge was solvent except for the amount of any cash paid to the company at the time of and in consideration for or subsequent to the creation of the charge together with interest on that amount at the rate of 5 per cent per annum or such other rate as may be notified by the Central Government in this behalf.

B List Contributories

- (a) **Persons:** Shareholders who had transferred Partly Paid Shares (otherwise than by operation of law or by death) within one year, prior to the date of winding up may be called upon to pay an amount to pay off such Creditors as existed on the date of transfer of shares. These Transferors are called as B List Contributories.
- (b) **Liability:** Their liability is restricted to the amount not called up when the shares were transferred. They cannot be called upon to pay more than the entire face value of the share. For example, if Shares having Face Value ₹ 100 were paid up ₹ 60, the B List Contributory can be called up to pay a maximum of ₹ 40 only.

- (c) **Conditions:** Liability of B List Contributories will crystallize only (a) when the existing assets available with the liquidator are not sufficient to cover the liabilities; (b) when the existing shareholders fail to pay the amount due on the shares to the Liquidator.

V. Maintenance of Statutory Liquidity Ratio (SLR)

Section 24 and Section 56 of the Banking Regulation Act, 1949 – Maintenance of SLR and holdings of SLR in HTM category

It has been decided to reduce the SLR requirement of banks from 20.0 per cent of their Net Demand and Time Liabilities (NDTL) to 19.5 per cent from the fortnight commencing October 14, 2017 as announced in the Fourth Bi-monthly Monetary Policy Statement, 2017-18 on October 04, 2017. The related notification is DBR.No.Ret.BC.91/12.02.001/2017-18 dated October 4, 2017.

Currently, the banks are permitted to exceed the limit of 25 per cent of the total investments under HTM category, provided the excess comprises of SLR securities and total SLR securities held under HTM category are not more than 20.5 per cent of NDTL. In order to align this ceiling on the SLR holdings under HTM category with the mandatory SLR, it has been decided to reduce the ceiling from 20.5 per cent to 19.5 per cent in a phased manner, i.e. 20 per cent by December 31, 2017 and 19.5 per cent by March 31, 2018.

As per extant instructions, banks may shift investments to/from HTM with the approval of the Board of Directors once a year, and such shifting will normally be allowed at the beginning of the accounting year. In order to enable banks to shift their excess SLR securities from the HTM category to AFS/HFT to comply with instructions as indicated in paragraph 3 above, it has been decided to allow such shifting of the excess securities and direct sale from HTM category. This would be in addition to the shifting permitted at the beginning of the accounting year, i.e., in the month of April. Such transfer to AFS/HFT category as well as sale of securities from HTM category, to the extent required to reduce the SLR securities in HTM category in accordance with the regulatory instructions, would be excluded from the 5 per cent cap prescribed for value of sales and transfers of securities to/from HTM category under paragraph 2.3 (ii) of the Master Circular on Prudential Norms for Classification, Valuation and Operation of Investment Portfolio by Banks.

VI. 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.

VII. Relevant Provisions of the Insurance Act [updated as per the Insurance (Amendment) Act, 2015]

The provisions of sections 10 and 11 have been modified vide the Insurance Laws (Amendment) Act, 2015. These amendments have necessitated changes to the IRDA (Preparation of Financial Statements and Auditors' Report of Insurance Companies) Regulations 2002. The significant provisions are as follows:

- (1) Forms for final accounts [Section 11(1)]: Every insurer, on or after the date of the commencement of the Insurance Laws (Amendment) Act, 2015, in respect of insurance business transacted by him and in respect of his shareholders' funds, should, at the expiration of each financial year, prepare with reference to that year, balance sheet, a profit and loss account, a separate account of receipts and payments, a revenue account in accordance with the regulations as may be specified.
- (2) Audit [Section 12]: The balance sheet, profit and loss account, revenue account and profit and loss appropriation account of every insurer, in respect of all insurance business transacted by him, should, unless they are subject to audit under the Companies Act, 2013, be audited annually by an auditor, and the auditor should in the audit of all such accounts have the powers of, exercise the functions vested in, and discharge the duties and be subject to the liabilities and penalties imposed on, auditors of companies by Section 147 of the Companies Act, 2013.
- (3) Register of policies [Section 14(1)]: Every insurer, in respect of all business transacted by him, should maintain— (a) a record of policies, in which should be entered, in respect of every policy issued by the insurer, the name and address of the policyholder, the date when the policy was effected and a record of any transfer, assignment or nomination of which the insurer has notice; (b) a record of claims, every claim made together with the date of the claim, the name and address of the claimant and the date on which the claim was discharged, or, in the case of a claim which is rejected, the date of rejection and the grounds thereof; and (c) a record of policies and claims in accordance with clauses (a) and (b) may be maintained in any such form, including electronic mode, as may be specified by the regulations made under this Act.
- (4) Approved investments (Section 27B(1)): A company carrying on general insurance business must invest its funds only in approved securities listed in this section.
- (5) Payment of commission to authorized agents (Section 40(1)): As per the Insurance (Amendment) Act 2015, no person should, pay or contract to pay any remuneration or reward, whether by way of commission or otherwise for soliciting or procuring insurance business in India to any person except an insurance agent or an intermediary or insurance intermediary in such manner as may be specified by the regulations.

- (6) Limit on expenditure (Sections 40B and 40C): As per the Insurance (Amendment) Act 2015 No insurer should, in respect of insurance business transacted by him in India, spend as expenses of management in any financial year any amount exceeding the amount as may be specified by the regulations made under this Act and every insurer transacting insurance business in India should furnish to the Authority, the details of expenses of management in such manner and form as may be specified by the regulations made under this Act."
- (7) Sufficiency of assets [Section 64VA(1)]: Every insurer and re-insurer should at all times maintain an excess of value of assets over the amount of liabilities of, not less than fifty per cent. of the amount of minimum capital as stated under section 6 and arrived at in the manner specified by the regulations.
- (8) Segregation of Policyholders' and Shareholders' Funds by the insurers carrying on General Insurance, Health Insurance and Reinsurance business: Section 11 (2) of the Insurance Laws (Amendment) Act, 2015 mandates that every insurer shall keep separate funds of shareholders and policyholders.
- (9) Unearned Premium Reserve (UPR): A Reserve for Unearned Premium shall be created as the amount representing that part of the premium written which is attributable to, and is to be allocated to the succeeding accounting periods. Such Reserves shall be computed as under:
- Marine Hull: 100 percent of Net Written Premium during the preceding twelve months;
 - Other Segments: Insurers have an option to create UPR either at 50 percent of Net Written Premium of preceding twelve months or on the basis of 1/365th method on the unexpired period of the respective policies.
- The insurers can follow either percentage or 1/365th method for computation of UPR of the other segments. However, Insurers shall follow the method of provisioning of UPR in a consistent manner. Any change in the method of provisioning can be done only with the prior written approval of the Authority.
10. Recoupment of the Deficit: Every Insurer shall ensure that the policyholders' fund is fully supported by the policyholders' investments shown in Schedule-SA. Therefore, any deficit/shortfall in policyholders' investments arising out of the loss in the Revenue Account or otherwise shall be recouped by transfer of securities from the shareholders' investments to the policyholders' investments on a half yearly basis. The valuation of such securities shall be in accordance with the valuation norms as specified in the IRDA (Preparation of Financial Statements and Auditors' Report) Regulations, 2002.
11. Investment made out of the policyholders' funds: Investment made out of the policyholders' funds shall be shown in a separate schedule i.e., 8 A. The format of the same is given as below:

Annexure

SCHEDULE- 8A

INVESTMENTS-POLICYHOLDERS

Particulars	Current Year	Previous Year
	('000)	('000)
LONG TERM INVESTMENTS		
1. Government securities and Government guaranteed bonds including Treasury Bills		
2. Other Approved Securities		
3. Other Investments		
(a) Shares - i) Equity, ii) Preference		
(b) Mutual Funds		
(c) Debentures/ Bonds		
(d) Investment Property-Real Estate		
(e) Other Securities (to be specified)		
4. Investments in Infrastructure and Housing		
Sub-Total		
SHORT TERM INVESTMENTS		
1. Government securities and Government guaranteed bonds including Treasury Bills		
2. Other Approved Securities		
3. Other Investments		
(a) Shares- i) Equity ii) Preference		
(b) Mutual Funds		
(c) Debentures/ Bonds		
(d) Other Securities (to be specified)		
4. Investments in Infrastructure and Housing		
Sub-Total		
Total		

B. Not applicable for May, 2019 examination

Non-Applicability of Ind AS for May, 2019 Examination

The Ministry of Corporate Affairs has notified Companies (Indian Accounting Standards) Rules, 2015 on 16th February, 2015, for compliance by certain class of companies. These Ind AS are not applicable for May, 2019 Examination.

PART – II : QUESTIONS AND ANSWERS

QUESTIONS

Dissolution of partnership firm

1. A partnership firm was dissolved on 30th June, 2018. Its Balance Sheet on the date of dissolution was as follows:

Capitals:			Cash	21,600
A	1,52,000		Sundry Assets	3,78,400
B	96,000			
C	<u>72,000</u>	3,20,000		
Loan A/c – B		20,000		
Sundry Creditors		<u>60,000</u>		
		<u>4,00,000</u>		<u>4,00,000</u>

The assets were realized in instalments and the payments were made on the proportionate capital basis. Creditors were paid ₹ 58,000 in full settlement of their account. Expenses of realization were estimated to be ₹ 10,800 but actual amount spent was ₹ 8,000. This amount was paid on 15th September. Draw up a statement showing distribution of cash, which was realized as follows:

	₹
On 5 th July, 2018	50,400
On 30 th August, 2018	1,20,000
On 15 th September, 2018	1,60,000

The partners shared profits and losses in the ratio of 2 : 2 : 1. Prepare a statement showing distribution of cash amongst the partners by 'Highest Relative Capital' method.

Conversion of Partnership firms into a company

2. Arun and Varun, sharing profits and losses equally, directed to convert their business into a limited company on 31st December, 2018 when their balance sheet stood as follows:

Liabilities	₹	₹	Assets	₹
Sundry creditors		96,000	Sundry debtors	1,20,000
Loan creditors		80,000	Bills receivable	20,000
Bank overdraft		32,000	Stock in trade	72,000

Reserve fund		12,000	Patents	16,000
Capital accounts:			Plant and machinery	32,000
Arun	80,000		Land and building	1,20,000
Varun	<u>80,000</u>	<u>1,60,000</u>		
		<u>3,80,000</u>		<u>3,80,000</u>

- The goodwill of the firm was to be valued at two years' purchase of the profits of the previous three years.
- The loan creditors were agreed to accept 7½% redeemable preference shares in settlement of their claim.
- Land and buildings and plant and machinery were to be valued at ₹ 2,00,000 and ₹ 48,000 respectively.
- The vendors were to be allotted equity shares of the value of ₹ 2,10,000.
- The past working results of the firm showed that they had made profits of ₹ 60,000 in 2016, ₹ 72,000 in 2017 and ₹ 84,000 in 2018 after setting aside ₹ 4,000 to reserve fund each year.

You are required to show realisation account and partners' capital accounts in the books of the firm assuming that all the transactions are duly completed.

Sale of Partnership firm to Company

- 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 31.3.2017:

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	<u>3,00,000</u>	<u>13,00,000</u>			
	<u>10,00,000</u>	<u>40,00,000</u>		<u>10,00,000</u>	<u>40,00,000</u>

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.

LLP

4. What are circumstances when LLP can be wound up by the Tribunal. Explain in brief.

ESOPs

5. A company has its share capital divided into shares of ₹ 10 each. On 1-1-20X1, it granted 7,500 employees stock options at ₹ 50, when the market price was ₹ 140. The options were to be exercised between 1-3-20X2 to 31-03-20X2. The employees exercised their options for 7,200 shares only; remaining options lapsed. Pass the necessary journal entries for the year ended 31-3-20X2, with regard to employees' stock options.

Buy Back of Securities

6. Alpha Limited furnishes the following summarized Balance Sheet as at 31st March, 2017:

<i>Liabilities</i>	<i>(₹ in lakhs)</i>	<i>Assets</i>	<i>(₹ in lakhs)</i>
Equity share capital (fully paid up shares of ₹ 10 each)	2,400	Machinery	3,600
Securities premium	350	Furniture	450
General reserve	530	Investment	148
Capital redemption reserve	400	Inventory	1,200
Profit & loss A/c	340	Trade receivables	500
12% Debentures	1,500	Cash at bank	1,500
Trade payables	1,400		
Other current liabilities	478		
	<u>7,398</u>		<u>7,398</u>

On 1st April, 2017, the company announced the buy back of 25% of its equity shares @ ₹ 15 per share. For this purpose, it sold all of its investments for ₹ 150 lakhs.

On 5th April, 2017, the company achieved the target of buy back.

You are required to:

- (1) Pass necessary journal entries for the buy-back.
- (2) Prepare Balance Sheet of Alpha Limited after buy-back of the shares.

Redemption of Debentures

7. On 1st January, 2008 Raman Ltd. allotted 20,000 9% Debentures of ₹ 100 each at par, the total amount having been received along with applications.
 - (i) On 1st January, 2010 the Company purchased in the open market 2,000 of its own debentures @ ₹ 101 each and cancelled them immediately.
 - (ii) On 1st January, 2013 the company redeemed at par debentures for ₹ 6,00,000 by draw of a lot.
 - (iii) On 1st January, 2014 the company purchased debentures of the face value of ₹ 4,00,000 for 3,95,600 in the open market, held them as investments for one year and then cancelled them.
 - (iv) Finally, as per resolution of the board of directors, the remaining debentures were redeemed at a premium of 2% on 1st January, 2018 when Securities Premium Account in the company's ledger showed a balance of ₹ 60,000.

Pass journal entries for the above mentioned transactions ignoring debenture redemption reserve, debenture - interest and interest on own' debentures.

Underwriting of Shares

8. A joint stock company resolved to issue 10 lakh equity shares of ₹ 10 each at a premium of ₹ 1 per share. One lakh of these shares were taken up by the directors of the company, their relatives, associates and friends, the entire amount being received forthwith. The remaining shares were offered to the public, the entire amount being asked for with applications.

The issue was underwritten by X, Y and Z for a commission @2% of the issue price, 65% of the issue was underwritten by X, while Y's and Z's shares were 25% and 10% respectively. Their firm underwriting was as follows :

X 30,000 shares, Y 20,000 shares and Z 10,000 shares. The underwriters were to submit unmarked applications for shares underwritten firm with full application money along with members of the general public.

Marked applications were as follows:

X 1,19,500 shares, Y 57,500 shares and Z 10,500 shares.

Unmarked applications totaled 7,00,000 shares.

Accounts with the underwriters were promptly settled.

You are required to prepare a statement calculating underwriters' liability for shares other than shares underwritten firm.

Amalgamation of Companies

9. P Ltd. and Q Ltd. decided to amalgamate as on 01.04.2018 Their summarized Balance Sheets as on 31.03.2018 were as follows: (₹ in '000)

Particulars	P Ltd.	Q Ltd.
Source of Funds:		
Equity share capital (₹10 each)	300	280
9% preference share Capital (₹100 each)	60	40
Investment allowance Reserve	10	4
Profit and Loss Account	68	68
10 % Debentures	100	60
Trade Payables	50	30
Tax provision	<u>14</u>	<u>8</u>
Total	<u>602</u>	<u>490</u>
Application of Funds:		
Building	120	100
Plant and Machinery	160	140
Investments	80	50
Trade receivables	90	70
Inventories	72	80
Cash and Bank	<u>80</u>	<u>50</u>
Total	<u>602</u>	<u>490</u>

From the following information, you are required to prepare the Balance Sheet as on 01.04.2018 of a new company, R Ltd., which was formed to take over the business of both the companies and took over all the assets and liabilities:

- (i) 50 % Debenture are to be converted into Equity Shares of the New Company.
- (ii) Investments are non-current in nature.
- (iii) Fixed Assets of P Ltd. were valued at 10% above cost and that of Q Ltd. at 5% above cost.

- (iv) 10 % of trade receivables were doubtful for both the companies. Inventories to be carried at cost.
- (v) Preference shareholders were discharged by issuing equal number of 9% preference shares at par.
- (vi) Equity shareholders of both the transferor companies are to be discharged by issuing Equity shares of ₹10 each of the new company at a premium of ₹ 5 per share.

Give your answer on the basis that amalgamation is in the nature of purchase.

Internal Reconstruction of a Company

10. The Balance Sheet of Lion Limited as on 31-03-2018 is given below:

<i>Particulars</i>	<i>Note No.</i>	<i>Amount (₹ in lakh)</i>
<u>Equity & Liabilities</u>		
<u>Shareholders' Funds</u>		
Shares' Capital	1	1,400
Reserves & Surplus	2	(522)
<u>Non-Current Liabilities</u>		
Long term Borrowings	3	700
<u>Current Liabilities</u>		
Trade Payables	4	102
Other Liabilities	5	24
Total		1704
<u>Assets</u>		
<u>Non-Current Assets</u>		
<u>Property, Plant & Equipment</u>		
Tangible Assets	6	750
<u>Current Assets</u>		
Current Investments	7	200
Inventories	8	300
Trade Receivables	9	450
Cash & Cash Equivalents	10	4
Total		1704

Notes to Accounts:

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

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

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

You are required to:

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

Liquidation of Company

11. The following is the summarized Balance Sheet of Shah Ltd. Co. which is in the hands of the liquidator:

Balance Sheet as at 31.3.2017

<i>Liabilities</i>	₹	<i>Assets</i>	₹
Share Capital:		Fixed assets	2,00,000
1,000, 6% Preference Shares of ₹ 100 each, fully paid	1,00,000	Inventory	1,20,000
2,000 Equity shares of ₹ 100 each, fully paid	2,00,000	Book debts	2,40,000
2,000 Equity shares of ₹ 100 each ₹ 75 paid up	1,50,000	Cash in hand	40,000
		Profit and loss A/c	3,00,000

Loan from bank (on security of stock)	1,00,000		
Trade Payables	<u>3,50,000</u>		
	<u>9,00,000</u>		<u>9,00,000</u>

The assets realized the following amounts (after all costs of realization and liquidator's commission amounting to ₹ 5,000 paid out of cash in hand).

	₹
Fixed assets	1,68,000
Inventory	1,10,000
Trade Receivables	2,30,000

Calls on partly paid shares were made but the amounts due on 200 shares were found to be irrecoverable.

You are required to prepare Liquidator's Final Statement of Receipts and Payments.

Financial Statements of Insurance Companies

12. From the following balances extracted from the books of REAL General Insurance Company Ltd. as on 31st March, 2017, you are required to prepare Revenue Accounts in respect of Fire and Marine Insurance Business for the year ended 31st March, 2017.

Particulars	Fire ₹	Marine ₹
Outstanding Claim as on 1 st April, 2016	28,000	7,000
Claims Paid	1,00,000	80,000
Reserved for unexpired Risk as on 1 st April 2016	2,00,000	1,40,000
Premium Received	4,50,000	3,30,000
Agent's Commission	40,000	20,000
Expenses of management	60,000	45,000
Re Insurance Premium –Dr.	25,000	15,000

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

- (1) Claims outstanding as on 31st March 2017 were as follows:
 - (a) Fire Insurance - ₹ 10,000
 - (b) Marine Insurance - ₹ 15,000
- (2) Premium outstanding as on 31st March, 2017 were as follows:
 - (a) Fire Insurance - ₹ 30,000
 - (b) Marine Insurance - ₹ 20,000

- (3) Reserve for unexpired risk to be maintained at 50% and 100% of net premiums in respect of Fire & Marine Insurance respectively.
- (4) Expenses of management due on 31st March, 2017 were ₹ 10,000 for Fire Insurance and ₹ 5,000 in respect of Marine Insurance.

Financial Statements of Banking Companies

13. From the following information of Wealth Bank Limited, Prepare Profit and Loss Account for the year ended 31st March, 2018:

Particulars	₹ in lakhs	Particulars	₹ in lakhs
Interest on Cash Credit	364	Interest paid on Recurring Deposits	17
Interest on Overdraft	150	Interest paid on Savings Bank Deposits	12
Interest on Term Loans	308	Auditor's Fees and Allowances	24
Income on Investments	168	Directors' Fees and Allowance	50
Interest on Balance with RBI	30	Advertisement	36
Commission on remittances and transfer	15	Salaries, allowances and bonus to employees	248
Commission on Letters of Credit	24	Payment to Provident Fund	56
Commission on Government Business	16	Printing & Stationery	28
Profit on Sale of Land & Building	5	Repairs & Maintenance	10
Loss on exchange transactions	10	Postage, courier & telephones	16
Interest paid on Fixed Deposits	25		

Other Information:

		₹ in lakhs	
		Earned	Collected
(i)	Interest on NPA is as follows:		
	Cash Credit	164	80
	Term Loans	90	20
	Overdraft	150	50

(ii)	Classification of Non-performing Advances:		
	Standard		60
	Sub-standard-fully secured		22
	Doubtful assets-fully unsecured		40
	Doubtful assets covered fully by security:		
	Less than 1 year		6
	More than 1 year upto 3 years		3
	More than 3 years		2
	Loss Assets		38

(iii) Provide 35% of the profits towards provision for taxation.

(iv) Transfer 25% of the profit to Statutory Reserves.

Departmental Accounts

14. The following balances were extracted from the books of M/s Division. You are required to prepare Departmental Trading Account and Profit and Loss account for the year ended 31st December, 2018 after adjusting the unrealized department profits if any.

	Deptt. A ₹	Deptt. B ₹
Opening Stock	50,000	40,000
Purchases	6,50,000	9,10,000
Sales	10,00,000	15,00,000

General expenses incurred for both the departments were ₹ 1,25,000 and you are also supplied with the following information: (a) Closing stock of Department A ₹ 1,00,000 including goods from Department B for ₹ 20,000 at cost of Department A. (b) Closing stock of Department B ₹ 2,00,000 including goods from Department A for ₹ 30,000 at cost to Department B. (c) Opening stock of Department A and Department B include goods of the value of ₹ 10,000 and ₹ 15,000 taken from Department B and Department A respectively at cost to transferee departments. (d) The rate of gross profit is uniform from year to year.

Branch Accounting

15. M/s ABC & Co. has head office at New York (U.S.A.) and branch in Bangalore (India). Bangalore branch is an integral foreign operation of ABC & Co.

Bangalore branch furnishes you with its trial balance as on 31st March, 2018 and the additional information given thereafter:

	Dr.	Cr.
	(Rupees in thousands)	
Stock on 1 st April, 2017	300	
Purchases and Sales	800	1,200
Sundry Debtors & Creditors	400	300
Bills of Exchange	120	240
Wages & Salaries	560	-
Rent, Rates & Taxes	360	-
Sundry Charges	160	-
Computers	240	-
Bank Balance	420	-
New York Office A/c	-	1,620
	<u>3,360</u>	<u>3,360</u>

Additional Information:

- (a) Computers were acquired from a remittance of US \$ 6,000 received from New York head office and paid to the suppliers. Depreciate computers at 60% for the year.
- (b) Unsold stock of Bangalore branch was worth ₹ 4,20,000 on 31st March, 2018.
- (c) The rates of exchange may be taken as follows:
 - On 01.04.2017 @ ₹ 55 per US \$
 - On 31.03.2018 @ ₹ 60 per US \$
 - Average exchange rate for the year @ ₹ 58 per US \$
 - Conversion in \$ shall be made up to two decimal accuracy.

You are asked to prepare in US dollars the revenue statement for the year ended 31st March, 2018 and the balance sheet as on that date of Bangalore branch as would appear in the books of New York head office of ABC & Co. You are informed that Bangalore branch account showed a debit balance of US \$ 29845.35 on 31.3.2018 in New York books and there were no items pending reconciliation.

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?

Accounting Standards**AS 4 Contingencies and Events Occurring after the Balance Sheet Date**

17. (a) The Board of Directors of New Graphics Ltd. in its Board Meeting held on 18th April, 2017, considered and approved the Audited Financial results along with Auditors Report for the Financial Year ended 31st March, 2017 and recommended a dividend of ₹ 2 per equity share (on 2 crore fully paid up equity shares of ₹ 10 each) for the year ended 31st March, 2017 and if approved by the members at the forthcoming Annual General Meeting of the company on 18th June, 2017, the same will be paid to all the eligible shareholders.

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

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

- (b) Goods of ₹ 5,00,000 were destroyed due to flood in September, 2015. A claim was lodged with insurance company, but no entry was passed in the books for insurance claim.

In March, 2018, the claim was passed and the company received a payment of ₹ 3,50,000 against the claim. Explain the treatment of such receipt in final accounts for the year ended 31st March, 2018.

AS 12 Accounting for Government Grants

18. (a) Viva Ltd. received a specific grant of ₹ 30 lakhs for acquiring the plant of ₹ 150 lakhs during 2014- 15 having useful life of 10 years. The grant received was credited to deferred income in the balance sheet and was not deducted from the cost of plant. During 2017-18, due to non-compliance of conditions laid down for the grant, the company had to refund the whole grant to the Government. Balance in the deferred income on that date was ₹ 21 lakhs and written down value of plant was ₹ 105 lakhs. What should be the treatment of the refund of the grant and the effect on cost of the fixed asset and the amount of depreciation to be charged during the year 2017-18 in profit and loss account?

AS 16 Borrowing Costs

- (b) Zen Bridge Construction Limited obtained a loan of ₹ 64 crores to be utilized as under:

(i)	Construction of Hill link road in Kedarnath	₹ 50 crores
(ii)	Purchase of Equipment and Machineries	₹ 6 crores
(iii)	Working Capital	₹ 4 crores
(iv)	Purchase of Vehicles	₹ 1 crore

(v)	Advances for tools/cranes etc.	₹ 1crore
(vi)	Purchase of Technical Know how	₹ 2 crores
(vii)	Total Interest charged by the Bank for the year ending 31 st March, 2018	₹ 1.6 crores

Show the treatment of Interest according to Accounting Standard by Zen Bridge Construction Limited.

AS 19 Leases

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

You are required to comment with reason whether the lease constitute finance lease or operating lease. If it is finance lease, calculate unearned finance income.

AS 20 Earnings Per Share

- (b) “While calculating diluted EPS, effect is given to all dilutive potential equity shares that were outstanding during the period.” Explain this statement in the light of relevant AS.

Also calculate the diluted EPS from the following information:

Net Profit for the current year (After Tax)	₹ 1,00,00,000
No. of Equity shares outstanding	10,00,000
No. of 10% Fully Convertible Debentures of ₹ 100 each (Each Debenture is compulsorily & fully convertible into 10 equity shares)- issued at the mid of the year	1,00,000
Debenture interest expense for the current year	₹ 5,00,000
Assume applicable Income Tax rate @ 30%	

AS 26 Intangible Assets

- 20 (a) A Company with a turnover of ₹ 375 crores and an annual advertising budget of ₹ 3 crores had taken up the marketing of a new product. It was estimated that the company would have a turnover of ₹ 37.5 crores from the new product. The company had debited to its Profit and Loss account the total expenditure of ₹ 3 crores incurred on extensive special initial advertisement campaign for the new product.

Is the procedure adopted by the Company correct?

AS 29 Provisions, Contingent Liabilities and Contingent Assets

- (b) M/s. XYZ Ltd. is in a dispute with a competitor company. The dispute is regarding alleged infringement of Copyrights. The competitor has filed a suit in the court of law seeking damages of ₹ 200 lacs.

The Directors are of the view that the claim can be successfully resisted by the Company.

How would the matter be dealt in the annual accounts of the Company in the light of AS 29? Explain in brief giving reasons for your answer.

SUGGESTED ANSWERS/HINTS**1. Statement showing distribution of cash amongst the partners**

	<i>Creditors</i>	<i>B's loan</i>	<i>A</i>	<i>B</i>	<i>C</i>
2018	₹	₹	₹	₹	₹
Jun-30					
Balance b/d	60,000	20,000	1,52,000	96,000	72,000
Cash balance less Provision for expenses (₹ 21,600– ₹ 10,800)	10,800	-	-	-	-
Balances unpaid	49,200	20,000	1,52,000	96,000	72,000
Jul-05					
1 st Instalment of ₹ 50,400	47,200	3,200	-	-	-
Discount received on full settlement	2,000	16,800	1,52,000	96,000	72,000
Less: Transferred to Realisation A/c	2,000				
Aug-30					
2 nd instalment of ₹ 1,20,000 (W.N. 2)		16,800	65,280	9,280	28,640
Balance unpaid			86,720	86,720	43,360
Sep-15					
Amount realised ₹ 1,60,000					
Add: Balance out of the Provision for Expenses A/c					
			2,800		
			1,62,800		
Amount unpaid being loss on Realisation in the ratio of 2 : 2 : 1			21,600	21,600	10,800

Working Notes:

1. Highest relative capital basis

		A	B	C
		₹	₹	₹
1.	Present Capitals	1,52,000	96,000	72,000
2.	Profit-sharing ratio	<u>2</u>	<u>2</u>	<u>1</u>
3.	Capital per unit of Profit share (1 ÷ 2)	<u>76,000</u>	<u>48,000</u>	<u>72,000</u>
4.	Proportionate capitals taking B, whose capital is the least, as the basis	96,000	96,000	48,000
5.	Excess capital (1-4)	56,000	Nil	24,000
6.	Profit-sharing ratio	<u>2</u>	<u>-</u>	<u>1</u>
7.	Excess capital per unit of Profit share (5 ÷ 6)	28,000		24,000
8.	Proportionate capitals as between A and C taking C capital as the basis	48,000	-	24,000
9.	Excess of A's Capital over C's Excess capital (5-8)	8,000	-	-
10.	Balance of Excess capital (5-9)	48,000		24,000
11.	Distribution sequence:			
	First ₹ 8,000 (2 : 0 : 0)	8,000	-	-
	Next ₹ 72,000 (2 : 0 : 1)	48,000	-	24,000
	Over ₹ 80,000 (2 : 2 : 1)			

2. Distribution of Second instalment

		Creditors	A	B	C
First	₹ 16,800	16,800	-	-	-
Next	₹ 8,000 (2 : 0 : 0)		8,000	-	-
Next	₹ 72,000 (2 : 0 : 1)		48,000	-	24,000
Balance	<u>₹ 23,200</u> (2 : 2 : 1)		9,280	9,280	4,640
	1,20,000	16,800	65,280	9,280	28,640

2.

Books of Arun and Varun

Realisation Account

	₹	₹		₹
To Sundry debtors		1,20,000	By Sundry creditors	96,000

To Bills receivable		20,000	By Loan creditors	80,000
To Stock in trade		72,000	By Bank overdraft	32,000
To Patents		16,000	By Purchasing Company	4,20,000
To Plant and Machinery		32,000	(W.N. 2)	
To Land and Building		1,20,000		
To Capital A/c (Profit)				
Arun	1,24,000			
Varun	<u>1,24,000</u>	<u>2,48,000</u>		
		6,28,000		<u>6,28,000</u>

Partners' Capital Accounts

	Arun	Varun		Arun	Varun
	₹	₹		₹	₹
To Shares in Purchasing Co.	2,10,000	2,10,000	By Balance b/d	80,000	80,000
			By Reserves	6,000	6,000
			By Realization A/c	<u>1,24,000</u>	<u>1,24,000</u>
	<u>2,10,000</u>	<u>2,10,000</u>		<u>2,10,000</u>	<u>2,10,000</u>

Working Notes

1. Goodwill = $(60,000 + 72,000 + 84,000 + 12,000^*)/3 \times 2 \text{ Years} = 1,52,000$

* Profit transferred to reserve @ ₹4,000 for 3 years.

2.

Purchase Consideration

	₹	₹
Assets taken over:		
Goodwill (W.N.1)		1,52,000
Land and Buildings		2,00,000
Plant and Machinery		48,000
Sundry Debtors		1,20,000
Bills Receivable		20,000
Stock in trade		72,000
Patents		<u>16,000</u>
		6,28,000
Less: Liabilities taken over:		
Creditors	96,000	
Loan Creditors	80,000	

Bank Overdraft	32,000	2,08,000
Purchase Consideration		<u>4,20,000</u>

3. (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 Inventories	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	<u>10,000</u>
	<u>9,50,000</u>		<u>9,50,000</u>

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	<u>20,000</u>	-	<u>10,000</u>
	<u>2,60,000</u>	<u>3,40,000</u>	<u>1,30,000</u>		<u>2,60,000</u>	<u>3,40,000</u>	<u>1,30,000</u>

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	<u>10,000</u>				
	<u>80,000</u>	<u>10,000</u>		<u>80,000</u>	<u>10,000</u>

* 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.

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

			Dr. (₹)	Cr. (₹)
1.	Business Purchase Account To XYZ & Co. (Being business of XYZ & Co. purchased and payment due)	Dr.	6,00,000	6,00,000
2.	Plant and Machinery Account Furniture and Fixture Account Inventories Account Trade Receivables Account To Trade Payables Account To Unrecorded Liability Account To Business Purchase Account To Capital Reserve Account (Bal. Fig.) (Being take over of all assets and liabilities)	Dr. Dr. Dr. Dr.	5,00,000 50,000 2,00,000 2,00,000	3,00,000 25,000 6,00,000 25,000
3.	XYZ & Co. To Equity Share Capital Account To Securities Premium Account (Being purchase consideration discharged in the form of shares of ₹ 10 each issued at a premium of ₹ 2 each)	Dr.	6,00,000	5,00,000 1,00,000
4.	Trade Payables Account To Trade Receivables Account (Being mutual owings eliminated)	Dr.	1,00,000	1,00,000

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

as at 31.3.2017

	Note No.	₹
Equity and Liabilities		
<i>Shareholders funds</i>		
Share capital	1	25,00,000
Reserve and Surplus	2	8,25,000
<i>Current liabilities</i>		

Trade Payables (3,00,000 + 13,00,000 – 1,00,000)		15,00,000
Others (Unrecorded Liability)		<u>25,000</u>
Total		<u>48,50,000</u>
Assets		
<i>Non-current assets</i>		
Property, Plant & Equipment		
Tangible assets	3	23,75,000
<i>Current assets</i>		
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	<u>5,00,000</u>
Total		<u>48,50,000</u>

Notes to Accounts

		₹
1. <i>Share Capital</i>		
2,50,000, Equity shares of ₹ 10 each fully paid up (out of which 50,000 shares has been issued for consideration other than cash)		25,00,000
2. <i>Reserve and Surplus</i>		
Securities Premium	1,00,000	
Capital Reserve	25,000	
General Reserve	<u>7,00,000</u>	8,25,000
3. <i>Tangible assets</i>		
Plant and Machinery (5,00,000 + 16,00,000)	21,00,000	
Furniture and fixture (50,000 + 2,25,000)	<u>2,75,000</u>	23,75,000
4. <i>Cash and cash equivalent</i>		
Cash at Bank	4,00,000	
Cash in hand	<u>1,00,000</u>	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

4. Under section 64 of the LLP Act, 2008, an LLP may be wound up by the Tribunal:
- 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. **In the books of Company**

Journal Entries

Date	Particulars	Dr. ₹	Cr. ₹
1-3-X2 to 31-3-X2	Bank A/c (7,200 x 50) Dr. Employees compensation expenses A/c Dr. To Equity Share Capital A/c (7,200 x 10) To Securities Premium A/c (7,200 x Rs.130) (Being allotment to employees 7,200 shares of ₹ 10 each at a premium of ₹ 130 at an exercise price of ₹ 50 each)	3,60,000 6,48,000	72,000 9,36,000
31-3-X2	Profit and Loss account Dr. To Employees compensation expenses A/c (Being transfer of employees compensation expenses)	6,48,000	6,48,000

Working Note:

1. Employee Compensation Expenses = Discount between Market Price and option price = ₹ 140 – ₹ 50 = ₹ 90 per share = ₹ 90 x 7,200 = ₹ 6,48,000 in total.
2. Securities Premium Account = ₹ 50 – ₹ 10 = ₹ 40 per share + ₹ 90 per share on account of discount of option price over market price = ₹ 130 per share = ₹ 130 x 7,200 = ₹ 9,36,000 in total.

6. **In the books of Alpha Limited**
Journal Entries

<i>Date 2017</i>	<i>Particulars</i>	<i>Dr.</i>	<i>Cr.</i>
			<i>(₹ in lakhs)</i>
April 1	Bank A/c Dr. To Investment A/c To Profit on sale of investment (Being investment sold on profit)	150	148 2
April 5	Equity share capital A/c Dr. Securities premium A/c Dr. To Equity shares buy back A/c (Being the amount due to equity shareholders on buy back)	600 300	900
	Equity shares buy back A/c Dr. To Bank A/c (Being the payment made on account of buy back of 60 Lakh Equity Shares)	900	900
April 5	General reserve A/c Dr. Profit and Loss A/c Dr. To Capital redemption reserve A/c (Being amount equal to nominal value of bought back shares from free reserves transferred to capital redemption reserve account as per the law)	530 70	600

Balance Sheet (After buy back)

<i>Particulars</i>	<i>Note No</i>	<i>Amount (₹ in Lakhs)</i>
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	1,800
(b) Reserves and Surplus	2	1,322
(2) Non-Current Liabilities		
(a) Long-term borrowings - 12% Debentures		1,500
(3) Current Liabilities		
(a) Trade payables		1,400
(b) Other current liabilities		478

		Total	6,500
II. Assets			
(1) Non-current assets			
(a) Property, Plant & Equipment			
(i) Tangible assets	3	4,050	
(2) Current assets			
(a) Current investments			1,200
(b) Inventory			5,00
(c) Trade receivables			750
(d) Cash and cash equivalents (W.N.)			750
	Total		6,500

Notes to Accounts

			₹ (₹ in Lakhs)
1. Share Capital			
Equity share capital (Fully paid up shares of ₹10 each)			1800
2. Reserves and Surplus			
General Reserve	530		
Less: Transfer to CRR	<u>(530)</u>	-	
Capital Redemption Reserve	400		
Add: Transfer due to buy-back of shares from P/L	70		
Transfer due to buy-back of shares from Gen. res.	<u>530</u>	1,000	
Securities premium	350		
Less: Adjustment for premium paid on buy back	<u>(300)</u>	50	
Profit & Loss A/c	340		
Add: Profit on sale of investment	2		
Less: Transfer to CRR	<u>(70)</u>	<u>272</u>	1,322
3. Tangible assets			
Machinery		3,600	
Furniture		<u>450</u>	4,050

Working Note:

Cash at bank after buy-back

	<i>₹ in lakhs</i>
Cash balance as on 1 st April, 2017	1,500
Add: Sale of investments	<u>150</u>
	1,650
Less: Payment for buy back of shares	<u>(900)</u>
	<u>750</u>

7.

Journal

		(₹) Dr.	(₹) Cr.
2008 Jan 1	Bank Dr. To 9% Debenture Applications & Allotment Account (Being application money on 20,000 debentures @ ₹ 100 per debenture received)	20,00,000	20,00,000
	9% Debentures Applications & Allotment Account Dr. To 9% Debentures Account (Being allotment of 20,000 9% Debentures of ₹100 each at par)	10,00,000	20,00,000
(i) 2010 Jan. 1	9% Debenture Account Dr. Loss on Redemption of Debentures Account Dr. To Bank (Being redemption of 2,000 9% Debentures of ₹100 each by purchase in the open market @ ₹101 each)	2,00,000 2,000	2,02,000
" "	Profit & Loss Account/Securities Premium Account Dr. To Loss on Redemption of Debentures Account (Being loss on redemption of debentures being written off by transfer to Profit and Loss Account or Securities Premium Account)	2,000	2,000
(ii) 2013 Jan. 1	9% Debentures Account Dr. To Sundry Debentureholders (Being Amount payable to debentureholders on redemption debentures for ₹6,00,000 at par by draw of a lot)	6,00,000	6,00,000
" "	Sundry Debentureholders Dr. To Bank (Being Payment made to sundry debentureholders for redeeming debentures of ₹6,00,000 at par)	6,00,000	6,00,000

(iii) 2014 Jan. 1	Own Debentures To Bank (Being purchase of own debentures of the face value of ₹4,00,000 for ₹3,95,600)	Dr.	3,95,600	3,95,600
2015 "	9% Debentures To Own Debentures To Profit on Cancellation of Own Debentures Account (Being Cancellation of own debentures of the face value of ₹4,00,000 purchased last year for ₹3,95,600)	Dr.	4,00,000	3,95,600 4,400
" "	Profit on Cancellation of Own Debentures Account To Capital Reserve Account (Being transfer of profit on cancellation of own debentures to capital reserve)	Dr.	4,400	4,400
(iv) 2018 Jan.	9% Debentures Account Premium on Redemption of Debentures Account To Sundry Debentureholders (Being amount payable to holders of debentures of the face value of ₹ 8,00,000 on redemption at a premium of 2% as per resolution of the board of directors)	Dr. Dr.	8,00,000 16,000	8,16,000
" "	Sundry Debentureholders To Bank Account (Being payment to sundry debentureholders)	Dr.	8,16,000	8,16,000
" "	Securities Premium Account To Premium on Redemption of Debentures Account (Being utilisation of a part of the balance in Securities Premium Account to write off premium paid on redemption of debentures)	Dr.	16,000	16,000

8. Statement showing underwriters' liability for shares other than shares underwritten firm

	X	Y	Z	Total
Gross liability (Issued shares – purchased by promoters, directors etc.) (9,00,000 shares in the ratio of 65 : 25 : 10)	5,85,000	2,25,000	90,000	9,00,000
Less: Marked applications	(1,19,500)	(57,500)	(10,500)	(1,87,500)
	4,65,500	1,67,500	79,500	7,12,500

Less: Allocation of unmarked applications (including firm underwriting i.e. 7,00,000) in the ratio 65 : 25 : 10	<u>(4,55,000)</u>	<u>(1,75,000)</u>	<u>(70,000)</u>	<u>(7,00,000)</u>
	10,500	(7,500)	9,500	12,500
Surplus of Y allocated to X and Z in the ratio 65 : 10	<u>(6,500)</u>	<u>7,500</u>	<u>(1,000)</u>	<u>—</u>
Additional shares to be purchased by X & Z	<u>4,000</u>	<u>—</u>	<u>8,500</u>	<u>12,500</u>

	₹	₹	₹
Additional Liability for additional shares @ ₹11	44,000	—	93,500
Underwriting commission payable on Gross Liability (Shares underwritten as Gross liability × ₹11 × 2%)	<u>(1,28,700)</u>	<u>(49,500)</u>	<u>(19,800)</u>
Net Amount payable	(84,700)	(49,500)	-
Net Amount receivable	-	-	73,700

9.

M/s R Ltd.

Balance Sheet as at 1.4.2018

	Particulars	Notes	₹ in'000
	Equity and Liabilities		
1	Shareholders' funds		
a	Share capital	1	6,55,980
b	Reserves and Surplus	2	2,77,990
2	Non-current liabilities		
a	Long-term borrowings	3	80,000
3	Current liabilities		
a	Trade Payables	4	80,000
b	Short term provision	5	<u>22,000</u>
	Total		<u>11,15,970</u>
	Assets		
1	Non-current assets		
a	Property, Plant & Equipment		
	Tangible assets	6	5,60,000
b	Non-current investments	7	1,30,000

2	Current assets		
a	Inventory	8	1,52,000
b	Trade receivables	9	1,44,000
c	Cash and cash equivalents	10	1,29,970
	Total		<u>11,15,970</u>

Notes to accounts

		₹ in'000
1.	Share Capital	
	Equity share capital	
	55,598 Equity shares of ₹10 each, fully paid up (W.N.2)	5,55,980
	Preference share capital	
	9% Preference share capital (Share of ₹100 each) (W.N.2)	1,00,000
		<u>6,55,980</u>
2.	Reserves and Surplus	
	Securities premium (W.N.2)	2,77,990
	Investment allowance reserve (₹10,000+ ₹4,000)	14,000
	Amalgamation adjustment reserve	(14,000)
		<u>2,77,990</u>
3.	Long-term borrowings	
	Secured	
	10% Debentures (50% of ₹1,60,000)	80,000
4.	Trade Payables (₹50,000+ ₹30,000)	80,000
5.	Short term provisions	
	Provision for tax (₹14,000+ ₹8,000)	22,000
6.	Tangible assets	
	Building (₹1,32,000+₹1,05,000)	2,37,000
	Plant and machinery (₹1,76,000+₹1,47,000)	<u>3,23,000</u>
		<u>5,60,000</u>

7. Non – current Investments (₹80,000+ ₹50,000)	1,30,000
8. Inventory	
Stock (₹ 72,000+ ₹ 80,000)	1,52,000
9. Trade receivables	
Trade receivables (90% of (₹90,000+ ₹70,000))	1,44,000
10. Cash and cash equivalents	
Cash and Bank (₹ 80,000+ ₹ 50,000 – ₹ 30)	1,29,970

Working Notes:

1. Calculation of value of equity shares issued to transferor companies

		P Ltd.		Q Ltd.
		(₹)		(₹)
Assets taken over:				
Building		1,32,000		1,05,000
Plant and machinery		1,76,000		1,47,000
Investments		80,000		50,000
Inventories		72,000		80,000
Trade receivables		81,000		63,000
Cash & Bank		<u>80,000</u>		<u>50,000</u>
		6,21,000		4,95,000
Less: Liabilities:				
10% Debentures	1,00,000		60,000	
Trade payables	50,000		30,000	
Tax Provision	<u>14,000</u>	<u>1,64,000</u>	<u>8,000</u>	<u>98,000</u>
		4,57,000		3,97,000
Less: Preference Share Capital		<u>60,000</u>		<u>40,000</u>
		<u>3,97,000</u>		<u>3,57,000</u>

2. Number of shares issued to equity shareholders, debenture holders and preference shareholders

	P Ltd.	Q Ltd.	Total
Equity shares issued @ ₹15 per share (including ₹ 5 premium)			
₹3,97,000/15	26,466 shares ²		

² Cash paid for fraction of shares = ₹ 3,97,000 less ₹ 3,96,990 = ₹10

₹3,57,000/15		23,800 shares	50,266 shares
Equity share capital @ ₹10	₹2,64,660	₹2,38,000	₹5,02,660
Securities premium @ ₹5	<u>₹1,32,330</u>	<u>₹1,19,000</u>	<u>₹2,51,330</u>
	₹3,96,990	₹3,57,000	₹7,53,990
<i>50% of Debentures are converted into equity shares @ ₹15 per share</i>			
1,00,000/2 = 50,000/15	3,332 shares ³		
60,000/2 = 30,000/15		2,000 shares	5,332 shares
Equity share capital @ ₹10	₹33,320	₹20,000	₹53,320
Security premium @ ₹5	<u>₹16,660</u>	<u>₹10,000</u>	<u>₹26,660</u>
	<u>₹49,980</u>	<u>₹30,000</u>	<u>₹79,980</u>
9% Preference share capital issued	₹60,000	₹40,000	₹1,00,000

10. (a)

Journal Entries in the books of Lion Ltd.

	Particulars	Debit (₹ in lakhs)	Credit (₹ in lakhs)
(i)	8% Preference share capital A/c (₹100 each) Dr.	400	
	To 8% Preference share capital A/c (₹80 each)		320
	To Capital Reduction A/c		80
	(Being the preference shares of ₹100 each reduced to ₹80 each as per the approved scheme)		
(ii)	Equity share capital A/c (₹10 each) Dr.	1,000	
	To Equityshare capital A/c (₹2 each)		200
	To Capital Reduction A/c		800
	(Being the equity shares of ₹10 each reduced to ₹2 each)		
(iii)	Capital Reduction A/c Dr.	32	

³ Cash paid for fraction of shares = ₹50,000 less ₹49,980 = ₹20

	To Equity share capital A/c (₹2 each) (Being 1/3 rd arrears of preference share dividend of 3 years to be satisfied by issue of 16 lakhs equity shares of ₹ 2 each)			32
(iv)	6% Debentures A/c	Dr.	300	
	To Freehold property A/c (Being claim of Debenture holders settled in part by transfer of freehold property)			300
(v)	Accrued debenture interest A/c	Dr.	24	
	To Bank A/c (Being accrued debenture interest paid)			24
(vi)	Freehold property A/c	Dr.	150	
	To Capital Reduction A/c (Being appreciation in the value of freehold property)			150
(vii)	Bank A/c	Dr.	250	
	To Investments A/c			200
	To Capital Reduction A/c (Being investment sold at profit)			50
(viii)	Director's loan A/c	Dr.	300	
	To Equity share capital A/c (₹ 2 each)			90
	To Capital Reduction A/c (Being director's loan waived by 70% and balance being discharged by issue of 45 lakhs equity shares of ₹2 each)			210
(ix)	Capital Reduction A/c	Dr.	972	
	To Profit and loss A/c			522
	To Trade receivables A/c (450x 40%)			180
	To Inventories-in-trade A/c (300x 80%)			240
	To Bank A/c (600 x 5%) (Being certain value of various assets, penalty on cancellation of contract, profit and loss account debit balance written off through Capital Reduction Account)			30
(x)	Capital Reduction A/c		286	
	To Capital reserve A/c (Being balance transferred to capital reserve account as per the scheme)			286

(b) Capital Reduction Account

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

(c) Notes to Balance Sheet

	(₹ in lakhs)	(₹ in lakhs)
1. <u>Share Capital</u>		
<u>Authorised:</u>		
200 lakhs Equity shares of ₹ 2 each		400
8 lakhs 8% Preference shares of ₹ 80 each		<u>640</u>
		<u>1,040</u>
<u>Issued:</u>		
161 lakhs equity shares of ₹2 each		322
4 lakhs Preference Shares of ₹80 each		<u>320</u>
		<u>642</u>
2. <u>Tangible Assets</u>		
Freehold Property	550	
Less: Utilized to pay Debenture holders	<u>(300)</u>	
	250	
Add: Appreciation	<u>150</u>	400
Plant and Machinery		<u>200</u>
		<u>600</u>

11. **Liquidator's Final Statement of Receipts and Payments A/c**

	₹	₹		₹
To Cash in hand		40,000	By Liquidator's remuneration and expenses	5,000
To Assets realised:			By Trade Payables	3,50,000
Fixed assets	1,68,000		By Preference shareholders	1,00,000
Inventory			By Equity shareholders @ ₹ 10 on 2,000 shares	20,000
(1,10,000 – 1,00,000)	10,000			
Book debts	<u>2,30,000</u>	4,08,000		
To Cash - proceeds of call on 1,800 equity shares @ ₹ 15*		<u>27,000</u>		
		<u>4,75,000</u>		<u>4,75,000</u>

Working Note:

Return per equity share

	₹
Cash available before paying preference shareholders (₹ 4,48,000 – ₹ 3,55,000)	93,000
Add: Notional calls 1,800 shares (2,000-200) × ₹ 25	<u>45,000</u>
	1,38,000
Less: Preference share capital	<u>(1,00,000)</u>
Available for equity shareholders	<u>38,000</u>
Return per share = $\frac{₹ 38,000}{3,800 (4,000 - 200)} = ₹ 10$	
and Loss per Equity Share ₹ (100-10) = ₹ 90	

*Calls to be made @ ₹ 15 per share (₹ 90-75) on 1,800 shares.

12. **Form B – RA (Prescribed by IRDA)**
Real General Insurance Co. Ltd
Revenue Account for the year ended 31st March, 2017
Fire and Marine Insurance Business

	Schedule	Fire Current Year	Marine Current Year
		₹	₹
Premiums earned (net)	1	4,27,500	1,40,000

Profit / (Loss) on sale / redemption of investments		—	—
Others (to be specified)			
Interest, Dividends and Rent – Gross		<u>—</u>	<u>—</u>
Total (A)		<u>4,27,500</u>	<u>1,40,000</u>
Claims incurred (net)	2	82,000	88,000
Commission	3	40,000	20,000
Operating expenses related to Insurance business	4	<u>70,000</u>	<u>50,000</u>
Total (B)		<u>1,92,000</u>	<u>1,58,000</u>
Profit from Fire / Marine Insurance business (A-B)		2,35,500	(18,000)

Schedules forming part of Revenue Account

	<i>Fire</i>	<i>Marine</i>
	₹	₹
Schedule -1		
Premium earned (net)		
Premium received during the year	4,50,000	3,30,000
Add: Outstanding on 31 st March 2017	<u>30,000</u>	<u>20,000</u>
	4,80,000	3,50,000
Less: Reinsurance premiums	<u>(25,000)</u>	<u>(15,000)</u>
	4,55,000	3,35,000
Less: Adjustment for change in provision for unexpired risk	<u>(27,500)</u>	<u>(1,95,000)</u>
	<u>4,27,500</u>	<u>1,40,000</u>
Schedule – 2		
Claims incurred (net)		
Claims paid during the year	1,00,000	80,000
Add: Outstanding on 31 st March,2017	<u>10,000</u>	<u>15,000</u>
	1,10,000	95,000
Less: Outstanding on 1 st April,2016	<u>(28,000)</u>	<u>(7,000)</u>
	<u>82,000</u>	<u>88,000</u>

Schedule – 3		
Commission paid	<u>40,000</u>	<u>20,000</u>
Schedule – 4		
Operating expenses		
Expenses of Management		
Expenses paid during the year	60,000	45,000
Add: Outstanding on 31 st March, 2017	<u>10,000</u>	<u>5,000</u>
	<u>70,000</u>	<u>50,000</u>

Working note for changes in unexpired Risk Reserve

Reserve for unexpired Risk (Fire Insurance @50%)	
Opening Reserve (1)	₹ 2,00,000
Closing Reserve (₹ 4,55,000 X 50/100) (2)	₹ 2,27,500
Additional Transfer to Reserve (2 – 1)	₹ 27,500

Reserve for unexpired Risk (Marine Insurance @100%)	
Opening Reserve (1)	₹ 1,40,000
Closing Reserve (₹ 3,35,000 X 100/100) (2)	₹ 3,35,000
Additional Transfer to Reserve (2 – 1)	₹ 1,95,000

13.

Wealth Bank Limited**Profit and Loss Account****For the year ended 31st March, 2018**

₹ in lakhs

<i>Particulars</i>	<i>Schedule</i>	<i>Year ended 31-3-2018</i>
I Income		
Interest earned	13	766
Other income	14	50
		<u>816</u>
II Expenditure		
Interest expended	15	54
Operating expenses	16	468

	Provisions and Contingencies (Refer W.N.)	158.96
		<u>680.96</u>
III	Profit/Loss	
	Net Profit/(Loss) for the year	135.04
	Net Profit/(Loss) brought forward	Nil
		<u>135.04</u>
IV	Appropriations:	
	Transfer to Statutory reserve (25% of the profits)	33.76
	Balance carried to the balance sheet	<u>101.28</u>
	Total	<u>135.04</u>

Schedule 13 - Interest Earned

		Year ended 31-3-2018 (₹ in lakhs)	
I	Interest/discount on advances/bills		
	Interest on cash credit (364-84)	280	
	Interest on overdraft (150-100)	50	
	Interest on term loans (308-70)	238	568
II	Income on investments		168
III	Interest on Balance with RBI		30
			<u>766</u>

Interest on NPA is recognized on cash basis, hence difference of accrued interest not received have been reduced from the total accrued interest.

Schedule 14 - Other Income

		Year ended 31-3-2018 (₹ in lakhs)	
I	Commission, Exchange and Brokerage:		
	Commission on remittances and transfer	15	
	Commission on letter of credit	24	
	Commission on Government business	<u>16</u>	55
II	Profit on sale of Land and Building		5
III	Loss on Exchange Transactions		<u>(10)</u>
			<u>50</u>

Schedule 15 - Interest Expended

		Year ended 31-3-2018 (₹ in lakhs)
I	Interest on Deposits	
	Fixed deposits	25
	Recurring deposits	17
	Saving bank deposits	<u>12</u>
		54

Schedule 16 - Operating Expenses

		Year Ended 31-3-2018 (₹ in lakhs)
I	Payment to and provision for employees	
	Salaries, allowances and bonus	248
	Provident Fund Contribution	<u>56</u>
		304
II	Printing and Stationery	28
III	Advertisement and publicity	36
IV	Directors' fees, allowances and expenses	50
V	Auditors' fees and expenses	24
VI	Postage, telegrams, telephones etc.	16
VII	Repairs and maintenance	10
		<u>468</u>

Working Note:

<i>Provisions and contingencies</i>		(₹ in lakhs)	
Provision for Advances:			
Standard	60 × 0.40%		0.24
Sub-standard	22 × 15%		3.3
Doubtful not covered by security	40 × 100%		40
Doubtful covered by security:			
Less than 1 year	6 × 25%	1.5	4.7
More than 1 year but less than 3 years	3 × 40%	1.2	
More than 3 years	2 × 100%	<u>2.0</u>	
Loss Assets	(38 × 100%)		38
			<u>86.24</u>

Provision for tax	35% of (Total Income – Total Expenditure) 35% of [816- (54+468+86.24)] 35% of 207.76		
			72.72
			158.96

14. Departmental Trading and Loss Account of M/s Division

For the year ended 31st December, 2018

	Deptt. A	Deptt. B		Deptt. A	Deptt. B
	₹	₹		₹	₹
To Opening stock	50,000	40,000	By Sales	10,00,000	15,00,000
To Purchases	6,50,000	9,10,000	By Closing stock	1,00,000	2,00,000
To Gross profit	<u>4,00,000</u>	<u>7,50,000</u>		<u>11,00,000</u>	<u>17,00,000</u>
	<u>11,00,000</u>	<u>17,00,000</u>			
To General Expenses			By Gross profit	4,00,000	7,50,000
(in ratio of sales)	50,000	75,000			
To Profit ts/f to general profit and loss account	3,50,000	6,75,000			
	<u>4,00,000</u>	<u>7,50,000</u>		<u>4,00,000</u>	<u>7,50,000</u>

General Profit and Loss Account

	₹		₹
To Stock reserve required (additional:		By Profit from:	
Stock in Deptt. A		Deptt. A	3,50,000
50% of (₹ 20,000 - ₹ 10,000) (W.N.1)	5,000	Deptt. B	6,75,000
Stock in Deptt. B			
40% of (₹ 30,000 - ₹ 15,000) (W.N.2)	6,000		
To Net Profit	<u>10,14,000</u>		
	<u>10,25,000</u>		<u>10,25,000</u>

Working Notes:

1. Stock of department A will be adjusted according to the rate applicable to department B = $[(7,50,000 \div 15,00,000) \times 100] = 50\%$

2. Stock of department B will be adjusted according to the rate applicable to department A = $[(4,00,000 \div 10,00,000) \times 100] = 40\%$

15. **M/s ABC & Co.**

Bangalore Branch Trial Balance in (US \$)
as on 31st March, 2018

	<i>Conversion rate per US \$ (₹)</i>	<i>Dr. US \$</i>	<i>Cr. US \$</i>
Stock on 1.4.17	55	5,454.55	–
Purchases and sales	58	13,793.10	20,689.66
Sundry debtors and creditors	60	6,666.67	5,000.00
Bills of exchange	60	2,000.00	4,000.00
Wages and salaries	58	9,655.17	–
Rent, rates and taxes	58	6,206.90	–
Sundry charges	58	2,758.62	–
Computers	–	6,000.00	–
Bank balance	60	7,000.00	–
New York office A/c	–	–	29,845.35
		59,535.01	59,535.01

Trading and Profit & Loss Account
for the year ended 31st March, 2018

	<i>US \$</i>		<i>US \$</i>
To Opening Stock	5,454.55	By Sales	20,689.66
To Purchases	13,793.10	By Closing stock	7,000.00
To Wages and salaries	9,655.17	(₹ 4,20,000/60)	
		By Gross Loss c/d	1,213.16
	28,902.82		28,902.82
To Gross Loss b/d	1,213.16	By Net Loss	13,778.68
To Rent, rates and taxes	6,206.90		
To Sundry charges	2,758.62		
To Depreciation on computers (US \$ 6,000 × 0.6)	3,600.00		
	13,778.68		13,778.68

**Balance Sheet of Bangalore Branch
as on 31st March, 2018**

<i>Liabilities</i>		<i>US \$</i>	<i>Assets</i>	<i>US \$</i>	<i>US \$</i>
New York Office A/c	29,845.35		Computers	6,000.00	
Less: Net Loss	(13,778.68)	16,066.67	Less: Depreciation	(3,600.00)	2,400.00
Sundry creditors		5,000.00	Closing stock		7,000.00
Bills payable		4,000.00	Sundry debtors		6,666.67
			Bills receivable		2,000.00
			Bank balance		7,000.00
		25,066.67			25,066.67

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)** As per the amendment in AS 4 "Contingencies and Events Occurring After the Balance Sheet Date" vide Companies (Accounting Standards) Amendments Rules, 2016 dated 30th March, 2016, the events which take place after the balance sheet date, are sometimes reflected in the financial statements because of statutory requirements or because of their special nature.

However, dividends declared after the balance sheet date but before approval of financial statements are not recognized as a liability at the balance sheet date because no statutory obligation exists at that time. Hence such dividends are disclosed in the notes to financial statements.

No, provision for proposed dividends is not required to be made. Such proposed dividends are to be disclosed in the notes to financial statements. Accordingly, the dividend of ₹ 4 crores recommended by New Graphics Ltd. in its Board meeting on 18th April, 2017 shall not be accounted for in the books for the year 2016-17 irrespective of the fact that it pertains to the year 2016-17 and will be paid after approval in the Annual General Meeting of the members / shareholders.

- (b) As per the provisions of AS 5 “Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies”, prior period items are income or expenses, which arise, in the current period as a result of error or omissions in the preparation of financial statements of one or more prior periods. Further, the nature and amount of prior period items should be separately disclosed in the statement of profit and loss in a manner that their impact on current profit or loss can be perceived.

In the given instance, it is clearly a case of error in preparation of financial statements for the year 2015-16. Hence, claim received in the financial year 2017-18 is a prior period item and should be separately disclosed in the statement of Profit and Loss.

18. (a) As per AS-12, ‘Accounting for Government Grants’, “the amount refundable in respect of a grant related to specific fixed asset should be recorded by reducing the deferred income balance. To the extent the amount refundable exceeds any such deferred credit, the amount should be charged to profit and loss statement.

In this case the grant refunded is ₹ 30 lakhs and balance in deferred income is ₹ 21 lakhs, ₹ 9 lakhs shall be charged to the profit and loss account for the year 2017-18. There will be no effect on the cost of the fixed asset and depreciation charged will be on the same basis as charged in the earlier years.

- (b) According to AS 16 ‘Borrowing costs’, qualifying asset is an asset that necessarily takes substantial period of time to get ready for its intended use. As per the standard, borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalized as part of the cost of that asset. Other borrowing costs should be recognized as an expense in the period in which they are incurred. Capitalization of borrowing costs is also not suspended when a temporary delay is a necessary part of the process of getting an asset ready for its intended use or sale.

The treatment of interest by Zen Bridge Construction Ltd. can be shown as:

	<i>Qualifying Asset</i>	<i>Interest to be capitalized ₹ in crores</i>	<i>Interest to be charged to Profit & Loss A/c ₹ in crores</i>	
Construction of hill road*	Yes	1.25		1.6/64 x 50
Purchase of equipment and machineries	No		0.15	1.6/64 x 6
Working capital	No		0.10	1.6/64 x 4
Purchase of vehicles	No		0.025	1.6/64 x 1
Advance for tools, cranes etc.	No		0.025	1.6/64 x 1
Purchase of technical know-how	No		0.05	1.6/64 x 2
Total		<u>1.25</u>	<u>0.35</u>	

***Note:** It is assumed that construction of hill road will normally take more than a year (substantial period of time), hence considered as qualifying asset.

19. (a) Determination of Nature of Lease

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

$$= ₹ 50,000 \times 0.7513$$

$$= ₹ 37,565$$

Present value of lease payments

$$= ₹ 5,00,000 - ₹ 37,565$$

$$= ₹ 4,62,435$$

The percentage of present value of lease payments to fair value of the equipment is

$$(₹ 4,62,435 / ₹ 5,00,000) \times 100 = 92.487\%.$$

Since, lease payments substantially covers the major portion of the fair value; the lease constitutes a finance lease.

Calculation of Unearned Finance Income

Annual lease payment = ₹ 4,62,435 / 2.4868 = ₹ 1,85,956 (approx.)

Gross investment in the lease = Total minimum lease payments + unguaranteed residual value

$$= (₹ 1,85,956 \times 3) + ₹ 50,000$$

$$= ₹ 5,57,868 + ₹ 50,000 = ₹ 6,07,868$$

Unearned finance income = Gross investment - Present value of minimum lease payments and unguaranteed residual value

$$= ₹ 6,07,868 - ₹ 5,00,000 = ₹ 1,07,868$$

- (b) As per AS 20 'Earnings per Share', the net profit or loss for the period attributable to equity shareholders and the weighted average number of shares outstanding during the period should be adjusted for the effects of all dilutive potential equity shares for calculation of diluted earnings per share. Hence, "in calculating diluted earnings per share, effect is given to all dilutive potential equity shares that were outstanding during the period."

Computation of diluted earnings per share = $\frac{\text{Adjusted net profit for the current year}}{\text{Weighted average number of equity shares}}$

Adjusted net profit for the current year

	₹
Net profit for the current year (after tax)	1,00,00,000
Add: Interest expense for the current year	5,00,000

Less: Tax relating to interest expense (30% of ₹5,00,000)	(1,50,000)
Adjusted net profit for the current year	<u>1,03,50,000</u>

Weighted average number of equity shares

Number of equity shares resulting from conversion of debentures

$$= \frac{1,00,000 \times 100}{10} = 10,00,000 \text{ Equity shares}$$

Weighted average number of equity shares used to compute diluted earnings per share

$$= [(10,00,000 \times 12) + (10,00,000 \times 6)] / 12 = 15,00,000 \text{ equity shares}$$

$$\text{Diluted earnings per share} = ₹ 1,03,50,000 / 15,00,000 \text{ shares} = ₹ 6.90 \text{ per share}$$

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

In the given case, advertisement expenditure of ₹ 3 crores had been taken up for the marketing of a new product which may provide future economic benefits to an enterprise by having a turnover of ₹ 37.5 crores. Here, no intangible asset or another asset is acquired or created that can be recognized.

Therefore, the accounting treatment by the company of debiting the entire advertising expenditure of ₹ 3 crores to the Profit and Loss account of the year is correct.

- (b) As per AS 29, 'Provisions, Contingent Liabilities and Contingent Assets', a provision should be recognized when
- an enterprise has a present obligation as a result of a past event;
 - it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and
 - a reliable estimate can be made of the amount of the obligation.

If these conditions are not met, no provision should be recognized.

In the given situation, since, the directors of the company are of the opinion that the claim can be successfully resisted by the company, therefore there will be no outflow of the resources. Hence, no provision is required. The company will disclose the same as contingent liability by way of the following note:

"Litigation is in process against the company relating to a dispute with a competitor who alleges that the company has infringed copyrights and is seeking damages of ₹ 200 lakhs. However, the directors are of the opinion that the claim can be successfully resisted by the company."

PAPER – 6: AUDITING AND ASSURANCE

PART – I : ACADEMIC UPDATE

(Legislative Amendments / Notifications / Circulars / Rules / Guidelines issued by Regulating Authority)

Revised Chapter 7-Company Audit-I is given hereunder:

1 Eligibility, Qualifications and Disqualifications of an Auditor



The provisions relating to eligibility, qualifications and disqualifications of an auditor are governed by **section 141** of the Companies Act, 2013 (hereinafter referred as the Act). The main provisions are stated below:

(1) A person shall be **eligible for appointment** as an auditor of a company **only if he is a chartered accountant**.

It may be noted that a firm whereof majority of partners practising in India are qualified for appointment as aforesaid may be appointed by its firm name to be auditor of a company.

Fig.: Is the person eligible for appointment as auditor?¹

- (2) Where a firm including a limited liability partnership is appointed as an auditor of a company, only the partners who are chartered accountants shall be authorised to act and sign on behalf of the firm.
- (3) Under **sub-section (3) of section 141** along with **Rule 10** of the Companies (Audit and Auditors) Rules, 2014 (hereinafter referred as CAAR), the following persons shall not be eligible for appointment as an auditor of a company, namely-
 - (a) a body corporate other than a limited liability partnership registered under the Limited Liability Partnership Act, 2008;
 - (b) an officer or employee of the company;
 - (c) a person who is a partner, or who is in the employment, of an officer or employee of the company;
 - (d) a person who, or his relative or partner -
 - (i) is holding any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company;

¹ Source of image: <http://yourfinancebook.com>

It may be noted that the relative may hold security or interest in the company of face value not exceeding ₹ 1,00,000.

It may also be noted that the condition of ₹ 1,00,000 shall, wherever relevant, be also applicable in the case of a company not having share capital or other securities.

Students may also note that in the event of acquiring any security or interest by a relative, above the threshold prescribed, the corrective action to maintain the limits as specified above shall be taken by the auditor **within 60** days of such acquisition or interest.

The following points merit consideration in this regard:

- (i) The value of shares of ₹ 1,00,000 that can be hold by relative is the face value not the market value.
- (ii) The limit of ₹ 1,00,000 would be applicable where the securities are held by the relative of an auditor and not where the securities are held by an auditor himself or his partner. In case of an auditor or his partner, securities of even small value shall be a disqualification.
- (iii) Grace period of 60 days for corrective action shall apply only in respect of securities held by relatives. This would not apply to auditor or his partner.

[The term “relative”, as defined under the Companies Act, 2013, means anyone who is related to another as members of a Hindu Undivided Family; husband and wife; Father (including step- father), Mother (including step-mother), Son (including step- son), Son’s wife, Daughter, Daughter’s husband, Brother (including step- brother), Sister (including step- sister).]

EXAMPLES

Ex 1: Mr. A, a practicing Chartered Accountant, is holding securities of XYZ Ltd. having face value of ₹900. Whether Mr. A is qualified for appointment as an auditor of XYZ Ltd.?

As per section 141(3)(d)(i), an auditor is disqualified to be appointed as an auditor if he, or his relative or partner holding any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company.

In the present case, Mr. A is holding security of ₹ 900 in XYZ Ltd. Therefore, he is not eligible for appointment as an auditor of XYZ Ltd.

Ex 2: Mr. P is a practicing Chartered Accountant and Mr. Q, the relative of Mr. P, is holding securities of ABC Ltd. having face value of ₹90,000. Whether Mr. P is qualified from being appointed as an auditor of ABC Ltd.?

As per section 141(3)(d)(i), a person is disqualified to be appointed as an auditor if he, or his relative or partner is holding any security of or interest in

the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company. Further, as per proviso to this section, the relative of the person may hold the securities or interest in the company of face value not exceeding of ₹ 1,00,000.

In the present case, Mr. Q. (relative of Mr. P), is having securities of ₹ 90,000 face value in ABC Ltd., which is as per requirement of proviso to section 141(3)(d)(i). Therefore, Mr. P will not be disqualified to be appointed as an auditor of ABC Ltd.

Ex 3: M/s BC & Co. is an Audit Firm having partners Mr. B and Mr. C, and Mr. A the relative of Mr. C, is holding securities of MWF Ltd. having face value of ₹ 1,01,000. Whether M/s BC & Co. is qualified from being appointed as an auditor of MWF Ltd.?

As per section 141(3)(d)(i), a person is disqualified to be appointed as an auditor if he, or his relative or partner is holding any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company. Further as per proviso to this section, the relative of the person may hold the securities or interest in the company of face value not exceeding of ₹ 1,00,000.

In the instant case, M/s BC & Co, will be disqualified for appointment as an auditor of MWF Ltd. as the relative of Mr. C (i.e. partner of M/s BC & Co.) is holding the securities in MWF Ltd. which is exceeding the limit mentioned in proviso to section 141(3)(d)(i).

Ex 4: M/s RM & Co. is an audit firm having partners CA. R and CA. M. The firm has been offered the appointment as an auditor of Enn Ltd. for the Financial Year 2016-17. Mr. Bee, the relative of CA. R, is holding 5,000 shares (face value of ₹10 each) in Enn Ltd. having market value of ₹1,50,000. Whether M/s RM & Co. is disqualified to be appointed as auditors of Enn Ltd.?

As per section 141(3)(d)(i), a person shall not be eligible for appointment as an auditor of a company, who, or his relative or partner is holding any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company. However, as per proviso to this section, the relative of the person may hold the securities or interest in the company of face value not exceeding of ₹1,00,000.

In the instant case, M/s RM & Co. is an audit firm having partners CA. R and CA. M. Mr. Bee is a relative of CA. R and he is holding shares of Enn Ltd. of face value of ₹50,000 only (5,000 shares x ₹10 per share).

Therefore, M/s RM & Co. is not disqualified for appointment as an auditors of Enn Ltd. as the relative of CA. R (i.e. partner of M/s RM & Co.) is holding the securities in Enn Ltd. which is within the limit mentioned in proviso to section 141(3)(d)(i) of the Companies Act, 2013.

- (ii) is indebted to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, in excess of ₹ 5,00,000; or
 - (iii) has given a guarantee or provided any security in connection with the indebtedness of any third person to the Company or its Subsidiary, or its Holding or Associate Company or a Subsidiary of such Holding Company, in excess of ₹ 1,00,000.
- (e) a person or a firm who, whether directly or indirectly has business relationship with the Company, or its Subsidiary, or its Holding or Associate Company or Subsidiary of such holding company or associate company, of such nature as may be prescribed;

Students may note that for the purpose of clause (e) above, the term “business relationship” shall be construed as any transaction entered into for a commercial purpose, except –

- (i) commercial transactions which are in the nature of professional services permitted to be rendered by an auditor or audit firm under the Act and the Chartered Accountants Act, 1949 and the rules or the regulations made under those Acts;
- (ii) commercial transactions which are in the ordinary course of business of the company at arm’s length price - like sale of products or services to the auditor, as customer, in the ordinary course of business, by companies engaged in the business of telecommunications, airlines, hospitals, hotels and such other similar businesses.

- (f) a person whose relative is a Director or is in the employment of the Company as a director or key Managerial Personnel.
- (g) a person 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 other than one person companies, dormant companies, small companies and private companies having paid-up share capital less than ₹ 100 crore.
- (h) a person who has been convicted by a Court of an offence involving fraud and a period of ten years has not elapsed from the date of such conviction.
- (i) **a person who, directly or indirectly, renders any service referred to in section 144 to the company or its holding company or its subsidiary company.**

It may be noted that, for the purposes of this clause, the term "directly or indirectly" shall have the same meaning as assigned to it in the Explanation to section 144, i.e.

In case of auditor being an individual, either himself or through his relative or any other person connected or associated with such individual or through any other entity, whatsoever, in which such individual has significant influence or control, or whose name or trade mark or brand is used by such individual, shall be termed as rendering of services directly or indirectly by the auditor; and

In case of auditor being a firm, either itself or through any of its partners or through its parent, subsidiary or associate entity or through any other entity, whatsoever, in which the firm or any partner of the firm has significant influence or control, or whose name or trade mark or brand is used by the firm or any of its partners, shall be termed as rendering of services directly or indirectly 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;

Fig.: Auditor restrained from entering into certain services²

- (vii) rendering of outsourced financial services;
- (viii) management services; and
- (ix) any other kind of services as may be prescribed.

It may be noted that an auditor or audit firm who or which has been performing any non-audit services on or before the commencement of this Act shall comply with the provisions of this section before the closure of the first financial year after the date of such commencement.

Example: CA. Poshin is providing the services of investment banking to C Ltd. Later on, he was also offered to be appointed as an auditor of the company for the current financial year. Advise.

Section 141(3)(i) of the Companies Act, 2013 disqualifies a person for appointment as an auditor of a company who, **directly or indirectly, renders any service referred to in section 144 to the company or its holding company or its subsidiary company.** Section 144 of the Companies Act, 2013 prescribes certain

² Source of image: webuildbuzz.com

services not to be rendered by the auditor which includes investment banking services.

Therefore, CA. Poshin is advised not to accept the assignment of auditing as the investment banking service is specifically notified in the list of services not to be rendered by him as per section 141(3)(i) read with section 144 of the Companies Act, 2013.

- (4) Where a person appointed as an auditor of a company incurs any of the disqualifications mentioned in **sub-section (3)** 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.

CASE STUDY

Facts of the Case: Mr. A, a chartered accountant, has been appointed as an auditor of Laxman Ltd. in the Annual General Meeting of the company held in September, 2016, which assignment he accepted. Subsequently in January, 2017 he joined Mr. B, another chartered accountant, who is the Manager Finance of Laxman Ltd., as partner.

Provisions and Explanation: Section 141(3)(c) of the Companies Act, 2013 prescribes that any person who is a partner or in employment of an officer or employee of the company will be disqualified to act as an auditor of a company. Sub-section (4) of Section 141 provides that an auditor who becomes subject, after his appointment, to any of the disqualifications specified in sub-sections (3) of Section 141, he shall be deemed to have vacated his office as an auditor.

Conclusion: In the present case, Mr. A, an auditor of Laxman Ltd., joined as partner with Mr. B, who is Manager Finance of Laxman Limited. The given situation has attracted sub-section (3)(c) of Section 141 and, therefore, he shall be deemed to have vacated office of the auditor of Laxman Limited in accordance with sub-section (4) of section 141.

2 Appointment of Auditor

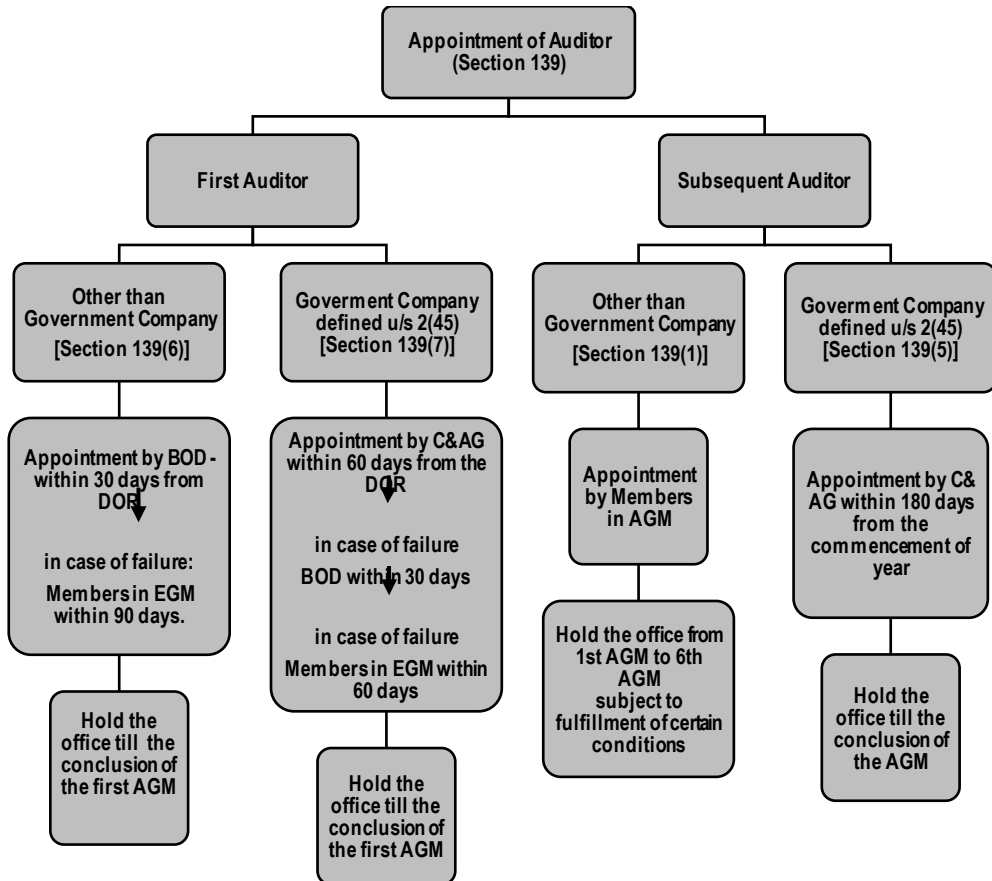


Section 139 of the Companies Act, 2013 contains provisions regarding Appointment of Auditors. Discussion on appointment of auditors may be grouped under two broad headings-

- I Appointment of First Auditors.
- II Appointment of Subsequent Auditors.

Fig: Meeting for appointment of Auditor³

³ Source of image: <http://newhavenscience.org>



2.1 Appointment of First Auditor

2.1.1 Appointment of First Auditors in the case of a company, other than a Government Company: As per **Section 139(6)**, the first auditor of a company, other than a Government company, shall be appointed by the Board of Directors within 30 days from the date of registration of the company.

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

The members of the company shall within 90 days at an extraordinary general meeting appoint the auditor. Appointed auditor shall hold office till the conclusion of the first annual general meeting.

CASE STUDY

Facts of the Case: Managing Director of Pigeon Ltd. himself wants to appoint CA. Champ, a practicing Chartered Accountant, as first auditor of the company.

Provisions and Explanation: Section 139(6) of the Companies Act, 2013 lays down that the first auditor of a company shall be appointed by the Board of Directors within 30 days from the date of registration of the company. In the instant case, the proposed appointment of CA. Champ, a practicing Chartered Accountant, as first auditor by the Managing Director of Pigeon Ltd. by himself is in violation of Section 139(6) of the Companies Act, 2013, which authorizes the Board of Directors to appoint the first auditor of the company.

Conclusion: In view of the above, the Managing Director of Pigeon Ltd. should be advised not to appoint the first auditor of the company.

2.1.2 Appointment of First Auditors in the case of Government Company: A “Government company” is a company in which not less than 51% of the paid-up share capital is held by the Central Government or by any State Government or Governments or partly by the Central Government and partly by one or more State Governments, and includes a company which is a subsidiary company of such a Government company.

Section 139(7) provides that in the case of a Government company or any other company owned or controlled, directly or indirectly, by the Central Government, or by any State Government, or Governments, or partly by the Central Government and partly by one or more State Governments, the first auditor shall be appointed by the Comptroller and Auditor-General of India within 60 days from the date of registration of the company.

In case the Comptroller and Auditor-General of India does not appoint such auditor within the above said period, the Board of Directors of the company shall appoint such auditor within the next 30 days. Further, in the case of failure of the Board to appoint such auditor within next 30 days, it shall inform the members of the company who shall appoint such auditor within 60 days at an extraordinary general meeting. Auditors shall hold office till the conclusion of the first annual general meeting.

CASE STUDY

Facts of the Case: The first auditor of Bhartiya Petrol Ltd., a Government company, was appointed by the Board of Directors.

Provisions and Explanation: In the case of a Government Company, the appointment of first auditor is governed by the provisions of Section 139(7) of the Companies Act, 2013 which states that in the case of a Government company, the first auditor shall be appointed by the Comptroller and Auditor-General of India within 60 days from the date of registration of the company. Hence, in the case of Bhartiya Petrol Ltd., being a government company, the first auditor shall be appointed by the Comptroller and Auditor General of India.

Conclusion: Thus, the appointment of first auditor made by the Board of Directors of Bhartiya Petrol Ltd., is null and void.

2.2 Appointment of Subsequent Auditor/Reappointment of Auditor

2.2.1 Appointment of Subsequent Auditors in case of Non Government Companies: Section 139(1) of the Companies Act, 2013 provides that every company shall, at the first

annual general meeting appoint an individual or a firm as an auditor who shall hold office from the conclusion of that meeting till the conclusion of its sixth annual general meeting and thereafter till the conclusion of every sixth meeting.

The following points need to be noted in this regard-

- (i) Before such appointment is made, the written consent of the auditor to such appointment, and a certificate from him or it that the appointment, if made, shall be in accordance with the conditions as may be prescribed, shall be obtained from the auditor.
- (ii) The certificate shall also indicate whether the auditor satisfies the criteria provided in **section 141**.
- (iii) The company shall inform the auditor concerned of his or its appointment, and also file a notice of such appointment with the Registrar within 15 days of the meeting in which the auditor is appointed.

2.2.2 Appointment of Subsequent Auditors in case of Government Companies: As per **section 139(5)**, in the case of a Government company or any other company owned or controlled, directly or indirectly, by the Central Government, or by any State Government or Governments, or partly by the Central Government and partly by one or more State Governments, the Comptroller and Auditor-General of India shall, in respect of a financial year, appoint an auditor duly qualified to be appointed as an auditor of companies under this Act, within a period of 180 days from the commencement of the financial year, who shall hold office till the conclusion of the annual general meeting.

2.3 Filling of a Casual Vacancy

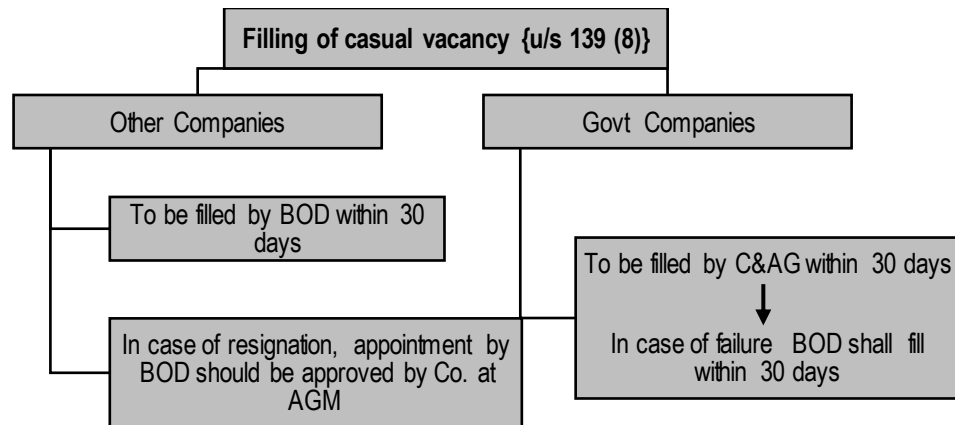
As per **Section 139(8)**, any casual vacancy in the office of an auditor shall-

- (i) **In the case of a company other than a company whose accounts are subject to audit by an auditor appointed by the Comptroller and Auditor-General of India**, be filled by the Board of Directors within 30 days.

If such casual vacancy is as a result of the resignation of an auditor, such appointment shall also be approved by the company at a general meeting convened within three months of the recommendation of the Board and he shall hold the office till the conclusion of the next annual general meeting.

- (ii) **In the case of a company whose accounts are subject to audit by an auditor appointed by the Comptroller and Auditor-General of India**, be filled by the Comptroller and Auditor-General of India within 30 days.

It may be noted that in case the Comptroller and Auditor-General of India does not fill the vacancy within the said period the Board of Directors shall fill the vacancy within next 30 days.



2.3.1 Casual Vacancy by Resignation: As per **section 140(2)** the auditor who has resigned from the company shall file within a period of 30 days from the date of resignation, a statement in the prescribed **Form ADT-3** (as per Rule 8 of CAAR) with the company and the Registrar, and in case of the companies referred to in **section 139(5)** i.e. Government company, the auditor shall also file such statement with the Comptroller and Auditor-General of India, indicating the reasons and other facts as may be relevant with regard to his resignation. In case of failure the auditor shall be punishable with fine which shall not be less than **fifty thousand rupees or the remuneration of the auditor, whichever is less** but which may extend to five lakh rupees as per **section 140(3)**.

CASE STUDY

Facts of the Case: CA. Donald was appointed as the auditor of PS Ltd. at the remuneration of ₹30,000. However, after 4 months of continuing his services, he could not continue to hold his office of the auditor as his wife got a government job at a distant place and he needs to shift along with her to the new place. Thus, he resigned from the company and did not perform his responsibilities relating to filing of statement to the company and the registrar indicating the reasons and other facts as may be relevant with regard to his resignation.

How much fine may he be punishable with under section 140(3) for non-compliance of section 140(2) of the Companies Act, 2013?

Provisions and Explanation: For non-compliance of sub-section (2) of section 140 of the Companies Act, 2013, the auditor shall be punishable with fine, which shall not be less than fifty thousand rupees or the remuneration of the auditor, whichever is less but which may extend to five lakh rupees, under section 140(3) of the said Act.

Conclusion: Thus, the fine under section 140(3) of the Companies Act, 2013 shall not be less than ₹30,000 but which may extend to ₹5,00,000.

Other Important Provisions Regarding Appointment of Auditors

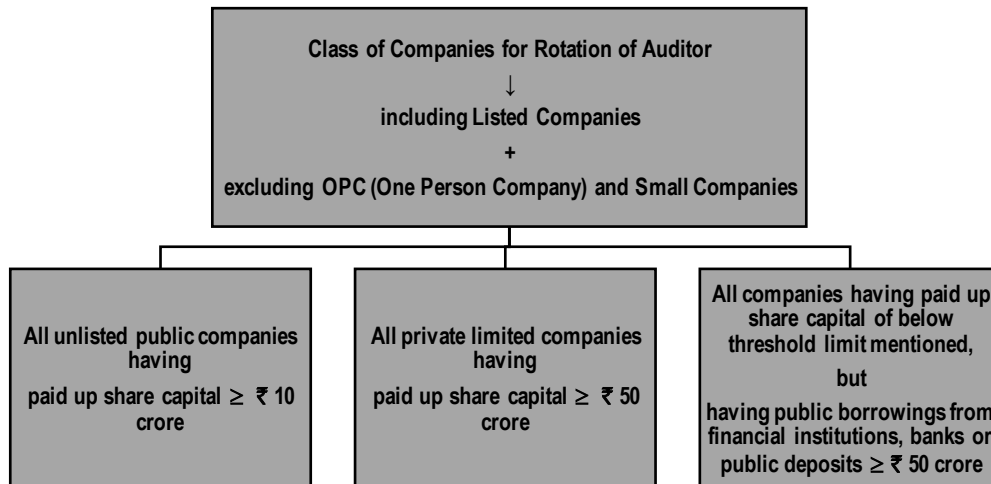
- (1) A retiring auditor may be re-appointed at an annual general meeting, if-
 - (a) he is not disqualified for re-appointment;
 - (b) he has not given the company a notice in writing of his unwillingness to be re-appointed; and
 - (c) a special resolution has not been passed at that meeting appointing some other auditor or providing expressly that he shall not be re-appointed.
- (2) Where at any annual general meeting, no auditor is appointed or re-appointed, the existing auditor shall continue to be the auditor of the company.

3 Rotation of Auditor

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



Fig: Rotation of Auditors⁴



- (I) all unlisted public companies having paid up share capital of rupees ten crore or more;
- (II) all private limited companies having paid up share capital of rupees fifty crore or more;
- (III) all companies having paid up share capital of below threshold limit mentioned above, but

⁴ Source of image: thehindubusinessline.com

having public borrowings from financial institutions, banks or public deposits of rupees fifty crores or more.

Example: Rano Pvt. Ltd. is a private limited Company, having paid up share capital of ₹ 42 crore but having public borrowing from nationalized banks and financial institutions of ₹ 72 crore, manner of rotation of auditor will be applicable.

As per **section 139(2)**, no listed company or a company belonging to such class or classes of companies as mentioned above, shall appoint or re-appoint-

- (a) an individual as auditor for more than one term of five consecutive years; and
- (b) an audit firm as auditor for more than two terms of five consecutive years. Provided that -
 - (i) an individual auditor who has completed his term under clause (a) shall not be eligible for re-appointment as auditor in the same company for five years from the completion of his term;
 - (ii) an audit firm which has completed its term under clause (b), shall not be eligible for re-appointment as auditor in the same company for five years from the completion of such term.

Example: Jolly Ltd., a listed company, appointed M/s Polly & Co., a Chartered Accountant firm, as the statutory auditor in its AGM held at the end of September, 2016 for 11 years. Here, the appointment of M/s Polly & Co. is not valid as the appointment can be made only for one term of five consecutive years and then another one more term of five consecutive years. It can't be appointed for two terms in one AGM only. Further, a cooling period of five years from the completion of term is required i.e. the firm can't be re-appointed for further 5 years after completion of two terms of five consecutive years.

The following points merit consideration in this regard-

- (1) As on the date of appointment, no audit firm having a common partner or partners to the other audit firm, whose tenure has expired in a company immediately preceding the financial year, shall be appointed as auditor of the same company for a period of five years.

Example: M/s XYZ & Co., is an audit firm having partner Mrs. X, Mr. Y and Mr. Z, whose tenure has expired in the company immediately preceding the financial year. M/s ABZ & Co., another audit firm in which Mr. Z is a common partner, will also be disqualified for the same company along with M/S XYZ & Co. for the period of five years.

- (2) Every company, existing on or before the commencement of this Act which is required to comply with provisions of this sub-section, shall comply with the requirements of this sub-section within a period which shall not be later than the date of the first annual general meeting of the company held, within the period specified under sub-section (1) of section 96, after three years from the date of commencement of this Act.

EXAMPLES

Ex 1: Mr. Raj, a Chartered Accountant, is an individual auditor of Binaca Limited for last 5 years as on March, 2013 (i.e. existing on or before the date of Commencement of Companies Act, 2013). Keeping in view the transition period as stated in the Companies Act, 2013, Mr. Raj can continue the audit of Binaca Ltd. upto the first annual general meeting to be held after three years from the date of commencement of the Act.

Ex 2: M/s Raj & Associates, a Chartered Accountants Audit Firm, is doing audit of Binaca Limited for last 11 years as on March, 2013 (i.e. existing on or before the date of Commencement of Companies Act, 2013). Keeping in view the transition period as stated in the Companies Act, 2013, M/s Raj Associates can continue the audit of Binaca Ltd. upto the first annual general meeting to be held after three years from the date of commencement of the Act.

Students may interlink the above example with Illustrative table explaining rotation in case of individual auditor as well as audit firm which has been given after the 3.2 i.e. Manner of rotation of Auditors by the Companies on Expiry of their Term.*

- (3) It has also been provided that right of the company to remove an auditor or the right of the auditor to resign from such office of the company shall not be prejudiced.
- (4) Subject to the provisions of this Act, members of a company may resolve to provide that-
 - (a) in the audit firm appointed by it, the auditing partner and his team shall be rotated at such intervals as may be resolved by members; or
 - (b) the audit shall be conducted by more than one auditor.
- (5) The Central Government may, by rules, prescribe the manner in which the companies shall rotate their auditors.

3.2 Manner of Rotation of Auditors by the Companies on Expiry of their Term: Rule 6 of the Companies (Audit and Auditors) Rules, 2014 prescribes the manner of rotation of auditors on expiry of their term which is given below-

- (1) The Audit Committee shall recommend to the Board, the name of an individual auditor or of an audit firm who may replace the incumbent auditor on expiry of the term of such incumbent.
- (2) Where a company is required to constitute an Audit Committee, the Board shall consider the recommendation of such committee, and in other cases, the Board shall itself consider the matter of rotation of auditors and make its recommendation for appointment of the next auditor by the members in annual general meeting.
- (3) For the purpose of the rotation of auditors-
 - (i) in case of an auditor (whether an individual or audit firm), the period for which the individual or the firm has held office as auditor prior to the commencement of the

Act shall be taken into account for calculating the period of five consecutive years or ten consecutive years, as the case may be;

- (ii) the incoming auditor or audit firm shall not be eligible if such auditor or audit firm is associated with the outgoing auditor or audit firm under the same network of audit firms.

Explanation I - For the purposes of these rules the term “same network” includes the firms operating or functioning, hitherto or in future, under the same brand name, trade name or common control.

Explanation II - For the purpose of rotation of auditors,

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

***Illustration explaining rotation in case of individual auditor**

Number of consecutive years for which an individual auditor has been functioning as auditor in the same company [in the first AGM held after the commencement of provisions of section 139(2)]	Maximum number of consecutive years for which he may be appointed in the same company (including transitional period)	Aggregate period which the auditor would complete in the same company in view of column I and II
I	II	III
5 Years (or more than 5 years)	3 years	8 years or more
4 years	3 years	7 years
3 years	3 years	6 years
2 years	3 years	5 years
1 year	4 years	5 years

Note:

- (1) Individual auditor shall include other individuals or firms whose name or trade mark or brand is used by such individual, if any.
- (2) Consecutive years shall mean all the preceding financial years for which the individual

auditor has been the auditor until there has been a break by five years or more.

***Illustration explaining rotation in case of audit firm**

Number of consecutive years for which an audit firm has been functioning as auditor in the same company [in the first AGM held after the commencement of provisions of section 139(2)]	Maximum number of consecutive years for which the firm may be appointed in the same company (including transitional period)	Aggregate period which the firm would complete in the same company in view of column I and II
I	II	III
10 Years (or more than 10years)	3 years	13 years or more
9 years	3 years	12 years
8 years	3 years	11 years
7 years	3 years	10 years
6 year	4 years	10 years
5 years	5 years	10 years
4 years	6 years	10 years
3 year	7 years	10 years
2 years	8 years	10 years
1 years	9 years	10 years

Note:

1. Audit Firm shall include other firms whose name or trade mark or brand is used by the firm or any of its partners.
 2. Consecutive years shall mean all the preceding financial years for which the firm has been the auditor until there has been a break by five years or more.
- (4) Where a company has appointed two or more individuals or firms or a combination thereof as joint auditors, the company may follow the rotation of auditors in such a manner that both or all of the joint auditors, as the case may be, do not complete their term in the same year.

4 Provisions relating to Audit Committee

4.1 Applicability of section 177 i.e. Constitution of Audit Committee: Where a company is required to constitute an Audit Committee under section 177, all appointments, including the filling of a casual vacancy of an auditor under this section shall be made after taking into account the recommendations of such committee.

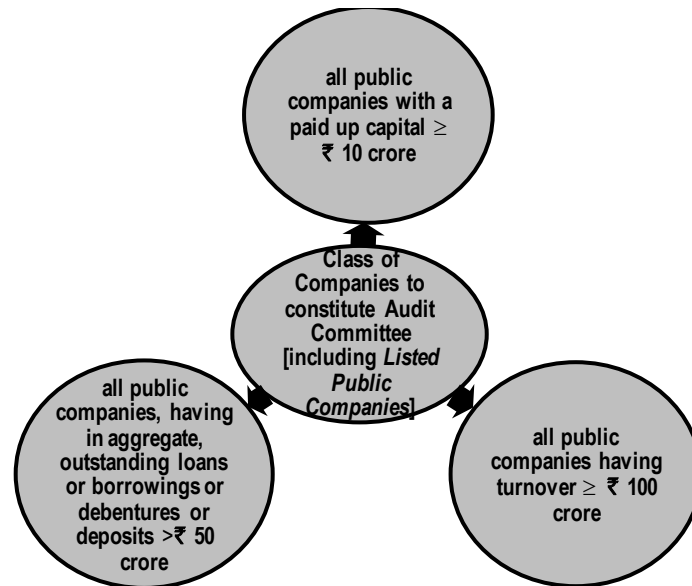


Diagram showing class of companies to constitute Audit Committee

It is important to know that in addition to *listed public companies*, following classes of companies shall constitute an Audit Committee -

- (i) all public companies with a paid up capital of ten crore rupees or more;
- (ii) all public companies having turnover of one hundred crore rupees or more;
- (iii) all public companies, having in aggregate, outstanding loans or borrowings or debentures or deposits exceeding fifty crore rupees or more.

Explanation- The paid up share capital or turnover or outstanding loans, or borrowings or debentures or deposits, as the case may be, as existing on the date of last audited Financial Statements shall be taken into account for the purposes of this rule.

Example: XYZ Ltd., a public company having paid up capital of ₹ 9 crore but having turnover of ₹ 150 crore, will be required to constitute an Audit Committee under section 177 because the requirement for constitution of Audit Committee arises if the company falls into any of the prescribed category.

4.2 Manner and procedure of selection and appointment of auditors- Rule 3 of CAAR, 2014 prescribes the following manner and procedure of selection and appointment of auditors-

- (1) In case of a company that is required to constitute an Audit Committee under section 177, the committee, and, in cases where such a committee is not required to be constituted, the Board, shall take into consideration the qualifications and experience of the individual or the firm proposed to be considered for appointment as auditor and whether such qualifications and experience are commensurate with the size and requirements of the company.

It may be noted that while considering the appointment, the Audit Committee or the Board, as the case may be, shall have regard to any order or pending proceeding relating to professional matters of conduct against the proposed auditor before the Institute of Chartered Accountants of India or any competent authority or any Court.

- (2) The Audit Committee or the Board, as the case may be, may call for such other information from the proposed auditor as it may deem fit.
- (3) Subject to the provisions of sub-rule (1), where a company is required to constitute the Audit Committee, the committee shall recommend the name of an individual or a firm as auditor to the Board for consideration and in other cases, the Board shall consider and recommend an individual or a firm as auditor to the members in the annual general meeting for appointment.
- (4) If the Board agrees with the recommendation of the Audit Committee, it shall further recommend the appointment of an individual or a firm as auditor to the members in the annual general meeting.
- (5) If the Board disagrees with the recommendation of the Audit Committee, it shall refer back the recommendation to the committee for reconsideration citing reasons for such disagreement.
- (6) If the Audit Committee, after considering the reasons given by the Board, decides not to reconsider its original recommendation, the Board shall record reasons for its disagreement with the committee and send its own recommendation for consideration of the members in the annual general meeting; and if the Board agrees with the recommendations of the Audit Committee, it shall place the matter for consideration by members in the annual general meeting.
- (7) The auditor appointed in the annual general meeting shall hold office from the conclusion of that meeting till the conclusion of the sixth annual general meeting, with the meeting wherein such appointment has been made being counted as the first meeting.

5. Auditor's Remuneration

As per section 142 of the Act, the remuneration of the auditor of a company shall be fixed in its general meeting or in such manner as may be determined therein. However, board may fix remuneration of the first auditor appointed by it.

Further, the remuneration, in addition to the fee payable to an auditor, include the expenses, if any, incurred by the auditor in connection with the audit of the company and any facility extended to him but does not include any remuneration paid to him for any other service rendered by him at the request of the company. Therefore, it has been clarified that the remuneration to Auditor shall also include any facility provided to him.

6. Removal of Auditors

6.1 Removal of Auditor Before Expiry of Term: According to **Section 140(1)**, the auditor appointed under section 139 may be removed from his office before the expiry of his term only by a special resolution of the company, after obtaining the previous approval of the Central Government in that behalf as per **Rule 7 of CAAR, 2014-**



Fig: Auditor leaving office of the auditor⁵

(1) 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.

(2) The application shall be made to the Central Government within 30 days of the resolution passed by the Board.

(3) 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.

Direction by Tribunal in case Auditor acted in a Fraudulent Manner:

As per sub-section (5) of the section 140, the Tribunal either *suo motu* or on an application made to it by the Central Government or by any person concerned, if it is satisfied that the auditor of a company has, whether directly or indirectly, acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to, the company or its directors or officers, it may, by order, direct the company to change its auditors.

However, if the application is made by the Central Government and the Tribunal is satisfied that any change of the auditor is required, it shall within fifteen days of receipt of such application, make an order that he shall not function as an auditor and the Central Government may appoint another auditor in his place.

It may be noted that an auditor, whether individual or firm, against whom final order has been passed by the Tribunal under this section shall not be eligible to be appointed as an auditor of any company for a period of five years from the date of passing of the order and the auditor shall also be liable for action under section 447.

It is hereby clarified that in the case of a firm, the liability shall be of the firm and that of every partner or partners who acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to, the company or its director or officers.

⁵ Source of image: www.123rf.com

6.2 Appointment of Auditor Other Than Retiring Auditor: Section 140(4) lays down procedure to appoint an auditor other than retiring auditor who was removed-

- (1) Special notice shall be required for a resolution at an annual general meeting appointing as auditor a person other than a retiring auditor, or providing expressly that a retiring auditor shall not be re-appointed, except where the retiring auditor has completed a consecutive tenure of five years or as the case maybe, ten years, as provided under **sub-section (2) of section 139**.
- (2) On receipt of notice of such a resolution, the company shall forthwith send a copy thereof to the retiring auditor.
- (3) Where notice is given of such a resolution and the retiring auditor makes with respect thereto representation in writing to the company (not exceeding a reasonable length) and requests its notification to members of the company, the company shall, unless the representation is received by it too late for it to do so,-
 - (a) in any notice of the resolution given to members of the company, state the fact of the representation having been made; and
 - (b) send a copy of the representation to every member of the company to whom notice of the meeting is sent, whether before or after the receipt of the representation by the company. and if a copy of the representation is not sent as aforesaid because it was received too late or because of the company's default, the auditor may (without prejudice to his right to be heard orally) require that the representation shall be read out at the meeting.

Students may note that if a copy of representation is not sent as aforesaid, a copy thereof shall be filed with the Registrar.

Curtailing right of the auditor regarding circulation of copy of representation in the case of appointment of auditor other than retiring auditor under section 140(4) of the companies act, 2013:

If the Tribunal is satisfied on an application either of the company or of any other aggrieved person that the rights conferred by **section 140(4)** of the Companies Act, 2013 are being abused by the auditor, then, the copy of the representation may not be sent and the representation need not be read out at the meeting.

7. Ceiling on Number of Audits

It has been mentioned earlier that 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 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** other than one person companies, dormant

companies, small companies and private companies having paid-up share capital less than ₹ 100 crore, shall not be eligible for appointment as an Auditor of a Company.

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.

This limit of 20 company audits is per person. In the case of an audit firm having 3 partners, the overall ceiling will be $3 \times 20 = 60$ company audits. Sometimes, a chartered accountant is a partner in a number of auditing firms. In such a case, all the firms in which he is partner or proprietor will be together entitled to 20 company audits on his account. Subject to the overall ceiling of company audits, how they allocate the 20 audits between themselves is their affairs.

CASE STUDY

"ABC & Co." is an Audit Firm having partners "Mr. A", "Mr. B" and "Mr. C", Chartered Accountants. "Mr. A", "Mr. B" and "Mr. C" are holding appointment as an Auditor in 4, 6 and 10 Companies respectively.

- (i) Provide the maximum number of Audits remaining in the name of "ABC & Co."
- (ii) Provide the maximum number of Audits remaining in the name of individual partner i.e. Mr. A, Mr. B and Mr. C.
- (iii) Can ABC & Co. accept the appointment as an auditor in 60 private companies having paid-up share capital less than ₹ 100 crore, 2 small companies and 1 dormant company?
- (iv) Would your answer be different, if out of those 60 private companies, 45 companies are having paid-up share capital of ₹ 110 crore each?

Fact of the Case: In the instant case, Mr. A is holding appointment in 4 companies, whereas Mr. B is having appointment in 6 Companies and Mr. C is having appointment in 10 Companies. In aggregate all three partners are having 20 audits.

Provisions and Explanations: Section 141(3)(g) of the Companies Act, 2013 states that the following persons shall not be eligible for appointment as an auditor of a company i.e. a person 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 other than one person companies, dormant companies, small companies and private companies having paid-up share capital less than ₹ 100 crore.

As per section 141(3)(g), this limit of 20 company audits is per person. In the case of an audit firm having 3 partners, the overall ceiling will be $3 \times 20 = 60$ company audits. Sometimes, a chartered accountant is a partner in a number of auditing firms. In such a case, all the firms in which he is partner or proprietor will be together entitled to 20 company audits on his account.

Conclusion:

- (i) Therefore, ABC & Co. can hold appointment as an auditor of 40 more companies:

Total Number of Audits available to the Firm	= 20*3	= 60
Number of Audits already taken by all the partners		
In their individual capacity	= 4+6+10	= 20
Remaining number of Audits available to the Firm		=40
(ii) With reference to above provisions an auditor can hold more appointment as auditor = ceiling limit as per section 141(3)(g)- already holding appointments as an auditor. Hence (1) Mr. A can hold: 20 - 4 = 16 more audits. (2) Mr. B can hold 20-6 = 14 more audits and (3) Mr. C can hold 20-10 = 10 more audits.		
(iii) In view of above discussed provisions, ABC & Co. can hold appointment as an auditor in all the 60 private companies having paid-up share capital less than ₹ 100 crore, 2 small companies and 1 dormant company as these are excluded from the ceiling limit of company audits given under section 141(3)(g) of the Companies Act, 2013.		
(iv) As per fact of the case, ABC & Co. is already having 20 company audits and they can also accept 40 more company audits. In addition they can also conduct the audit of one person companies, small companies, dormant companies and private companies having paid up share capital less than ₹ 100 crores. In the given case, out of the 60 private companies, ABC & Co. is offered 45 companies having paid-up share capital of ₹ 110 crore each. Therefore, ABC & Co. can also accept the appointment as an auditor for 2 small companies, 1 dormant company, 15 private companies having paid-up share capital less than ₹ 100 crore and 40 private companies having paid-up share capital of ₹ 110 crore each in addition to above 20 company audits already holding.		

Council General Guidelines, 2008 (Chapter VIII): In exercise of the powers conferred by clause (ii) of Part II of the Second Schedule to the Chartered Accountants Act, 1949, the Council of the Institute of Chartered Accountants of India hereby specifies that a member of the Institute in practice shall be deemed to be guilty of professional misconduct, if he holds at any time appointment of more than the "specified number of audit assignments of the companies under Section 224 and /or Section 226 of the Companies Act, 1956 (now section 141(3)(g) of the Companies Act, 2013).

It may be noted that in the case of a firm of chartered accountants in practice, the specified number of audit assignments shall be construed as the specified number of audit assignments for every partner of the firm.

It may also be noted that where any partner of the firm of chartered accountants in practice is also a partner of any other firm or firms of chartered accountants in practice, the number of audit assignments which may be taken for all the firms together in relation to such partner shall not exceed the specified number of audit assignments in the aggregate.

It is further provided that where any partner of a firm or firms of chartered accountants in practice accepts one or more audit assignments in his individual capacity, or in the name of his proprietary firm, the total number of such assignment which may be accepted by all firms in

relation to such chartered accountant and by him shall not exceed the specified number of audit assignments in the aggregate.

- (1) In computing the specified number of audit assignments-
 - (a) the number of such assignments, which he or any partner of his firm has accepted whether singly or in combination with any other chartered accountant in practice or firm of such chartered accountants, shall be taken into account.
 - (b) the number of partners of a firm on the date of acceptance of audit assignment shall be taken into account.
 - (c) a chartered accountant in full time employment elsewhere shall not be taken into account.
- (2) A chartered accountant in practice as well as firm of chartered accountants in practice shall maintain a record of the audit assignments accepted by him or by the firm of chartered accountants, or by any of the partner of the firm in his individual name or as a partner of any other firm as far as possible, in the prescribed manner.

Ceiling on Tax Audit Assignments: The specified number of tax audit assignments that an auditor, as an individual or as a partner of a firm, can accept is **60 numbers**. ICAI has notified that a chartered accountant in practice shall be deemed to be guilty of professional misconduct, if he accepts in a financial year, more than the specified number of tax audit assignments u/s 44AB.

8. Powers/Rights of Auditors

The auditor has the following powers/rights while conducting an audit:

(a) Right of access to books, etc. – Section 143(1) of the Act provides that the auditor of a company, at all times, shall have a right of access to the books of account and vouchers of the company, whether kept at the registered office of the company or at any other place and he is entitled to require from the officers of the company such information and explanation as he may consider necessary for the performance of his duties as auditor.

It may be noted that according to **section 2(59)** of the Act, the term 'officer' includes any director, manager or key managerial personnel or any person in accordance with whose directions or instructions the Board of Directors or any one or more of the directors is or are accustomed to act;

The phrase 'books, accounts and vouchers' includes all books which have any bearing, or are likely to have any bearing on the accounts, whether these be the usual financial books or the statutory or statistical books; memoranda books, e.g., inventory books, costing records and the like may also be inspected by the auditor. Similarly the term 'voucher' includes all or any of the correspondence which may in any way serve to vouch for the accuracy of the accounts. Thus, the right of access is not restricted to books of account alone and it is for the auditor to determine what record or document is necessary for the purpose of the audit.

The right of access is not limited to those books and records maintained at the registered or

head office so that in the case of a company with branches, the right also extends to the branch records, if the auditor considers it necessary to have access thereto as per **Section 143(8)**.

Example: *X Ltd. restrains its company auditor from visiting another branch at different location and having access to the inventory records maintained at that branch because the branch is already audited by another auditor and the report has been received. Here, it may be noted that the company auditor has right to visit the branch, even if the branch accounts are audited by another auditor, if he considers it necessary to do so for the performance of his duties as auditor.*

(b) Right to obtain information and explanation from officers - This right of the auditor to obtain from the officers of the company such information and explanations as he may think necessary for the performance of his duties as auditor is a wide and important power. In the absence of such power, the auditor would not be able to obtain details of amount collected by the directors, etc. from any other company, firm or person as well as of any benefits in kind derived by the directors from the company, which may not be known from an examination of the books. It is for the auditor to decide the matters in respect of which information and explanations are required by him. When the auditor is not provided the information required by him or is denied access to books, etc., his only remedy would be to report to the members that he could not obtain all the information and explanations he had required or considered necessary for the performance of his duties as auditors.

(c) Right to receive notices and to attend general meeting – The auditors of a company are entitled to attend any general meeting of the company (the right is not restricted to those at which the accounts audited by them are to be discussed); also to receive all the notices and other communications relating to the general meetings, which members are entitled to receive and to be heard at any general meeting in any part of the business of the meeting which concerns them as auditors.

Section 146 of the Companies Act, 2013 discusses right as well as duty of the auditor. According to the section 146:

“all notices of, and other communications relating to, any general meeting shall be forwarded to the auditor of the company, and the auditor shall, unless otherwise exempted by the company, attend either by himself or through his authorised representative, who shall also be qualified to be an auditor, any general meeting and shall have right to be heard at such meeting on any part of the business which concerns him as the auditor.”

Thus, it is right of the auditor to receive notices and other communications relating to any general meeting and to be heard at such meeting, relating to the matter of his concern, however, it is duty of the auditor to attend the same or through his authorised representative unless otherwise exempted.

(d) Right to report to the members of the company on the accounts examined by him – The auditor shall make a report to the members of the company on the accounts examined by him and on every financial statements which are required by or under this Act to be laid before the company in general meeting and the report shall after taking into account the provisions of this Act, the accounting and auditing standards and matters which are required to be included

in the audit report under the provisions of this Act or any rules made there under or under any order made under this section and to the best of his information and knowledge, the said accounts, 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.

(e) Right to Lien – In terms of the general principles of law, any person having the lawful possession of somebody else's property, on which he has worked, may retain the property for non-payment of his dues on account of the work done on the property. On this premise, auditor can exercise lien on books and documents placed at his possession by the client for non payment of fees, for work done on the books and documents. The Institute of Chartered Accountants in England and Wales has expressed a similar view on the following conditions:

- (i) Documents retained must belong to the client who owes the money.
- (ii) Documents must have come into possession of the auditor on the authority of the client. They must not have been received through irregular or illegal means. In case of a company client, they must be received on the authority of the Board of Directors.
- (iii) The auditor can retain the documents only if he has done work on the documents assigned to him.
- (iv) Such of the documents can be retained which are connected with the work on which fees have not been paid.

Under **section 128** of the Act, books of account of a company must be kept at the registered office. These provisions ordinarily make it impracticable for the auditor to have possession of the books and documents. The company provides reasonable facility to auditor for inspection of the books of account by directors and others authorised to inspect under the Act. Taking an overall view of the matter, it seems that though legally, auditor may exercise right of lien in cases of companies, it is mostly impracticable for legal and practicable constraints. His working papers being his own property, the question of lien, on them does not arise.

SA 230 issued by ICAI on Audit Documentation (explanatory text, A- 25), "Standard on Quality Control (SQC) 1, "Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements", issued by the Institute, provides that, unless otherwise specified by law or regulation, audit documentation is the property of the auditor. He may at his discretion, make portions of, or extracts from, audit documentation available to clients, provided such disclosure does not undermine the validity of the work performed, or, in the case of assurance engagements, the independence of the auditor or of his personnel."

9. Duties of Auditors

Sections 143 of the Companies Act, 2013 specifies the duties of an auditor of a company in a quite comprehensive manner. It is noteworthy that scope of duties of an auditor has generally been extending over all these years.

- (1) **Duty of Auditor to Inquire on certain matters:** It is the duty of auditor to inquire into the following matters-
- (a) whether loans and advances made by the company on the basis of security have been properly secured and whether the terms on which they have been made are prejudicial to the interests of the company or its members;
 - (b) whether transactions of the company which are represented merely by book entries are prejudicial to the interests of the company;
 - (c) where the company not being an investment company or a banking company, whether so much of the assets of the company as consist of shares, debentures and other securities have been sold at a price less than that at which they were purchased by the company;
 - (d) whether loans and advances made by the company have been shown as deposits;
 - (e) whether personal expenses have been charged to revenue account;
 - (f) where it is stated in the books and documents of the company that any shares have been allotted for cash, whether cash has actually been received in respect of such allotment, and if no cash has actually been so received, whether the position as stated in the account books and the balance sheet is correct, regular and not misleading.

The opinion of the Research Committee of the Institute of Chartered Accountants of India on section 143(1) is reproduced below:

“The auditor is not required to report on the matters specified in sub-section (1) unless he has any special comments to make on any of the items referred to therein. If he is satisfied as a result of the inquiries, he has no further duty to report that he is so satisfied. In such a case, the content of the Auditor’s Report will remain exactly the same as the auditor has to inquire and apply his mind to the information elicited by the enquiry, in deciding whether or not any reference needs to be made in his report. In our opinion, it is in this light that the auditor has to consider his duties under section 143(1).”

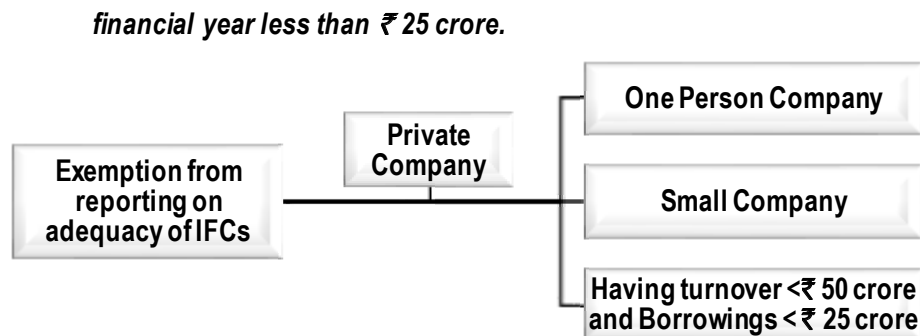
Therefore, it could be said that the auditor should make a report to the members in case he finds answer to any of these matters in adverse.

- (2) **Duty to Sign the Audit Report:** As per section 145 of the Companies Act, 2013, the person appointed as an auditor of the company shall sign the auditor's report or sign or certify any other document of the company, in accordance with the provisions of section 141(2).

Section 141(2) of the Companies Act, 2013 states that where a firm including a limited liability partnership is appointed as an auditor of a company, only the partners who are chartered accountants shall be authorised to act and sign on behalf of the firm.

The qualifications, observations or comments on financial transactions or matters, which have any adverse effect on the functioning of the company mentioned in the auditor's report shall be read before the company in general meeting.

- (3) **Duty to comply with Auditing Standards:** As per **section 143(9)** of the Companies Act, 2013, every auditor shall comply with the auditing standards. Further, as per **section 143(10)** of the Act, the Central Government may prescribe the standards of auditing as recommended by the Institute of Chartered Accountants of India, in consultation with and after examination of the recommendations made by the National Financial Reporting Authority.
- (4) **Duty to report:** As per **section 143(3)**, the auditor's report shall also state –
- (a) 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;
 - (b) 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;
 - (c) 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;
 - (d) whether the company's balance sheet and profit and loss account dealt with in the report are in agreement with the books of account and returns;
 - (e) whether, in his opinion, the financial statements comply with the accounting standards;
 - (f) the observations or comments of the auditors on financial transactions or matters which have any adverse effect on the functioning of the company;
 - (g) whether any director is disqualified from being appointed as a director under sub-section (2) of the section 164;
 - (h) any qualification, reservation or adverse remark relating to the maintenance of accounts and other matters connected therewith;
 - (i) whether the company has adequate internal financial controls **with reference to financial statements** in place and the operating effectiveness of such controls;
- However, it may be noted that the reporting requirement on adequacy of internal financial controls (IFCs) with reference to financial statements shall not be applicable to a private company which is a–**
- (I) **One person company; or**
 - (II) **Small company; or**
 - (III) **Company having turnover less than ₹ 50 crore as per latest audited financial statement and having aggregate borrowings from banks or financial institutions or any body corporate at any point of time during the**



- (j) such other matters as may be prescribed. 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.

[Notes: (1) Students may note that the auditor is also required to report on certain additional matters specified under CARO, 2016 which is discussed later under Para 10 Reporting under Companies (Auditor's Report) Order, 2016.

(2) Students are also required to refer Guidance note on Reporting under section 143(3)(f) and (h) of the Companies Act, 2013.]

(5) Duty to report on frauds:

A. Reporting to the Central Government- As per **section 143(12)** of the Companies Act, 2013 read with **Rule 13** of the Companies (Audit and Auditors) Rules, 2014, if an auditor of a company in the course of the performance of his duties as auditor, has reason



to believe that an offence of fraud, which involves or is expected to involve individually an amount of ₹ 1 crore or above, is being or has been committed in the company by its officers or employees, the auditor shall report the matter to the Central Government within such time and in such manner as prescribed.

Fig: Reporting of fraud⁶

⁶ Source of image: www.oig.lsc.gov

B. Reporting to the Audit Committee or Board- In case of a fraud involving lesser than the specified amount [i.e. less than ₹ 1 crore], the auditor shall report the matter to the audit committee constituted under section 177 or to the Board in other cases within such time and in such manner as prescribed.

C. Disclosure in the Board's Report: The companies, whose auditors have reported frauds under this sub-section (12) to the audit committee or the Board, but not reported to the Central Government, shall disclose the details about such frauds in the Board's report in such manner as prescribed.

Sub-section (13) of section 143 of the Companies Act, 2013 safeguards the act of fraud reporting by the auditor if it is done in good faith. It states that no duty to which an auditor of a company may be subject to shall be regarded as having been contravened by reason of his reporting the matter above if it is done in good faith.

It is very important to note that the provisions regarding fraud reporting shall also apply, *mutatis mutandis*, to a cost auditor and a secretarial auditor during the performance of his duties under section 148 and section 204 respectively. If any auditor, cost accountant or company secretary in practice do not comply with the provisions of sub-section (12) of section 143, he shall be punishable with fine which shall not be less than ₹ 1 lakh but which may extend to ₹ 25 lakh.

The auditor is also required to report under **clause (x) of paragraph 3 of Companies (Auditor's Report) Order, 2016 [CARO, 2016]**, whether any fraud by the company or any fraud on the Company by its officers or employees has been noticed or reported during the year. If yes, the nature and the amount involved is to be indicated.

[Notes: For detailed provisions of CARO, 2016, students may refer Para 10 Reporting under Companies (Auditor's Report) Order, 2016]

Example: The head accountant of a company entered fake invoices of credit purchases in the books of account aggregate of ₹ 50 lakh and cleared all the payments to such bogus creditor. Here, the auditor of the company is required to report the fraudulent activity to the Board or Audit Committee (as the case may be) within 2 days of his knowledge of fraud. Further, the company is also required to disclose the same in Board's Report.

It may be noted that the auditor need not to report the central government as the amount of fraud involved is less than ₹ 1 crore, however, reporting under CARO, 2016 is required.

- (6) **Duty to report on any other matter specified by Central Government:** The Central Government may, in consultation with the National Financial Reporting Authority (NFRA), by general or special order, direct, in respect of such class or description of companies, as may be specified in the order, that the auditor's report shall also include a statement on such matters as may be specified therein.

However, as per the notification dated 29.03.2016, till the time NFRA is constituted, the Central Government may hold consultation required under this sub-section with the

Committee chaired by an officer of the rank of Joint Secretary or equivalent in the MCA and the Committee shall have the representatives from the ICAI and Industry Chambers and also special invitees from the National Advisory Committee on Accounting Standards (NACAS) and the office of the C&AG.

[Note: Students may note that Companies (Auditor's Report) Order, 2016 has been notified in this perspective which is discussed later under Para 10 Reporting under Companies (Auditor's Report) Order, 2016]

- (7) **Duties and powers of the company's auditor with reference to the audit of the branch and the branch auditor are discussed separately in the chapter under heading 13 branch audit.**
- (8) **Duty to state the reason for qualification or negative report:** As per **section 143(4)**, where any of the matters required to be included in the audit report is answered in the negative or with a qualification, the report shall state the reasons there for.

10. Reporting under Companies (Auditor's Report) Order, 2016 [CARO, 2016]

The Central Government, after consultation with the committee constituted under proviso to **section 143(11)** of the Companies Act, 2013, and in supersession of the Companies (Auditor's Report) Order, 2015 dated the 10th April, 2015, has issued the Companies (Auditor's Report) Order, 2016, (CARO, 2016) under section 143(11) of the Companies Act, 2013, dated 29th March, 2016. 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.

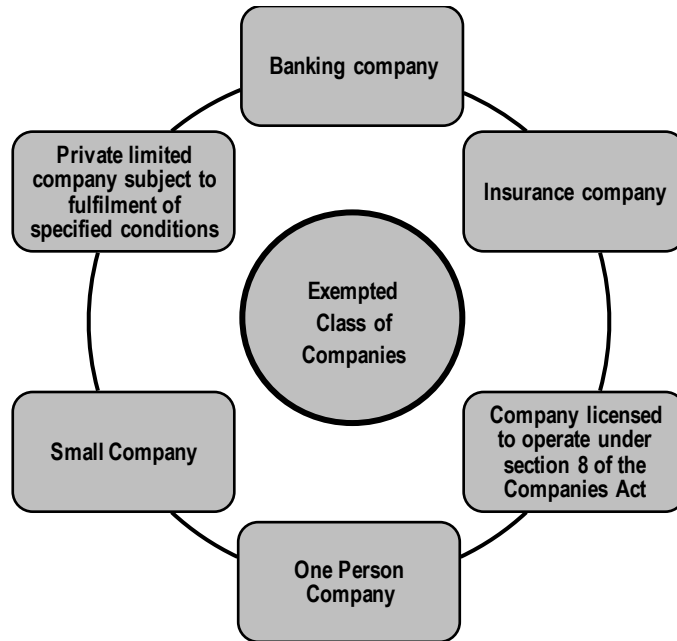
Applicability of the Order: The CARO, 2016 is an additional reporting requirement Order. The order applies to every company including a foreign company as defined in clause (42) of section 2 of the Companies Act, 2013.

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

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

does not have a total revenue as disclosed in Scheduled III to the Companies Act, 2013 (including revenue from discontinuing operations) exceeding ₹ 10 crore during the financial year as per the financial statements.

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



EXAMPLES

Ex. 1: 'Educating Child' is a limited company registered under section 8 of the Companies Act, 2013.

In the given case, 'Educating Child' is licensed to operate under section 8 of the Companies Act, 2013. Therefore, CARO, 2016 shall not be applicable to 'Educating Child' accordingly.

Ex. 2: Ashu Pvt. Ltd. has fully paid capital and reserves of ₹ 50 lakh. During the year, the company had borrowed ₹ 70 lakh each from a bank and a financial institution independently. It has the turnover of ₹ 900 lakh.

In the given case of Ashu Pvt. Ltd., it has paid capital and reserves of ₹ 50 lakh i.e. less than ₹ 1 crore, turnover of ₹ 9 crore i.e. less than ₹ 10 crore. However, it has maximum outstanding borrowings of ₹ 1.40 crore (₹ 70 lakh + ₹ 70 lakh) collectively from bank and financial institution.

Therefore, it fails to fulfill the condition relating to borrowings. Thus, CARO, 2016 shall be applicable to Ashu Pvt. Ltd. accordingly.

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;
- (c) whether the title deeds of immovable properties are held in the name of the company. If not, provide the details thereof;
- (ii) whether physical verification of inventory has been conducted at reasonable intervals by the management and whether any material discrepancies were noticed and if so, whether they have been properly dealt with in the books of account;
- (iii) whether the company has granted any loans, secured or unsecured to companies, firms, Limited Liability Partnerships or other parties covered in the register maintained under section 189 of the Companies Act, 2013. If so,
 - (a) whether the terms and conditions of the grant of such loans are not prejudicial to the company's interest;
 - (b) whether the schedule of repayment of principal and payment of interest has been stipulated and whether the repayments or receipts are regular;
 - (c) if the amount is overdue, state the total amount overdue for more than ninety days, and whether reasonable steps have been taken by the company for recovery of the principal and interest;
- (iv) in respect of loans, investments, guarantees, and security whether provisions of section 185 and 186 of the Companies Act, 2013 have been complied with. If not, provide the details thereof.
- (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, 2013 and the rules framed there under, where applicable, have been complied with? If not, the nature of such contraventions 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, 2013 and whether such accounts and records have been so made and maintained.
- (vii) (a) whether the company is regular in depositing undisputed statutory dues including provident fund, employees' state insurance, income-tax, sales-tax, service tax, duty of

customs, duty of excise, value added tax, cess and any other statutory dues 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;

- (b) where dues of income tax or sales tax or service tax or duty of customs or duty of excise or value added tax have not been deposited on account of any dispute, then the amounts involved and the forum where dispute is pending shall be mentioned. (A mere representation to the concerned Department shall not constitute a dispute).
- (viii) whether the company has defaulted in repayment of loans or borrowing to a financial institution, bank, Government or dues to debenture holders? If yes, the period and the amount of default to be reported (in case of defaults to banks, financial institutions, and Government, lender wise details to be provided).
- (ix) whether moneys raised by way of initial public offer or further public offer (including debt instruments) and term loans were applied for the purposes for which those are raised. If not, the details together with delays or default and subsequent rectification, if any, as may be applicable, be reported;
- (x) whether any fraud by the company or any fraud on the Company by its officers or employees has been noticed or reported during the year; If yes, the nature and the amount involved is to be indicated;
- (xi) whether managerial remuneration has been paid or provided in accordance with the requisite approvals mandated by the provisions of section 197 read with Schedule V to the Companies Act, 2013? If not, state the amount involved and steps taken by the company for securing refund of the same;
- (xii) whether the Nidhi Company has complied with the Net Owned Funds to Deposits in the ratio of 1:20 to meet out the liability and whether the Nidhi Company is maintaining ten per cent unencumbered term deposits as specified in the Nidhi Rules, 2014 to meet out the liability;
- (xiii) whether all transactions with the related parties are in compliance with sections 177 and 188 of Companies Act, 2013 where applicable and the details have been disclosed in the Financial Statements etc., as required by the applicable accounting standards;
- (xiv) whether the company has made any preferential allotment or private placement of shares or fully or partly convertible debentures during the year under review and if so, as to whether the requirement of section 42 of the Companies Act, 2013 have been complied with and the amount raised have been used for the purposes for which the funds were raised. If not, provide the details in respect of the amount involved and nature of non-compliance;
- (xv) whether the company has entered into any non-cash transactions with directors or persons connected with him and if so, whether the provisions of section 192 of Companies Act, 2013 have been complied with;

(xvi) whether the company is required to be registered under section 45-IA of the Reserve Bank of India Act, 1934 and if so, whether the registration has been obtained.

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 basis for such unfavourable or qualified answer, as the case may be.

Further, where the auditor is unable to express any opinion on any specified matter, his report shall indicate such fact together with the reasons why it is not possible for him to give his opinion on the same.

Example: *The company has dispensed with the practice of taking inventory 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. Explain reporting requirement under CARO, 2016.*

Reporting for Physical Verification of Inventory: *Clause (ii) of Para 3 of CARO, 2016, requires the auditor to report whether physical verification of inventory has been conducted at reasonable intervals by the management and whether any material discrepancies were noticed and if so, whether they have been properly dealt with in the books of account.*

The physical verification of inventory is the responsibility of the management of the company which should verify all material items at least once in a year and more often in appropriate cases.

In the given case, the above requirement of physical verification of inventory by the management has not been taken place and therefore the auditor should point out the same under CARO, 2016. He may consider the impact on financial statement and report accordingly.

11. Disclosure in the Auditor's Report

The following paragraphs deal with the manner of qualification and the manner of disclosure, if any, to be made in the auditor's report.

AS-1 – Disclosure of Accounting Policies

In the case of a company, members should qualify their audit reports in case –

- (a) accounting policies required to be disclosed under Schedule III or any other provisions of the Companies Act, 2013 have not been disclosed, or
- (b) accounts have not been prepared on accrual basis, or
- (c) the fundamental accounting assumption of going concern has not been followed and this fact has not been disclosed in the financial statements, or
- (d) proper disclosures regarding changes in the accounting policies have not been made.

Where a company has been given a specific exemption regarding any of the matters stated above but the fact of such exemption has not been adequately disclosed in the accounts, the

member should mention the fact of exemption in his audit report without necessarily making it a subject matter of audit qualification.

In view of the above, the auditor will have to consider different circumstances whether the audit report has to be qualified or only disclosures have to be given.

In the case of enterprises not governed by the Companies Act, the member should examine the relevant statute and make suitable qualification in his audit report in case adequate disclosures regarding accounting policies have not been made as per the statutory requirements. Similarly, the member should examine if the fundamental accounting assumptions have been followed in preparing the financial statements or not. In appropriate cases, he should consider whether, keeping in view the requirements of the applicable laws, a qualification in his report is necessary.

In the event of non-compliance by enterprises not governed by the Companies Act, in situations where the relevant statute does not require such disclosures to be made, the member should make adequate disclosure in his audit report without necessarily making it a subject matter of audit qualification.

In making a qualification / disclosure in the audit report, the auditor should consider the materiality of the relevant item. Thus, the auditor need not make qualification / disclosure in respect of items which, in his judgement, are not material.

A disclosure, which is not a subject matter of audit qualification, should be made in the auditor's report in a manner that it is clear to the reader that the disclosure does not constitute an audit qualification. The paragraph containing the auditor's opinion on true and fair view should not include a reference to the paragraph containing the aforesaid disclosure.

12. Joint Audit

The practice of appointing Chartered Accountants as joint auditors is quite widespread in big companies and corporations. Joint audit basically implies pooling together the resources and expertise of more than one firm of auditors to render an expert job in a given time period which may be difficult to accomplish acting individually. It essentially involves sharing of the total work. This is by itself a great advantage.

In specific terms the **advantages** that flow may be the following:

- (i) Sharing of expertise.
- (ii) Advantage of mutual consultation.
- (iii) Lower workload.
- (iv) Better quality of performance.
- (v) Improved service to the client.
- (vi) Displacement of the auditor of the company taken over in a take - over often obviated.
- (vii) In respect of multi-national companies, the work can be spread using the expertise of the local firms which are in a better position to deal with detailed work and the local laws and regulations.

- (viii) Lower staff development costs.
- (ix) Lower costs to carry out the work.
- (x) A sense of healthy competition towards a better performance.

The general **disadvantages** may be the following:

- (i) The fees being shared.
- (ii) Psychological problem where firms of different standing are associated in the joint audit.
- (iii) General superiority complexes of some auditors.
- (iv) Problems of co-ordination of the work.
- (v) Areas of work of common concern being neglected.
- (vi) Uncertainty about the liability for the work done.

The Institute of Chartered Accountants of India has issued Standard on Auditing (SA) 299 (Revised), "Joint Audit of Financial Statements" which lays down the principles for effective conduct of joint audit to achieve the overall objectives of the auditor as laid down in SA 200 "Overall Objectives of the Independent Auditor and the conduct of an audit in accordance with Standards on Auditing". This Standard deals with the special considerations in carrying out audit by joint auditors. It requires that–

- (i) the engagement partner and other key members of the engagement team from each of the joint auditors should be involved in planning the audit.***
- (ii) the joint auditors should jointly establish an overall audit strategy which sets the scope, timing and direction of the audit, and also guides the development of the audit plan.***
- (iii) before the commencement of the audit, the joint auditors should discuss and develop a joint audit plan. In developing the joint audit plan, the joint auditors should:***
 - (1) identify division of audit areas and common audit areas;***
 - (2) ascertain the reporting objectives of the engagement;***
 - (3) consider and communicate among all joint auditors the factors that are significant in directing the engagement team's efforts;***
 - (4) consider the results of preliminary engagement activities, or similar engagements performed earlier.***
 - (5) ascertain the nature, timing and extent of resources necessary to accomplish the engagement.***
- (iv) each of the joint auditors should consider and assess the risks of material misstatement and communicate to other joint auditors.***
- (v) the joint auditors should discuss and document the nature, timing, and the extent of the audit procedures for (I) common and (II) specific allotted areas of audit to be***

performed.

- (vi) the joint auditors should obtain common engagement letter and common management representation letter.*
- (vii) the work allocation document should be signed by all the joint auditors and communicated to those charged with governance.*

It further states that, in respect of audit work divided among the joint auditors, each joint auditor shall be responsible only for the work allocated to such joint auditor including proper execution of the audit procedures. On the other hand, all the joint auditors shall be jointly and severally responsible for:

- (i) the audit work which is not divided among the joint auditors and is carried out by all joint auditors;*
- (ii) decisions taken by all the joint auditors under audit planning in respect of common audit areas;*
- (iii) matters which are brought to the notice of the joint auditors by any one of them and there is an agreement among the joint auditors on such matters;*
- (iv) examining that the financial statements of the entity comply with the requirements of the relevant statutes;*
- (v) presentation and disclosure of the financial statements as required by the applicable financial reporting framework;*
- (vi) ensuring that the audit report complies with the requirements of the relevant statutes, applicable Standards on Auditing and other relevant pronouncements issued by ICAI.*

In case a joint auditor comes across matters which are relevant to the areas of responsibility of other joint auditors and which deserve their attention, or which require disclosure or require discussion with, or application of judgment by other joint auditors, the said joint auditor shall communicate the same to all the other joint auditors in writing prior to the completion of the audit.

It may be noted that the joint auditors are required to issue common audit report. However, where the joint auditors are in disagreement with regard to the opinion or any matters to be covered by the audit report, they shall express their opinion in a separate audit report. In such circumstances, the audit report(s) issued by the joint auditor(s) shall make a reference to each other's audit report(s).

[Note: Student may refer SA 299 (revised) “Joint Audit of Financial Statements” reproduced in “Auditing Pronouncements” for comprehensive knowledge.]

13. Audit of Branch Office Accounts

As per **section 128(1)** of the Companies Act, 2013, 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, and explain the transactions effected both at the registered office and its branches and such books shall be kept on accrual basis and according to the double entry system of accounting.

It may be noted that all or any of the books of account aforesaid and other relevant papers may be kept at such other place in India as the Board of Directors may decide and where such a decision is taken, the company shall, within 7 days thereof, file with the Registrar a notice in writing giving the full address of that other place.

Students may also note that the company may keep such books of account or other relevant papers in electronic mode in such manner as may be prescribed.

Sub-section (2) provides that where a company has a branch office in India or outside India, it shall be deemed to have complied with the provisions of sub-section (1), if proper books of account relating to the transactions effected at the branch office are kept at that office and proper summarised returns periodically are sent by the branch office to the company at its registered office or the other place referred in (1).

Further, **sub-section (8) of section 143 of the Companies Act, 2013**, prescribes the duties and powers of the company's auditor with reference to the audit of the branch and the branch auditor. Where a company has a branch office, the accounts of that office shall be audited either by the auditor appointed for the company (herein referred to as the company's auditor) under this Act or by any other person qualified for appointment as an auditor of the company under this Act and appointed as such under section 139, or where the branch office is situated in a country outside India, the accounts of the branch office shall be audited either by the company's auditor or by an accountant or by any other person duly qualified to act as an auditor of the accounts of the branch office in accordance with the laws of that country and the duties and powers of the company's auditor with reference to the audit of the branch and the branch auditor, if any, shall be such as may be prescribed:

It may be noted that the branch auditor shall prepare a report on the accounts of the branch examined by him and send it to the auditor of the company who shall deal with it in his report in such manner as he considers necessary.

Further as per **rule 12 of the Companies (Audit and Auditors) Rules, 2014**, the branch auditor shall submit his report to the company's auditor and reporting of fraud by the auditor shall also extend to such branch auditor to the extent it relates to the concerned branch.

Using the Work of another Auditor: When the accounts of the branch are audited by a person other than the company's auditor, there is need for a clear understanding of the role of such auditor and the company's auditor in relation to the audit of the accounts of the branch and the audit of the company as a whole; also, there is great necessity for a proper rapport between these two auditors for the purpose of an effective audit. In recognition of these needs, the Council of the Institute of Chartered Accountants of India has dealt with these issues in **SA 600, "Using the Work of another Auditor"**. It makes clear that in certain situations, the statute governing the entity may confer a right on the principal auditor to visit a component and examine

the books of account and other records of the said component, if he thinks it necessary to do so. Where another auditor has been appointed for the component, the principal auditor would normally be entitled to rely upon the work of such auditor unless there are special circumstances to make it essential for him to visit the component and/or to examine the books of account and other records of the said component. Further, it requires that the principal auditor should perform procedures to obtain sufficient appropriate audit evidence, that the work of the other auditor is adequate for the principal auditor's purposes, in the context of the specific assignment. When using the work of another auditor, the principal auditor should ordinarily perform the following procedures:

- (a) advise the other auditor of the use that is to be made of the other auditor's work and report and make sufficient arrangements for co-ordination of their efforts at the planning stage of the audit. The principal auditor would inform the other auditor of matters such as areas requiring special consideration, procedures for the identification of inter-component transactions that may require disclosure and the time-table for completion of audit; and
- (b) advise the other auditor of the significant accounting, auditing and reporting requirements and obtain representation as to compliance with them.

The principal auditor might discuss with the other auditor the audit procedures applied or review a written summary of the other auditor's procedures and findings which may be in the form of a completed questionnaire or check-list. The principal auditor may also wish to visit the other auditor. The nature, timing and extent of procedures will depend on the circumstances of the engagement and the principal auditor's knowledge of the professional competence of the other auditor. This knowledge may have been enhanced from the review of the previous audit work of the other auditor.

14. Cost Audit

Cost Audit is an audit process for verifying the cost of manufacture or production of any article, on the basis of accounts as regards utilisation of material or labour or other items of costs, maintained by the company.

It is covered by **Section 148** of the Companies Act, 2013. The audit conducted under this section shall be in addition to the audit conducted under section 143.

As per section 148 the Central Government may by order specify audit of items of cost in respect of certain companies.

Further, the Central Government may, by order, in respect of such class of companies engaged in the production of such goods or providing such services as may be prescribed, direct that particulars relating to the utilisation of material or labour or to other items of cost as may be prescribed shall also be included in the books of account kept by that class of companies.

In this regard, the Central Government has notified the Companies (Cost Records and Audit) Rules, 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.

Applicability for 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, having an overall turnover from all its products and services of ₹ 35 crore or more during the immediately preceding financial year, 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 (A) Regulated sectors and (B) Non-regulated sectors.

Maintenance of Cost Records: 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, 2016**, the auditor has to report whether maintenance of cost records has been specified by the Central Government under section 148(1) of the Companies Act, 2013 and whether such accounts and records have been so 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.

Who can be Cost Auditor: The audit shall be conducted by a Cost Accountant who shall be appointed by the Board of such remuneration as may be determined by the members in such manner as may be prescribed.

It may be noted that no person appointed under section 139 as an auditor of the company shall be appointed for conducting the audit of cost records.

It may also be noted that the auditor conducting the cost audit shall comply with the cost auditing standards ("cost auditing standards" mean such standards as are issued by the Institute of Cost Accountants of India, constituted under the Cost and Works Accountants Act, 1959, with the approval of the Central Government).

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. However, before such appointment is made, the written consent of the cost auditor to such appointment and a certificate from him or it shall be obtained.

The certificate to be obtained from the cost auditor shall certify that the-

- (a) the individual or the firm, as the case may be, is eligible for appointment and is not disqualified for appointment under the Companies Act, 2013, the Cost and Works Accountants Act, 1959 and the rules or regulations made thereunder;
- (b) the individual or the firm, as the case may be, satisfies the criteria provided in section 141 of the Companies Act, 2013 so far as may be applicable;
- (c) the proposed appointment is within the limits laid down by or under the authority of the Companies Act, 2013; and
- (d) the list of proceedings against the cost auditor or audit firm or any partner of the audit firm pending with respect to professional matters of conduct, as disclosed in the certificate, is true and correct.

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.

Removal of Cost Auditor: The cost auditor may be removed from his office before the expiry of his term, through a board resolution after giving a reasonable opportunity of being heard to the cost auditor and recording the reasons for such removal in writing.

It may be noted that the Form CRA-2 to be filed with the Central Government for intimating appointment of another cost auditor shall enclose the relevant Board Resolution to the effect.

It may further be noted that the above provisions shall not prejudice the right of the cost auditor to resign from such office of the company.

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.

Remuneration of Cost Auditor: As per rule 14 of the Companies (Audit and Auditors) Rules, 2014-

- (a) in the case of companies which are required to constitute an audit committee-
 - (i) the Board shall appoint an individual, who is a cost accountant, or a firm of cost accountants in practice, as cost auditor on the recommendations of the Audit committee, which shall also recommend remuneration for such cost auditor;
 - (ii) the remuneration recommended by the Audit Committee under (i) shall be considered and approved by the Board of Directors and ratified subsequently by the shareholders;
- (b) in the case of other companies which are not required to constitute an audit committee, the Board shall appoint an individual who is a cost accountant or a firm of cost accountants in practice as cost auditor and the remuneration of such cost auditor shall be ratified by shareholders subsequently.

Qualification, Disqualification, Rights, Duties and Obligations of Cost Auditor: The qualifications, disqualifications, rights, duties and obligations applicable to auditors under this Chapter shall, so far as may be applicable, apply to a cost auditor appointed under this section and it shall be the duty of the company to give all assistance and facilities to the cost auditor appointed under this section for auditing the cost records of the company.

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 in Extensible Business Reporting Language (XBRL) format in the manner as specified in the Companies (Filing of Documents and Forms in Extensible Business Reporting language) Rules, 2015 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: 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.
- (iii) which is engaged in generation of electricity for captive consumption through Captive Generating Plant.

Penal Provisions in Case of Default: If any default is made in complying with the provisions of this section,

- (a) the company and every officer of the company who is in default shall be punishable in the manner as provided in sub-section (1) of section 147;
- (b) the cost auditor of the company who is in default shall be punishable in the manner as provided in sub-sections (2) to (4) of section 147.

15. Punishment for non-compliance

Section 147 of the Companies Act, 2013 prescribes following punishments for contravention:

(1) If any of the provisions of sections 139 to 146 (both inclusive) is contravened, the company shall be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than ten thousand rupees but which may extend to one lakh rupees, or with both.

(2) If an auditor of a company contravenes any of the provisions of section 139 section 143, section 144 or section 145, the auditor shall be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees **or four times the remuneration of the auditor, whichever is less.**

It may be noted that if an auditor has contravened such provisions knowingly or willfully with the intention to deceive the company or its shareholders or creditors or tax authorities, he shall be punishable with imprisonment for a term which may extend to one year and with fine which shall not be less than **fifty thousand** rupees but which may extend to twenty-five lakh rupees **or eight times the remuneration of the auditor, whichever is less.**

- (3) Where an auditor has been convicted under sub-section (2), he shall be liable to-
 - (i) refund the remuneration received by him to the company;

(ii) and pay for damages to the company statutory bodies or authorities or to **members or creditors of the company** for loss arising out of incorrect or misleading statements of particulars made in his audit report.

(4) The Central Government shall, by notification, specify any statutory body or authority of an officer for ensuring prompt payment of damages to the company or the persons under clause (ii) of sub-section (3) and such body, authority or officer shall after payment of damages the such company or persons file a report with the Central Government in respect of making such damages in such manner as may be specified in the said notification.

(5) Where, in case of audit of a company being conducted by an audit firm, it is proved that the partner or partners of the audit firm has or have acted in a fraudulent manner or abetted or colluded in an fraud by, or in relation to or by, the company or its directors or officers, the liability, whether civil or criminal as provided in this Act or in any other law for the time being in force, for such act shall be of the partner or partners concerned of the audit firm and of the firm jointly and severally.

It may be noted that in case of criminal liability of an audit firm, in respect of liability other than fine, the concerned partner(s), who acted in a fraudulent manner or abetted or, as the case may be, colluded in any fraud shall only be liable.

16. Audit report

Management is responsible for the preparation of the financial statements. Management also accepts responsibility for necessary internal controls to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

The purpose of an audit is to enhance the degree of confidence of intended users of the financial statements. The aforesaid purpose is achieved by the expression of an independent reporting by the auditor as to whether the financial statements exhibit a true and fair view of the affairs of the entity.

Thus, an Audit report is an opinion drawn on the entity's financial statements to make sure that the records are true and fair representation of the transactions they claim to represent. This involves considering whether the financial statements have been prepared in accordance with an acceptable financial reporting framework applicable to the entity under audit. It is also necessary to consider whether the financial statements comply with the relevant statutory requirements. The main users of audit report are shareholders, members and all other stakeholders of the company.

17. Forming an Opinion on the Financial Statements- Objective of the Auditor

17.1 The objectives of the auditor as per SA 700 (Revised), "Forming An Opinion And Reporting On Financial Statements" are:

- (a) To form an opinion on the financial statements based on an evaluation of the conclusions drawn from the audit evidence obtained; and
- (b) To express clearly that opinion through a written report.

The auditor shall form an opinion on whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.

17.2 To form opinion - Auditor to obtain Reasonable assurance

In order to form that opinion, the auditor shall conclude as to whether the auditor has obtained reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error.

That conclusion shall take into account:

- (a) whether sufficient appropriate audit evidence has been obtained;
- (b) whether uncorrected misstatements are material, individually or in aggregate;
- (c) The evaluations

17.3 Evaluations by the Auditor


The auditor shall evaluate whether the financial statements are prepared in accordance with the requirements of the applicable financial reporting framework.


This evaluation shall include consideration of the qualitative aspects of the entity's accounting practices, including indicators of possible bias in management's judgments.

17.3.1 Qualitative Aspects of the Entity's Accounting Practices

1. Management makes a number of judgments about the amounts and disclosures in the financial statements.
2. SA 260 (Revised) contains a discussion of the qualitative aspects of accounting practices.
3. In considering the qualitative aspects of the entity's accounting practices, the auditor may become aware of possible bias in management's judgments. The auditor may conclude that lack of neutrality together with uncorrected misstatements causes the financial statements to be materially misstated. Indicators of a lack of neutrality include the following:
 - (i) The selective correction of misstatements brought to management's attention during the audit

Example

-  Correcting misstatements with the effect of increasing reported earnings, but not correcting misstatements that have the effect of decreasing reported earnings.

 The combination of several deficiencies affecting the same significant account or disclosure (or the same internal control component) could amount to a significant deficiency (or material weakness if required to be communicated in the jurisdiction). This evaluation requires judgment and involvement of audit executives.

- (ii) Possible management bias in the making of accounting estimates.
- 4. SA 540 addresses possible management bias in making accounting estimates.


Indicators of possible management bias do not constitute misstatements for purposes of drawing conclusions on the reasonableness of individual accounting estimates. They may, however, affect the auditor's evaluation of whether the financial statements as a whole are free from material misstatement.


17.4 Specific Evaluations by the auditor

In particular, the auditor shall evaluate whether :

- (a) The financial statements adequately disclose the significant accounting policies selected and applied;
- (b) The accounting policies selected and applied are consistent with the applicable financial reporting framework and are appropriate;
- (c) The accounting estimates made by management are reasonable;
- (d) The information presented in the financial statements is relevant, reliable, comparable, and understandable;
- (e) The financial statements provide adequate disclosures to enable the intended users to understand the effect of material transactions and events on the information conveyed in the financial statements; and
- (f) The terminology used in the financial statements, including the title of each financial statement, is appropriate.

Example:

 If an amount or disclosure in the financial statements is under greater scrutiny by users of the financial statements, then a smaller misstatement may be considered more significant.

 A misstatement may be objectively determinable or may involve a degree of subjectivity through estimation, allocation or uncertainty.

17.5 Form of Opinion

Unmodified Opinion: The auditor shall express an unmodified opinion when the auditor concludes that the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.

Modified Opinion: If the auditor:

(a) concludes that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement; or

(b) is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement,

the auditor shall modify the opinion in the auditor's report in accordance with SA 705.

17.6 Auditor's Report

The auditor's report shall be in writing. A written report encompasses reports issued in hard copy and those using an electronic medium.

This SA-700 requires the use of specific headings, which are intended to assist in making auditor's reports that refer to audits that have been conducted in accordance with SAs more recognizable.

17.6.1 Auditor's Report for Audits Conducted in Accordance with Standards on Auditing

Basic Elements of an Audit Report are given below:

1 Title: The auditor's report shall have a title that clearly indicates that it is the report of an independent auditor.

For example, "Independent Auditor's Report," distinguishes the independent auditor's report from reports issued by others.

2. Addressee: The auditor's report shall be addressed, as appropriate, based on the circumstances of the engagement. Law, regulation or the terms of the engagement may specify to whom the auditor's report is to be addressed.

The auditor's report is normally addressed to those for whom the report is prepared, often either to the shareholders or to those charged with governance of the entity whose financial statements are being audited.

3. Auditor's Opinion: The first section of the auditor's report shall include the auditor's opinion, and shall have the heading "Opinion."

The Opinion section of the auditor's report shall also:

(a) Identify the entity whose financial statements have been audited;

- (b) State that the financial statements have been audited;
- (c) Identify the title of each statement comprising the financial statements;
- (d) Refer to the notes, including the summary of significant accounting policies; and
- (e) Specify the date of, or period covered by, each financial statement comprising the financial statements.

Expressing an unmodified opinion on financial statements

When expressing an unmodified opinion on financial statements, the auditor's opinion shall, unless otherwise required by law or regulation, use one of the following phrases, which are regarded as being equivalent:

- (a) In our opinion, the accompanying financial statements **present fairly, in all material respects**, [...] in accordance with [the applicable financial reporting framework]; or
- (b) In our opinion, the accompanying financial statements **give a true and fair view of** [...] in accordance with [the applicable financial reporting framework].

“Present fairly, in all material respects” or “give a true and fair view”

The phrases “present fairly, in all material respects,” and “give a true and fair view” are regarded as being equivalent

When the auditor expresses an unmodified opinion, it is not appropriate to use phrases such as “with the foregoing explanation” or “subject to” in relation to the opinion, as these suggest a conditional opinion or a weakening or modification of opinion.

4. Basis for Opinion:

The auditor's report shall include a section, directly following the Opinion section, with the heading **“Basis for Opinion”**, that:

- (a) States that the audit was conducted in accordance with Standards on Auditing;
- (b) Refers to the section of the auditor's report that describes the auditor's responsibilities under the SAs;
- (c) Includes a statement that the auditor is independent of the entity in accordance with the relevant ethical requirements relating to the audit and has fulfilled the auditor's other ethical responsibilities in accordance with these requirements.
- (d) States whether the auditor believes that the audit evidence the auditor has obtained is sufficient and appropriate to provide a basis for the auditor's opinion.

5. Going Concern: Where applicable, the auditor shall report in accordance with SA 570 (Revised).

6. Key Audit Matters: For audits of complete sets of general purpose financial statements of listed entities, the auditor shall communicate key audit matters in the auditor's report in accordance with SA 701.

When the auditor is otherwise required by law or regulation or decides to communicate key audit matters in the auditor's report, the auditor shall do so in accordance with SA 701.

Law or regulation may require communication of key audit matters for audits of entities other than listed entities,

For example, entities characterized in such law or regulation as public interest entities.

The auditor may also decide to communicate key audit matters for other entities, including those that may be of significant public interest, for example because they have a large number and wide range of stakeholders and considering the nature and size of the business.

Examples of such entities may include financial institutions (such as banks, insurance companies, and pension funds), and other entities such as charities.

7. Responsibilities for the Financial Statements: The auditor's report shall include a section with a heading "Responsibilities of Management for the Financial Statements."

SA 200 explains the premise, relating to the responsibilities of management and, where appropriate, those charged with governance, on which an audit in accordance with SAs is conducted. Management and, where appropriate, those charged with governance accept responsibility for the preparation of the financial statements. Management also accepts responsibility for such internal control as it determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error. The description of management's responsibilities in the auditor's report includes reference to both responsibilities as it helps to explain to users the premise on which an audit is conducted.

This section of the auditor's report shall describe management's responsibility for:

- (a) **Preparing the financial statements** in accordance with the applicable financial reporting framework, **and for such internal control** as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; [because of the possible effects of fraud on other aspects of the audit, materiality does not apply to management's acknowledgement regarding its responsibility for the design, implementation, and maintenance of internal control (or for establishing and maintaining effective internal control over financial reporting) to prevent and detect fraud.] and
- (b) **Assessing the entity's ability to continue as a going concern** and whether the use of the going concern basis of accounting is appropriate as well as disclosing, if applicable, matters relating to going concern. The explanation of management's responsibility for this assessment shall include a description of when the use of the going concern basis of accounting is appropriate.

❖ Auditor cannot conclude that management has provided with all relevant information agreed in the terms of the audit engagement agreement without confirming with management whether such information has been provided.

- ❖ When those individuals who have signed the engagement agreement at the start of the audit have left the entity, the auditor would request those who are giving the representations to acknowledge their responsibilities within the letter of representations.
- ❖ A management representation as to the amount required for a particular provision is not a substitute for the audit procedures regarding the provision that the auditor would expect to perform.

Periods covered by the letter: The auditor to obtain representations for all financial statements and periods referred to in our auditor's report. Auditor would obtain a specific representation if a restatement is made to correct a material misstatement in the prior period financial statements that affects the comparative information in the financial statements. If current management was not present during all periods covered by auditor's report, he still would obtain written representations from current management on all such periods.

SA 210 requires the auditor to agree management's responsibilities in an engagement letter or other suitable form of written agreement.

Oversight of the financial reporting process: This section of the auditor's report shall also identify those responsible for the oversight of the financial reporting process, when those responsible for such oversight are different from Management. In this case, the heading of this section shall also refer to "Those Charged with Governance"

8. Auditor's Responsibilities for the Audit of the Financial Statements:

The auditor's report shall include a section with the heading "**Auditor's Responsibilities for the Audit of the Financial Statements.**"

This section of the auditor's report shall:

- (a) State that the objectives of the auditor are to:
 - (i) **Obtain reasonable assurance** about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error; and
 - (ii) **Issue an auditor's report** that includes the auditor's opinion.
- (b) State that reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with SAs will always detect a material misstatement when it exists; and
- (c) State that misstatements can arise from fraud or error, and either:
 - (i) Describe that they are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements; or
 - (ii) Provide a definition or description of materiality in accordance with the applicable financial reporting framework.

The Auditor’s Responsibilities for the Audit of the Financial Statements section of the auditor’s report shall further:

- (a) State that, as part of an audit in accordance with SAs, the auditor exercises professional judgment and maintains professional skepticism throughout the audit; and
- (b) Describe an audit by stating that the auditor’s responsibilities are:
 - (i) To identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error; to design and perform audit procedures responsive to those risks; and to obtain audit evidence that is sufficient and appropriate to provide a basis for the auditor’s opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

1. To identify and assess the risks of material misstatement of the financial statements.
2. to design and perform audit procedures in response to those risks
3. to obtain sufficient and appropriate audit evidence.

- (ii) To obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances.
- (iii) To evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- (iv) To conclude on the appropriateness of management’s use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the entity’s ability to continue as a going concern.

The Auditor’s Responsibilities for the Audit of the Financial Statements section of the auditor’s report also shall:

- (a) State that **the auditor communicates with those charged with governance** regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that the auditor identifies during the audit;
- (b) For audits of financial statements of listed entities, state that the auditor provides those charged with governance with a statement that the auditor has complied with relevant ethical requirements regarding independence and communicate with them all relationships and other matters that may reasonably be thought to bear on the auditor’s independence, and where applicable, related safeguards; and
- (c) For audits of financial statements of listed entities and any other entities for which key audit matters are communicated in accordance with SA 701, state that, from the matters

communicated with those charged with governance, the auditor determines those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. The auditor describes these matters in the auditor's report unless law or regulation precludes public disclosure.

9. Location of the description of the auditor's responsibilities for the audit of the financial statements: The description of the auditor's responsibilities for the audit of the financial statements shall be included:

- (a) Within the body of the auditor's report;
- (b) Within an appendix to the auditor's report, in which case the auditor's report shall include a reference to the location of the appendix; or
- (c) By a specific reference within the auditor's report to the location of such a description on a website of an appropriate authority, where law, regulation or national auditing standards expressly permit the auditor to do so.

ILLUSTRATION

The following is an illustration of how such a reference to an appendix could be made in the auditor's report:

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with SAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is included in appendix X of this auditor's report. This description, which is located at [*indicate page number or other specific reference to the location of the description*], forms part of our auditor's report.

10. Other Reporting Responsibilities: If the auditor addresses other reporting responsibilities in the auditor's report on the financial statements that are in addition to the auditor's responsibilities under the SAs, these other reporting responsibilities shall be addressed in a separate section in the auditor's report with a heading titled-

"Report on Other Legal and Regulatory Requirements" or otherwise as appropriate to the content of the section, unless these other reporting responsibilities address the same topics as those presented under the reporting responsibilities required by the SAs in which case the other reporting responsibilities may be presented in the same section as the related report elements required by the SAs.

If other reporting responsibilities are presented in the same section as the related report elements required by the SAs, the auditor's report shall clearly differentiate the other reporting responsibilities from the reporting that is required by the SAs.

If the auditor's report contains a separate section that addresses other reporting responsibilities, the requirements stated above shall be included under a section with a heading "Report on the Audit of the Financial Statements." The "Report on Other Legal and Regulatory Requirements" shall follow the "Report on the Audit of the Financial Statements."

11. Signature of the Auditor: The auditor's report shall be signed. The report is signed by the auditor (i.e. the engagement partner) in his personal name. Where the firm is appointed as the auditor, the report is signed in the personal name of the auditor and in the name of the audit firm.

The partner/proprietor signing the audit report also needs to mention the membership number assigned by the Institute of Chartered Accountants of India. They also include the registration number of the firm, wherever applicable, as allotted by ICAI, in the audit reports signed by them

12. Auditor's Address: The auditor's report shall name specific location, which is ordinarily the city where the audit report is signed.

13 Date of the Auditor's Report: The auditor's report shall be dated no earlier than the date on which the auditor has obtained sufficient appropriate audit evidence on which to base the auditor's opinion on the financial statements, including evidence that:

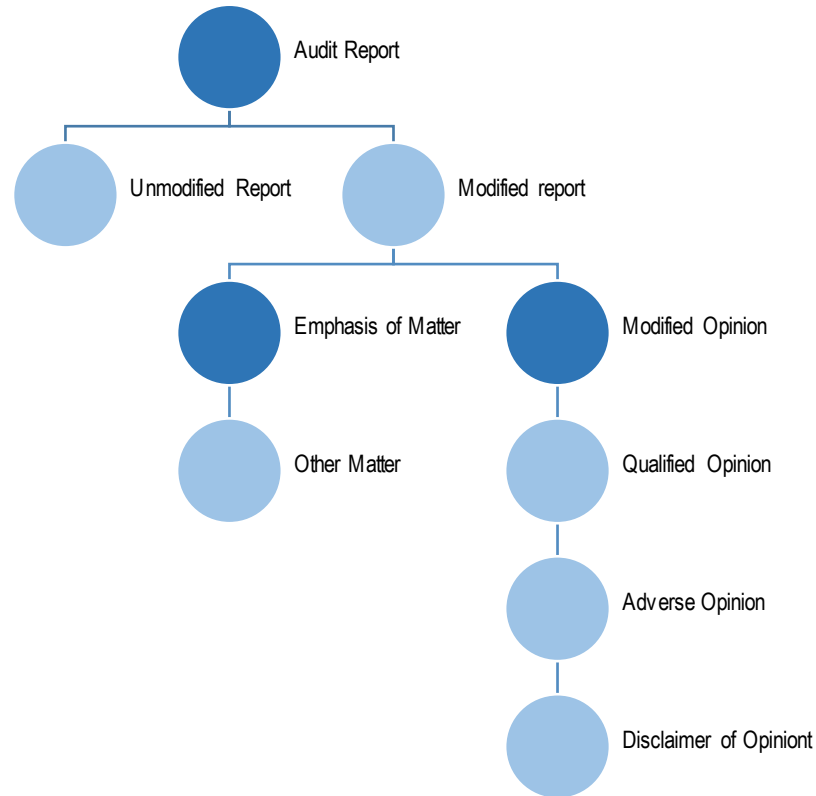
- (a) All the statements that comprise the financial statements, including the related notes, have been prepared; and
- (b) Those with the recognized authority have asserted that they have taken responsibility for those financial statements.

The date of the auditor's report informs the user of the auditor's report that the auditor has considered the effect of events and transactions of which the auditor became aware and that occurred up to that date. The auditor's responsibility for events and transactions after the date of the auditor's report is addressed in SA 560.

18 Modifications To The Opinion In The Independent Auditor's Report

Standard on Auditing (SA) 705 "Modifications To The Opinion In The Independent Auditor's Report" deals with the auditor's responsibility to issue an appropriate report in circumstances when, in forming an opinion in accordance with SA 700 (Revised) "**Forming An Opinion And Reporting On Financial Statements**", the auditor concludes that a modification to the auditor's opinion on the financial statements is necessary.

This SA also deals with how the form and content of the auditor's report is affected when the auditor expresses a modified opinion.



18.1 Circumstances When a Modification to the Auditor's Opinion Is Required

The auditor shall modify the opinion in the auditor's report when:

- (a) The auditor concludes that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement; or
- (b) The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement.

18.2 Objective of the auditor - to express clearly an appropriately modified opinion

As per Standard on Auditing (SA) 705 "Modifications To The Opinion In The Independent Auditor's Report", the objective of the auditor is **to express clearly an appropriately modified opinion** on the financial statements that is necessary when:

- (a) The auditor concludes, based on the audit evidence obtained, that the financial statements as a whole are not free from material misstatement; or
- (b) The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement.

18.3 Types of Modified Opinions

There are three types of modified opinions, namely-

1. A qualified opinion
2. An adverse opinion
3. A disclaimer of opinion.

Qualified Opinion	Adverse Opinion	Disclaimer of Opinion
<ul style="list-style-type: none"> • The auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements are material, but not pervasive 	<ul style="list-style-type: none"> • The auditor shall express an adverse opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive 	<ul style="list-style-type: none"> • The auditor shall disclaim an opinion when he is unable to obtain sufficient appropriate audit evidence and he concludes that the possible effects on the financial statements of undetected misstatements could be both material and pervasive.

Qualified Opinion

The auditor shall express a qualified opinion when:

- (a) The auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are material, but not pervasive, to the financial statements; or
- (b) The auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, but the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive.

Adverse Opinion

The auditor shall express an adverse opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements.

Disclaimer of Opinion The auditor shall disclaim an opinion when the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, and the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive.

The auditor shall disclaim an opinion when, in extremely rare circumstances involving multiple uncertainties, the auditor concludes that, notwithstanding having obtained sufficient appropriate audit evidence regarding each of the individual uncertainties, it is not possible to form an opinion

on the financial statements due to the potential interaction of the uncertainties and their possible cumulative effect on the financial statements.

Definition of Pervasive – A term used, in the context of misstatements, to describe the effects on the financial statements of misstatements or the possible effects on the financial statements of misstatements, if any, that are undetected due to an inability to obtain sufficient appropriate audit evidence.

Pervasive effects on the financial statements are those that, in the auditor's judgment:

- (i) Are not confined to specific elements, accounts or items of the financial statements;
- (ii) If so confined, represent or could represent a substantial proportion of the financial statements; or
- (iii) In relation to disclosures, are fundamental to users' understanding of the financial statements.

18.4 Which type of opinion is appropriate?

The decision regarding which type of modified opinion is appropriate depends upon:

- (a) The nature of the matter giving rise to the modification, that is, whether the financial statements are materially misstated or, in the case of an inability to obtain sufficient appropriate audit evidence, may be materially misstated; and
- (b) The auditor's judgment about the pervasiveness of the effects or possible effects of the matter on the financial statements.

The table below illustrates how the auditor's judgment about the nature of the matter giving rise to the modification, and the pervasiveness of its effects or possible effects on the financial statements, affects the type of opinion to be expressed.

Nature of Matter Giving Rise to the Modification	Auditor's Judgment about the Pervasiveness of the Effects or Possible Effects on the Financial Statements	
	Material but Not Pervasive	Material and Pervasive
Financial statements are materially misstated	Qualified opinion	Adverse opinion
Inability to obtain sufficient appropriate audit evidence	Qualified opinion	Disclaimer of opinion

18.5 Basis for Opinion

When the auditor modifies the opinion on the financial statements, the auditor shall, in addition to the specific elements required by SA 700 (Revised)

- (a) Amend the heading "Basis for Opinion" required by para of SA 700 (Revised) to "Basis for Qualified Opinion," "Basis for Adverse Opinion," or "Basis for Disclaimer of Opinion," as appropriate; and

(b) Within this section, include a description of the matter giving rise to the modification.

19 Emphasis Of Matter Paragraphs And Other Matter Paragraphs In The Independent Auditor's Report.

19.1 Objective of the Auditor as per SA 706

As per SA 706 (Revised) on “Emphasis of Matter Paragraphs and Other Matter Paragraphs In The Independent Auditor's Report”, the objective of the auditor, having formed an opinion on the financial statements, is to draw users' attention, when in the auditor's judgment it is necessary to do so, by way of clear additional communication in the auditor's report, to:

- (a) A matter, although appropriately presented or disclosed in the financial statements, that is of such importance that it is fundamental to users' understanding of the financial statements; or
- (b) As appropriate, any other matter that is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report.

Definitions:
Emphasis of Matter paragraph – A paragraph included in the auditor's report that refers to a matter appropriately presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements.
Other Matter paragraph – A paragraph included in the auditor's report that refers to a matter other than those presented or disclosed in the financial statements that, in the auditor's judgment, is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report.

19.2 Emphasis of Matter Paragraphs in the Auditor's Report

If the auditor considers it necessary to draw users' attention to a matter presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements, the auditor shall include an Emphasis of Matter paragraph in the auditor's report provided:

- (a) The auditor would not be required to modify the opinion in accordance with SA 705 (Revised) as a result of the matter; and
- (b) When SA 701 applies, the matter has not been determined to be a key audit matter to be communicated in the auditor's report.

19.2.1 Separate section for Emphasis of Matter paragraph

When the auditor includes an Emphasis of Matter paragraph in the auditor's report, the auditor shall:

- (a) Include the paragraph within a separate section of the auditor's report with an appropriate heading that includes the term “Emphasis of Matter”;
- (b) Include in the paragraph a clear reference to the matter being emphasized and to where relevant disclosures that fully describe the matter can be found in the financial statements.

The paragraph shall refer only to information presented or disclosed in the financial statements; and

- (c) Indicate that the auditor's opinion is not modified in respect of the matter emphasized.

19.3 Other Matter Paragraphs in the Auditor's Report

If the auditor considers it necessary to communicate a matter other than those that are presented or disclosed in the financial statements that, in the auditor's judgment, is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report, the auditor shall include an Other Matter paragraph in the auditor's report, provided:

- (a) This is not prohibited by law or regulation; and
 (b) When SA 701 applies, the matter has not been determined to be a key audit matter to be communicated in the auditor's report.

19.3.1 Separate section for Other Matter paragraph

When the auditor includes an Other Matter paragraph in the auditor's report, the auditor shall include the paragraph within a separate section with the heading "Other Matter," or other appropriate heading.

20. Communicating Key Audit Matters In The Independent Auditor's Report

Definition of Key Audit Matters : Those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period. Key audit matters are selected from matters communicated with those charged with governance.

20.1 Purpose of communicating key audit matters

As per SA 701, "Communicating Key Audit Matters in the Auditor's Report", the purpose of communicating key audit matters is to enhance the communicative value of the auditor's report by providing greater transparency about the audit that was performed. Communicating key audit matters provides additional information to intended users of the financial statements to assist them in understanding those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period. Communicating key audit matters may also assist intended users in understanding the entity and areas of significant management judgment in the audited financial statements.

20.2 Objectives of the auditor regarding Key Audit Matters

As per SA 701, "Communicating Key Audit Matters in The Independent Auditor's Report", the objectives of the auditor are to determine key audit matters and, having formed an opinion on the financial statements, communicate those matters by describing them in the auditor's report.

20.3 Determining Key Audit Matters

The auditor shall determine, from the matters communicated with those charged with governance, those matters that required significant auditor attention in performing the audit.

In making this determination, the auditor shall take into account the following:

- (a) Areas of higher assessed risk of material misstatement, or significant risks identified in accordance with SA 315.
- (b) Significant auditor judgments relating to areas in the financial statements that involved significant management judgment, including accounting estimates that have been identified as having high estimation uncertainty.
- (c) The effect on the audit of significant events or transactions that occurred during the period.

The auditor shall determine which of the matters determined in accordance with above stated para were of most significance in the audit of the financial statements of the current period and therefore are the key audit matters.

20.4 Communicating Key Audit Matters

The auditor shall describe each key audit matter, using an appropriate subheading, in a separate section of the auditor's report under the heading "Key Audit Matters". The introductory language in this section of the auditor's report shall state that:

- (a) Key audit matters are those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements [of the current period]; and
- (b) These matters were addressed in the context of the audit of the financial statements as a whole, and in forming the auditor's opinion thereon, and the auditor does not provide a separate opinion on these matters.

20.5 Communicating key audit matter- not a substitute for disclosure in the financial statements etc. :

Communicating key audit matters in the auditor's report is in the context of the auditor having formed an opinion on the financial statements as a whole. Communicating key audit matters in the auditor's report is not:

- (a) A substitute for disclosures in the financial statements that the applicable financial reporting framework requires management to make, or that are otherwise necessary to achieve fair presentation;
- (b) A substitute for the auditor expressing a modified opinion when required by the circumstances of a specific audit engagement in accordance with SA 705 (Revised);
- (c) A substitute for reporting in accordance with SA 570 when a material uncertainty exists relating to events or conditions that may cast significant doubt on an entity's ability to continue as a going concern; or
- (d) A separate opinion on individual matters

In Chapter 5-Vouching, the topic “Payments controlled by the Companies Act, 2013” given at page no. 5.11 has been revised and given hereunder:

In the case of a company, payments or transactions, directly or indirectly, have been controlled/restricted by the Companies Act, 2013 (hereinafter referred as the Act). This may be understood with some of the provisions of the Act as discussed below-

- (i) Only such expenses which are incurred related to the business of the company are chargeable to statement of profit and loss. The auditor is, therefore in terms of section 143(1)(e) of the Act, required to inquire whether personal expenses have been charged to the revenue account. In case of any special comments to the said inquiry, he is also required to report on the same.
- (ii) Section 180 of the Act specifically restricts the powers of the Board *i.e.* the Board of Directors of a company can exercise the following powers but only with the consent of the company by a special resolution, namely -
 - (a) sell, lease or otherwise dispose of the whole or substantially the whole of the undertaking of the company or where the company owns more than one undertaking, of the whole or substantially the whole of any of such undertakings.
 - (b) invest otherwise in trust securities the amount of compensation received by it as a result of any merger or amalgamation.
 - (c) borrow money, where the money to be borrowed, together with the money already borrowed by the company will exceed aggregate of its paid-up share capital and free reserves, apart from temporary loans obtained from the company's bankers in the ordinary course of business.

It is provided that the acceptance by a banking company, in the ordinary course of its business, of deposits of money from the public, repayable on demand or otherwise, and withdrawable by cheque, draft, order or otherwise, shall not be deemed to be a borrowing of monies by the banking company within the meaning of this clause.
 - (d) remit, or give time for the repayment of, any debt due from a director.
- (iii) Under section 181, the Board of Directors of a company can contribute to the *bonafide* charitable and other funds any amount in any financial year. However, prior permission of the company in general meeting is required if the aggregate of such contribution exceeds 5% of its average net profits for the three immediately preceding financial years.
- (iv) Section 182 deals with prohibition and restriction 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. Notwithstanding anything contained in any other provision of this Act, a Company, other than a Government Company and a company which has been in existence for less than three financial years, may contribute any amount directly or indirectly to any political party.

Every company shall disclose in its profit and loss account the total amount contributed by it under this section during the financial year to which the account relates.

The contribution under this section shall not be made except by an account payee cheque drawn on a bank or an account payee bank draft or use of electronic clearing system through a bank account.

- (v) Section 183 permits the Board and other person to make contributions to the National Defence Fund or any other Fund approved by the Central Government for the purpose of National Defence to any extent as it thinks fit.

PART – II A: Multiple Choice Questions

1. Marvin Ltd. is a renowned food chain supplier in a posh area providing restaurant facility along with food delivering. CA. Felix was appointed as an auditor of the company for the Financial Year 2017-18. While examining the books of account of the company, CA. Felix came to know about one of the major expenses of the company i.e. rent expense of ₹ 1,20,000 per month, for which he applied substantive analytical procedure for verification purpose. Explain, how would CA. Felix perform substantive analytical procedure in the given scenario?
 - (a) CA. Felix would inspect every single rent invoice per month of ₹ 1,20,000 and verify other elements appropriately.
 - (b) CA. Felix would compare the rental expense of the company with that of another nearby company having corresponding dimensions, for high degree of accuracy.
 - (c) CA. Felix would select the first month rent invoice of ₹ 1,20,000 and appropriately verifying other elements would predict that the rent for the whole year would be ₹ 14,40,000 (i.e. ₹ 1,20,000 * 12). Thereafter, he would compare the actuals with his prediction and follow-up for any fluctuation.
 - (d) (a) and (b), both.
2. Coyote Ltd. is dealing in trading of electronic goods. Huge inventory (60% approximately) of the company is lying on consignment (i.e. under the custody of third party). CA. Star, the auditor of the company, wants to obtain sufficient appropriate audit evidence regarding the existence and condition of the inventory lying on consignment. Thus, he requested & obtained confirmation from the third party as to the quantities and condition of inventory held on behalf of the entity, however, it raised doubts about the integrity and objectivity of the third party. Which of the following other audit procedures may be performed by CA. Star to obtain sufficient appropriate audit evidence regarding the existence and condition of the inventory under the custody of third party?
 - (a) Attend third party's physical counting of inventory.
 - (b) Arrange for another auditor to attend third party's physical counting of inventory.

- (c) Inspect warehouse receipts regarding inventory held by third parties.
 - (d) All of the above.
3. In July, 2018, M/s Tom & Co. entered into an agreement with M/s Jerry & Co. under which a machinery would be let on hire and M/s Jerry & Co. would have the option to purchase the machinery in accordance with the terms of the agreement. Thus, M/s Jerry & Co. agreed to pay M/s Tom & Co. a settled amount in periodical instalments. The property in the goods shall be passed to M/s Jerry & Co. on the payment of last of such instalments. While checking such hire-purchase transaction, what would the auditor examine?
- (a) That the periodical instalments paid are charged as an expenditure by M/s Jerry & Co.
 - (b) That the hire purchase agreement specifies clearly the hire-purchase price of the machinery to which the agreement relates.
 - (c) That M/s Tom & Co. charges depreciation throughout the life of the machinery.
 - (d) All of the above.
4. The management of Magoo Ltd. has developed a strong internal control in its accounting system in such a way that the work of one person is reviewed by another. Since no individual employee is allowed to handle a task alone from the beginning to the end, the chances of early detection of frauds and errors are high. CA. Olive has been appointed as an auditor of the company for current Financial Year 2017-18. Before starting the audit, she wants to evaluate the internal control system of Magoo Ltd. To facilitate the accumulation of the information necessary for the proper review and evaluation of internal controls, CA. Olive decided to use internal control questionnaire to know and assimilate the system and evaluate the same. Which of the following questions need not be framed under internal control questionnaire relating to purchases?
- (a) Are authorized signatories for purchases limited to elected officials?
 - (b) Are payments approved only on original invoices?
 - (c) Does authorized officials thoroughly review the documents before signing cheques?
 - (d) Are monthly bank reconciliations implemented for each and every bank accounts of the company?
5. CA Bobby is a recently qualified Chartered Accountant. He is appointed as an auditor of Droopy Ltd. for the current Financial Year 2017-18. He is quite conservative in nature which is also replicated in his professional work. CA. Bobby is of the view that he shall record all the matters related to audit, audit procedures to be performed, audit evidence obtained and conclusions reached. Thus, he maintained a file and recorded each and every of his findings during the audit. His audit file, besides other thing, includes audit programmes, notes reflecting preliminary thinking, letters of confirmation, e-mails concerning significant matters, etc. State which of the following need not be included in the audit documentation?

- (a) Audit programmes.
- (b) Notes reflecting preliminary thinking.
- (c) Letters of confirmation.
- (d) E-mails concerning significant matters.
6. While auditing the books of accounts of QHMP Ltd., CA Ranker, the statutory auditor of the company, came to know that the management of the company has recognized internally generated goodwill as a fixed asset. CA Ranker discussed with the management that according to accounting standards, internally generated goodwill is not recognized as an asset because it is not an identifiable resource controlled by the enterprise that can be measured reliably at cost. However, the management is quite rigid to the accounting treatment followed for internally generated goodwill and not paying attention to the auditor. Thus, through an example, CA Ranker explained which type of goodwill may be recognized as a fixed asset for which the management got justified. State which of the following examples the auditor must have given to the management?
- (a) If an item meeting the definition of an intangible asset is acquired in a business combination, it forms part of the goodwill to be recognized at the date of the amalgamation.
- (b) Only those goodwill needs to be recognized as a fixed asset which can be touched like physical assets, for example, land and buildings.
- (c) Goodwill is recognised only when there is a contractual or other legal rights for a physical asset which shall not be amortized over the period.
- (d) All of the above.
7. Eeyore Pvt. Ltd. is incorporated on 1st July, 2017. During the Financial Year ending on 31st March, 2018, the company did not opt for any borrowing at any point of time and have a total revenue of ₹ 60 Lakh. At the year end, it provides the following information regarding its paid-up capital and reserve & surplus-

Particulars	Amount (in ₹)
Paid-up Capital	
- Consideration received in cash for equity shares (including unpaid calls of ₹ 5,00,000)	40,00,000
- Consideration received in cash for preference shares	25,00,000
- Bonus shares allotted	7,00,000
- Share application money received pending allotment	10,00,000
Sub-Total	82,00,000
Reserve & Surplus	
- Balance in Statement of Profit and Loss	15,00,000

- Capital Reserves	10,00,000
Sub-Total	<u>25,00,000</u>
GRAND TOTAL	1,07,00,000

You are provided with the provisions regarding applicability of Companies (Auditor's Report) Order, 2016, (CARO, 2016) issued under section 143(11) of the Companies Act, 2013 to a private limited company that it specifically exempts a private limited company having a paid up capital and reserves and surplus not more than ₹ 1 crore as on the Balance Sheet date and which does not have total borrowings exceeding ₹ 1 crore from any bank at any point of time during the financial year and which does not have a total revenue as disclosed in Scheduled III to the Companies Act, 2013 exceeding ₹ 10 crore during the financial year.

Considering the information given above, which of the following shall be considered as a reason regarding applicability or non-applicability of CARO, 2016?

- (a) Reporting under CARO, 2016 shall be applicable as the company is having a paid up capital and reserves and surplus of ₹ 1.07 crore i.e. more than ₹ 1 crore as on the Balance Sheet date.
 - (b) Reporting under CARO, 2016 shall be applicable as the company is having a paid up capital and reserves and surplus of ₹ 1.02 crore i.e. more than ₹ 1 crore as on the Balance Sheet date.
 - (c) Reporting under CARO, 2016 shall not be applicable as the company is having a paid up capital and reserves and surplus of ₹ 0.92 crore i.e. not more than ₹ 1 crore as on the Balance Sheet date.
 - (d) Reporting under CARO, 2016 shall not be applicable as the company is having a paid up capital and reserves and surplus of ₹ 0.82 crore i.e. not more than ₹ 1 crore as on the Balance Sheet date.
8. CA. Goofy has been appointed as an auditor for audit of a complete set of financial statements of Dippy Ltd., a listed company. The financial statements of the company are prepared by the management in accordance with the Accounting Standards prescribed under section 133 of the Companies Act, 2013. However, the inventories are misstated which is deemed to be material but not pervasive to the financial statements. Based on the audit evidences obtained, CA. Goofy has concluded that a material uncertainty does not exist related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern in accordance with SA 570. Further, CA. Goofy is also aware of the fact that a qualified opinion would be appropriate due to a material misstatement of the Financial Statements. State what phrases should the auditor use while drafting such opinion paragraph?
- (a) In our opinion and to the best of our information and according to the explanations given to us, except for the effects of the matter described in the Basis for Qualified

Opinion section of our report, the aforesaid financial statements present fairly, in all material respects, or give a true and fair view in conformity with the applicable financial reporting framework.

- (b) In our opinion and to the best of our information and according to the explanations given to us, with the foregoing explanation, the aforesaid financial statements present fairly, in all material respects, or give a true and fair view in conformity with the applicable financial reporting framework.
 - (c) In our opinion and to the best of our information and according to the explanations given to us, subject to the misstatement regarding inventories, the aforesaid financial statements present fairly, in all material respects, or give a true and fair view in conformity with the applicable financial reporting framework.
 - (d) In our opinion and to the best of our information and according to the explanations given to us, with the explanation described in the Basis for Qualified Opinion section of our report, the aforesaid financial statements present fairly, in all material respects, or give a true and fair view in conformity with the applicable financial reporting framework.
9. While auditing the accounts of ThoughtCo Ltd., CA. Bliss, the auditor of the company came across certain accounts payable balances for which direct confirmation procedure needs to be applied. Thus, for the year ending 31st March, 2018, he sent positive confirmation requests wherein the trade payables are requested to respond whether or not they are in agreement with the balance shown. The auditor received all the confirmation replies from the trade payables on time as correct except from five of them. What other option the auditor is left with regard to trade payables from which no reply for confirmation requests received?
- (a) Perform additional testing which may include agreeing the balance to subsequent cash paid.
 - (b) Accept the balances as it is assuming other replies against received confirmation requests being correct.
 - (c) Accept the balances as it is assuming that the trade payables must have replied in case of any discrepancies.
 - (d) None of the above.
10. CA Daffy is the auditor of xBose Ltd. for the previous 2 years. However, due to certain unavoidable circumstances, no Annual General Meeting (AGM) was held for the current Financial Year ending on 31st March, 2018 within every possible time limit and thus, the ratification procedure for her appointment in the AGM could not be performed. Whether she may continue to hold the office of the auditor?

- (a) CA. Daffy may continue to hold the office of the auditor for the current Financial Year only and thereafter shall resign herself as the ratification procedure could not be completed.
- (b) CA. Daffy shall continue to hold the office of the auditor and ask the Board to re-appoint her in a private meeting.
- (c) CA. Daffy shall continue to hold the office of the auditor as no such ratification provisions for appointment by members at every AGM exist.
- (d) CA. Daffy shall not continue to hold office of the auditor as the ratification procedure could not be completed as per proviso to section 139(1) of the Companies Act, 2013.

PART – II B: DESCRIPTIVE QUESTIONS

1. State with reason (in short) whether the following statements are true or false:
 - (i) Communicating key audit matters in the auditor's report is a substitute for disclosures in the financial statements that the applicable financial reporting framework requires management to make, or that are otherwise necessary to achieve fair presentation;
 - (ii) When the auditor includes an Other Matter paragraph in the auditor's report, the auditor need not include the paragraph within a separate section.
 - (iii) The auditor shall disclaim an opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements.
 - (iv) In respect of audit work divided among the joint auditors, each joint auditor shall be responsible for the work allocated to such joint auditor only.
 - (v) Inherent risk is the susceptibility of an account balance or class of transactions to misstatement assuming that there were no related internal controls.
 - (vi) NGOs registered under the Companies Act, 2013 can maintain their books on either accrual or cash basis.
 - (vii) The method which involves dividing the population into groups of items is known as block sampling.
 - (viii) A flow chart is a graphic presentation of each point of the company's system of internal control.
 - (ix) It is necessary for the auditor to maintain professional skepticism throughout the audit.
 - (x) The scope of work of an internal auditor may extend even beyond the financial accounting.

Nature of Auditing

2. (a) Shakti Cables Ltd is engaged in manufacturing and trading of cables of different types. Its Books of account are not properly maintained and the control system is weak, so the possibility of frauds and errors are enormous and the auditor, even with the best of his efforts, may not be able to detect all of them. The fact is recognised by the Courts from a study of the various judgments. State the tests that would be applied by the courts to view the auditor's performance judicially.
(b) Discuss with reference to SA 510, "Initial Audit Engagement – Opening Balances", the procedures the auditor should undertake in respect of opening balances for a new audit engagement.
3. (a) Distinguish between absolute and reasonable assurance. Identify the type of assurance that is expected in an audit of the financial statements, clearly outlining the reasons to justify your point of view.
(b) State the Standards issued by AASB which are collectively known as engagement standards.
4. (a) Fraudulent financial reporting involves intentional misstatements including omissions of amounts or disclosures in financial statements to deceive financial statement users. Explain stating clearly how it can be accomplished.
(b) The chief utility of audit lies in reliable financial statements on the basis of which the state of affairs may be easy to understand. Explain stating the advantages of independent audit.

Basic Concepts in Auditing

5. (a) In the context of SA-315, state the assertions used by auditor to consider the different types of potential mis-statements that may occur w.r.t. classes of transactions and events for period under audit.
(b) What constitutes true and fair view is a matter of auditor's judgement, but some specific points must be seen by the auditor to ensure true and fair view.
6. (a) With reference to SA 320 indicate the factors which may affect the identification of an appropriate bench mark in determining materiality for the financial statement as a whole.
(b) Mr. A was appointed statutory auditor of P Ltd., but he was not able to gather the sufficient audit evidences. Discuss how he should proceed to gather more audit evidences.
7. (a) In order to achieve the objectives of the accountancy profession, professional accountants have to observe a number of prerequisites or fundamental principles Explain

- (b) The auditor R of GR and Co., a firm of Chartered Accountants is conducting audit of B Industries Ltd. State the specific inquiries by auditor when deviations from controls are detected.

Preparation for an Audit

8. (a) The agreed terms of the audit engagement shall be recorded in an audit engagement letter or other suitable form of written agreement. Explain stating its contents.
(b) The auditor should plan his work to enable him to conduct an effective audit in an efficient and timely manner. Discuss and explain what should be covered in audit plans.
9. (a) The audit working papers constitute the link between the auditor's report and the client's records. Explain clearly stating the definition and purpose of audit documentation.
(b) State the factors affecting form, content and extent of working papers.

Internal Control

10. (a) Explain the purpose of Internal Control.
(b) Internal control, no matter how effective, can provide an entity with only reasonable assurance about achieving the entity's financial reporting objectives. The likelihood of their achievement is affected by inherent limitations of internal control. Explain those limitations.
(c) How would you assess the reliability of internal control system in Computerised Information System (CIS) environment?
11. (a) Explain how does IT benefits an entity's internal control.
(b) Explain the specific risks to an entity's internal control posed by IT.
(c) State any four important elements of input control in processing of data in a computerised accounting system.

Vouching & Verification of Assets and Liabilities

12. How will you vouch/verify the following:
(a) Refund of General Insurance premium paid
(b) Payment of Taxes
(c) Sale Proceeds of junk material
13. How will you vouch/verify the following?
(a) Foreign Travel Expenses
(b) Receipt of Capital subsidy
(c) Royalties received

- (d) Goods sent out on Sale or Return basis.
14. How will you vouch and/or verify the following:
- (a) Personal expenses of directors met by the company.
 - (b) Preliminary expenses.
 - (c) Advances given to suppliers.

The Company Audit

15. Discuss the following:
- (a) The auditor CA Z appointed under section 139 was removed from his office before the expiry of his term by an ordinary resolution of the company. Comment explaining clearly the procedure of removal of auditor before expiry of term.
 - (b) RGS & Co. a firm of Chartered Accountants has three partners, namely, R, G & S. The firm is allotted the audit of BY Ltd. R, partner in the firm subsequently holds 100 shares in BY Ltd. Comment.
16. (a) Discuss the provisions relating to appointment of subsequent Auditors of Suruchi Yarns Pvt Ltd.
- (b) Discuss the reporting requirements regarding Fixed Assets under CARO, 2016
17. (a) Who shall authenticate financial statements of a company ?
- (b) The provisions in the matter of books of account which a company is required to maintain are contained in section 128 of the Companies Act, 2013. In the above context, explain clearly the meaning of Books of Account as contained in the Companies Act, 2013.
18. (a) Explain the provisions of the Companies Act, 2013 with regard to Alteration of Share Capital and auditor's duty in this regard.
- (b) Discuss the provisions of the Companies Act, 2013 with regard to issue of Sweat Equity Shares and auditor's duty in this regard.

Special Audits

19. (a) An audit of Expenditure is one of the major components of Government Audit. In the context of 'Government Expenditure Audit', write in brief, what do you understand by:
- (i) Audit against Rules and Orders
 - (ii) Audit of Sanctions
 - (iii) Audit against Provision of Funds
 - (iv) Propriety Audit
 - (v) Performance Audit.
- (b) Explain the powers of Comptroller and Auditor General of India.

20. Mention any eight special audit points to be considered by the auditor during the audit of a Hospital?

SUGGESTED ANSWERS / HINTS

ANSWERS - MCQ's

1. (c)
2. (d)
3. (b)
4. (d)
5. (b)
6. (a)
7. (c)
8. (a)
9. (a)
10. (c)

DESCRIPTIVE ANSWERS

1. (i) **Incorrect** Communicating key audit matters in the auditor's report is in the context of the auditor having formed an opinion on the financial statements as a whole. Communicating key audit matters in the auditor's report is not a substitute for disclosures in the financial statements that the applicable financial reporting framework requires management to make, or that are otherwise necessary to achieve fair presentation;
- (ii) **Incorrect:** When the auditor includes an Other Matter paragraph in the auditor's report, the auditor shall include the paragraph within a separate section with the heading "Other Matter," or other appropriate heading.
- (iii) **Incorrect:** The auditor shall express an adverse opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements.
- (iv) **Correct:** In respect of audit work divided among the joint auditors, each joint auditor shall be responsible only for the work allocated to such joint auditor including proper execution of the audit procedures.

- (v) **Correct:** Inherent risk is the susceptibility of an account balance or class of transactions to misstatement that could be material either individually or, when aggregated with misstatements in other balances or classes, assuming that there were no related internal controls.
 - (vi) **Incorrect:** NGOs registered under the Companies Act, 2013 must maintain their books of account under the accrual basis as required by the provisions of section 128 of the said Act. If the accounts are not maintained on accrual basis, it would amount to non-compliance of the provision of the Companies Act, 2013.
 - (vii) **Incorrect.** The method which involves dividing the population into groups of items is known as cluster sampling whereas block sampling involves the selection of a defined block of consecutive items.
 - (viii) **Correct.** Flow chart is a graphic presentation of each part of the entity's system of internal control. It minimizes the amount of narrative explanation and thereby achieves a presentation not possible in any other form. It gives bird's eye view of system for suggestion
 - (ix) **Correct.** As per SA 200, "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", professional skepticism is an attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence. Thus, it is necessary for the auditor to maintain professional skepticism throughout the audit.
 - (x) **Correct.** The scope of work of an internal auditor may extend even beyond the financial accounting and may include cost investigation, inquiries relating to losses and wastages, production audit, performance audit, etc.
2. (a) If the books of account are not properly maintained and if the control system is weak, the possibility of frauds and errors are enormous and the auditor, even with the best of his efforts, may not be able to detect all of them. The fact is recognised by the Courts as is obvious from a study of the various judgments. The auditor's performance is judicially viewed by applying the following tests:
- (i) whether the auditor has exercised reasonable care and skill in carrying out his work;
 - (ii) whether the errors and frauds were such as could have been detected in the ordinary course of checking without the aid of any special efforts;
 - (iii) whether the auditor had any reason to suspect the existence of the errors and frauds; and
 - (iv) whether the error or fraud was so deep laid that the same might not have been detected by the application of normal audit procedures.

(b) Audit Procedures in respect of Opening Balances for a New Audit Engagement:

As per SA 510 "Initial Audit Engagements – Opening Balances", the auditor should undertake the following procedures in respect of opening balances in case of new audit engagement:

- (i) The auditor shall read the most recent financial statements, if any, and the predecessor auditor's report thereon, if any, for information relevant to opening balances, including disclosures.
- (ii) The auditor shall obtain sufficient appropriate audit evidence about whether the opening balances contain misstatements that materially affect the current period's financial statements by:
 - (a) Determining whether the prior period's closing balances have been correctly brought forward to the current period or, when appropriate, any adjustments have been disclosed as prior period items in the current year's Statement of Profit and Loss;
 - (b) Determining whether the opening balances reflect the application of appropriate accounting policies; and

Performing one or more of the following:

- (1) Where the prior year financial statements were audited, perusing the copies of the audited financial statements including the other relevant documents relating to the prior period financial statements;
- (2) Evaluating whether audit procedures performed in the current period provide evidence relevant to the opening balances; or
- (3) Performing specific audit procedures to obtain evidence regarding the opening balances.

If the auditor obtains audit evidence that the opening balances contain misstatements that could materially affect the current period's financial statements, the auditor shall perform such additional audit procedures as are appropriate in the circumstances to determine the effect on the current period's financial statements. If the auditor concludes that such misstatements exist in the current period's financial statements, the auditor shall communicate the misstatements with the appropriate level of management and those charged with governance.

3. (a) **Absolute and Reasonable Assurance:** Absolute assurance is the highest level of assurance an auditor can give, if he check each and every transaction. Therefore, absolute assurance is the level of assurance that can only be given if the auditor does not perform sampling testing. However, it is not possible to give absolute assurance because of time and cost involved. Therefore, auditors give reasonable assurance. Reasonable assurance is less than absolute assurance.

As per SA-200 overall objectives of the independent auditor, in conducting an audit of financial statements, one of the objective of the auditor is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework.

As the basis for the auditor's opinion, SAs require the auditor to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error. Reasonable assurance is a high level of assurance. It is obtained when the auditor has obtained sufficient appropriate audit evidence to reduce audit risk (i.e., the risk that the auditor expresses an inappropriate opinion when the financial statements are materially misstated) to an acceptably low level. However, reasonable assurance is not an absolute level of assurance, because there are inherent limitations of an audit which result in most of the audit evidence on which the auditor draws conclusions and bases the auditor's opinion being persuasive rather than conclusive.

(b) Engagement Standards: The following standards issued by the Auditing and Assurance Standards Board under the authority of the Council are collectively known as the Engagement Standards-

- (i) Standards on Auditing (SAs), to be applied in the audit of historical financial information.
- (ii) Standards on Review Engagements (SREs), to be applied in the review of historical financial information.
- (iii) Standards on Assurance Engagements (SAEs), to be applied in assurance engagements, dealing with subject matters other than historical financial information.
- (iv) Standards on Related Services (SRSs), to be applied to engagements involving application of agreed-upon procedures to information, compilation engagements, and other related services engagements, as may be specified by the ICAI.

4. (a) Fraudulent Financial Reporting: Fraudulent financial reporting involves intentional misstatements including omissions of amounts or disclosures in financial statements to deceive financial statement users. It can be caused by the efforts of management to manage earnings in order to deceive financial statement users by influencing their perceptions as to the entity's performance and profitability. Such earnings management may start out with small actions or inappropriate adjustment of assumptions and changes in judgments by management. Pressures and incentives may lead these actions to increase to the extent that they result in fraudulent financial reporting.

In some entities, management may be motivated to reduce earnings by a material amount to minimize tax or to inflate earnings to secure bank financing.

Fraudulent financial reporting may be accomplished by the following:

- (i) Manipulation, falsification (including forgery), or alteration of accounting records or supporting documentation from which the financial statements are prepared.
- (ii) Misrepresentation in or intentional omission from, the financial statements of events, transactions or other significant information.
- (iii) Intentional misapplication of accounting principles relating to amounts, classification, manner of presentation, or disclosure.

Fraudulent financial reporting often involves management override of controls that otherwise may appear to be operating effectively.

(b) Advantages of Independent Audit: The chief utility of audit lies in reliable financial statements on the basis of which the state of affairs may be easy to understand. Apart from this obvious utility, there are other advantages of audit. Some or all of these are of considerable value even to those enterprises and organisations where audit is not compulsory, these advantages are given below-

- (i) It safeguards the financial interest of persons who are not associated with the management of the entity, whether they are partners or shareholders.
- (ii) It acts as a moral check on the employees from committing defalcations or embezzlement.
- (iii) Audited statements of account are helpful in settling liability for taxes, negotiating loans and for determining the purchase consideration for a business.
- (iv) These are also useful for settling trade disputes for higher wages or bonus as well as claims in respect of damage suffered by property by fire or some other calamity.
- (v) An audit can also help in the detection of wastages and losses to show the different ways by which these might be checked especially those that occur due to the absence or inadequacy of internal checks or internal control measures.
- (vi) Audit ascertains whether the necessary books of account and allied records have been properly kept and helps the client in making good deficiencies or inadequacies in this respect.
- (vii) As an appraisal function, audit reviews the existence and operations of various controls in the organisations and reports weaknesses, inadequacies, etc., in them.
- (viii) Audited accounts are of great help in the settlement of accounts at the time of admission or death of partner.

- (ix) Government may require audited and certified statement before it gives assistance or issues a license for a particular trade.
5. (a) **Assertions used by the auditor** to consider the different types of potential misstatements that may occur with respect to 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.
- (b) **True & Fair view:** This is correct that what constitutes a ‘true and fair’ view is a matter of an auditor’s judgment in the particular circumstances of a case. In more specific terms, to ensure true and fair view, an auditor has to see:
- (i) That the assets are neither undervalued nor overvalued, according to the applicable accounting principles.
 - (ii) No material asset is omitted.
 - (iii) The charge, if any, on assets are disclosed.
 - (iv) Material liabilities should not be omitted.
 - (v) The profit and loss account discloses all the matters required to be disclosed by Part II of Schedule III and the balance sheet has been prepared in accordance with Part I of Schedule III.
 - (vi) Accounting policies have been followed consistently.
 - (vii) All unusual, exceptional or non-recurring items have been disclosed separately.
6. (a) **Factors that may affect the Identification of an Appropriate Benchmark in Determining Materiality:** As per SA 320 “Materiality in Planning and Performing an Audit”, determining materiality involves the exercise of professional judgment. A percentage is often applied to a chosen benchmark as a starting point in determining materiality for the financial statements as a whole. Factors that may affect the identification of an appropriate benchmark include the following-
- (i) The elements of the financial statements (for example, assets, liabilities, equity, revenue, expenses);

- (ii) Whether there are items on which the attention of the users of the particular entity's financial statements tends to be focused (for example, for the purpose of evaluating financial performance users may tend to focus on profit, revenue or net assets);
 - (iii) The nature of the entity, where the entity is at in its life cycle, and the industry and economic environment in which the entity operates;
 - (iv) The entity's ownership structure and the way it is financed (for example, if an entity is financed solely by debt rather than equity, users may put more emphasis on assets, and claims on them, than on the entity's earnings); and
 - (v) The relative volatility of the benchmark
- (b) **Audit Evidence:** According to SA 500 "Audit Evidence", audit procedures to gather more audit evidence would include -

Inspection: Inspection involves examining records or documents, whether internal or external, in paper form, electronic form, or other media, or a physical examination of an asset. Inspection of records and documents provides audit evidence of varying degrees of reliability, depending on their nature and source and, in the case of internal records and documents, on the effectiveness of the controls over their production. An example of inspection used as a test of controls is inspection of records for evidence of authorisation.

Observation: Observation consists of looking at a process or procedure being performed by others, for example, the auditor's observation of inventory counting by the entity's personnel, or of the performance of control activities.

External Confirmation: An external confirmation represents audit evidence obtained by the auditor as a direct written response to the auditor from a third party (the confirming party), in paper form, or by electronic or other medium. External confirmation procedures frequently are relevant when addressing assertions associated with certain account balances and their elements. However, external confirmations need not be restricted to account balances only.

Recalculation: Recalculation consists of checking the mathematical accuracy of documents or records. Recalculation may be performed manually or electronically.

Re-performance: Re-performance involves the auditor's independent execution of procedures or controls that were originally performed as part of the entity's internal control.

Analytical Procedures: Analytical procedures consist of evaluations of financial information made by a study of plausible relationships among both financial and non-financial data. Analytical procedures also encompass the investigation of identified fluctuations and relationships that are inconsistent with other relevant information or deviate significantly from predicted amounts.

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

7. (a) **In order to achieve the objectives of the accountancy profession, professional accountants have to observe a number of prerequisites or fundamental principles as under:**

Integrity: A professional accountant should be straightforward and honest in performing professional services.

Objectivity: A professional accountant should be fair and should not allow prejudice or bias, conflict of interest or influence of others to override objectivity.

Professional Competence and Due Care: A professional accountant should perform professional services with due care, competence and diligence and has a continuing duty to maintain professional knowledge and skill at a level required to ensure that a client or employer receives the advantage of competent professional service based on up-to-date developments in practice, legislation and techniques.

Confidentiality: A professional accountant should respect the confidentiality of information acquired during the course of performing professional services and should not use or disclose any such information without proper and specific authority or unless there is a legal or professional right or duty to disclose.

Professional Behaviour: A professional accountant should act in a manner consistent with the good reputation of the profession and refrain from any conduct which might bring discredit to the profession.

Technical Standards: A professional accountant should carry out professional services in accordance with the relevant technical and professional standards. Professional accountants have a duty to carry out with care and skill, the instructions of the client or employer insofar as they are compatible with the requirements of integrity, objectivity and, in the case of professional accountants in public practice, independence.

- (b) **Specific inquiries by auditor when deviations from controls are detected.**

When deviations from controls upon which the auditor intends to rely are detected, the auditor shall make specific inquiries to understand these matters and their potential consequences, and shall determine whether:

- (a) The tests of controls that have been performed provide an appropriate basis for reliance on the controls;
- (b) Additional tests of controls are necessary; or

- (c) The potential risks of misstatement need to be addressed using substantive procedures.
8. (a) **The agreed terms of the audit engagement shall be recorded in an audit engagement letter or other suitable form of written agreement and shall include:**
- (a) The objective and scope of the audit of the financial statements;
 - (b) The responsibilities of the auditor;
 - (c) The responsibilities of management;
 - (d) Identification of the applicable financial reporting framework for the preparation of the financial statements; and
 - (e) Reference to the expected form and content of any reports to be issued by the auditor and a statement that there may be circumstances in which a report may differ from its expected form and content.

- (b) **“The auditor should plan his work to enable him to conduct an effective audit in an efficient and timely manner. Plans should be based on knowledge of the client’s business.**

Plans should be made to cover, among other things:

- (a) acquiring knowledge of the client’s accounting systems, policies and internal control procedures;
 - (b) establishing the expected degree of reliance to be placed on internal control;
 - (c) determining and programming the nature, timing, and extent of the audit procedures to be performed; and
 - (d) coordinating the work to be performed.
9. (a) **The audit working papers constitute the link between the auditor’s report and the client’s records.** According to SA-230, Audit Documentation refers to the record of audit procedures performed, relevant audit evidence obtained, and conclusions the auditor reached (terms such as “working papers” or “work papers” are also sometimes used). The objects of an auditor’s working papers are to record and demonstrate the audit work from one year to another.

Audit documentation serves a number of purposes:

- ◆ Assisting the engagement team to plan and perform the audit.
- ◆ Assisting members of the engagement team responsible for supervision to direct and supervise the audit work, and to discharge their review responsibilities in accordance with SA 220.
- ◆ Enabling the engagement team to be accountable for its work.
- ◆ Retaining a record of matters of continuing significance to future audits.

- ◆ Enabling the conduct of quality control reviews and inspections in accordance with SQC 1.
- ◆ Enabling the conduct of external inspections in accordance with applicable legal, regulatory or other requirements

(b) **Form and Content of Working Papers:** Working papers should record the audit plan, nature, timing and extent of auditing procedures performed, and the conclusions drawn from the evidence obtained.

The form, content and extent of working papers depend on factors such as:

- ◆ The size and complexity of the entity.
- ◆ The nature of the audit procedures to be performed.
- ◆ The identified risks of material misstatement.
- ◆ The significance of the audit evidence obtained.
- ◆ The nature and extent of exceptions identified.
- ◆ The need to document a conclusion or the basis for a conclusion not readily determinable from the documentation of the work performed or audit evidence obtained.
- ◆ The audit methodology and tools used.

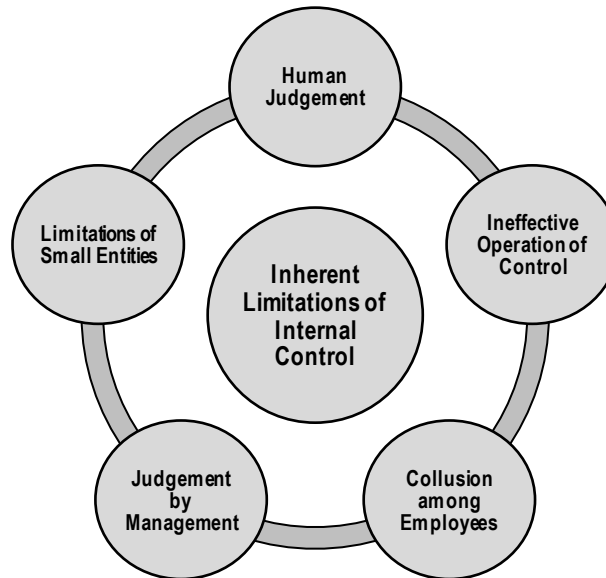
10. (a) **Purpose of Internal Control:** Internal control is designed, implemented and maintained to address identified business risks that threaten the achievement of any of the entity's objectives that concern-

- ◆ The reliability of the entity's financial reporting;
- ◆ The effectiveness and efficiency of its operations;
- ◆ Its compliance with applicable laws and regulations; and
- ◆ Safeguarding of assets.

(b) **Limitations of Internal Control:** Internal control, no matter how effective, can provide an entity with only reasonable assurance about achieving the entity's financial reporting objectives. The likelihood of their achievement is affected by inherent limitations of internal control. These include-

- (i) **Role of Human Judgement:** The realities that human judgment in decision-making can be faulty and that breakdowns in internal control can occur because of human error. For example, there may be an error in the design of, or in the change to, a control.
- (ii) **Ineffective Operation of Control:** Equally, the operation of a control may not be effective, such as where information produced for the purposes of internal control (for example, an exception report) is not effectively used because the

individual responsible for reviewing the information does not understand its purpose or fails to take appropriate action.



- (iii) **Collusion among Employees:** Additionally, controls can be circumvented by the collusion of two or more people or inappropriate management override of internal control. For example, management may enter into side agreements with customers that alter the terms and conditions of the entity's standard sales contracts, which may result in improper revenue recognition. Also, edit checks in a software program that are designed to identify and report transactions that exceed specified credit limits may be overridden or disabled.
- (iv) **Judgement by Management:** Further, in designing and implementing controls, management may make judgments on the nature and extent of the controls it chooses to implement, and the nature and extent of the risks it chooses to assume.
- (v) **Considerations specific to Smaller Entities:** Smaller entities often have fewer employees which may limit the extent to which segregation of duties is practicable. However, in a small owner-managed entity, the owner-manager may be able to exercise more effective oversight than in a larger entity. This oversight may compensate for the generally more limited opportunities for segregation of duties.

On the other hand, the owner-manager may be more able to override controls because the system of internal control is less structured. This is taken into account by the auditor when identifying the risks of material misstatement due to fraud.

(c) **Reliability of Internal Control System in CIS Environment:** For evaluating the reliability of internal control system in CIS environment, the auditor would consider the following-

- (i) That authorised, correct and complete data is made available for processing.
- (ii) That it provides for timely detection and corrections of errors.
- (iii) That in case of interruption due to mechanical, power or processing failures, the system restarts without distorting the completion of entries and records.
- (iv) That it ensures the accuracy and completeness of output.
- (v) That it provides security to application softwares & data files against fraud etc.
- (vi) That it prevents unauthorised amendments to programs.

11. (a) **Generally, IT benefits an entity's internal control by enabling an entity to:**

- ◆ Consistently apply predefined business rules and perform complex calculations in processing large volumes of transactions or data;
- ◆ Enhance the timeliness, availability, and accuracy of information;
- ◆ Facilitate the additional analysis of information;
- ◆ Enhance the ability to monitor the performance of the entity's activities and its policies and procedures;
- ◆ Reduce the risk that controls will be circumvented; and
- ◆ Enhance the ability to achieve effective segregation of duties by implementing security controls in applications, databases, and operating systems.

(b) **IT also poses specific risks to an entity's internal control, including, for example:**

- ◆ Reliance on systems or programs that are inaccurately processing data, processing inaccurate data, or both.
- ◆ Unauthorised access to data that may result in destruction of data or improper changes to data, including the recording of unauthorised or non-existent transactions, or inaccurate recording of transactions. Particular risks may arise where multiple users access a common database.
- ◆ The possibility of IT personnel gaining access privileges beyond those necessary to perform their assigned duties thereby breaking down segregation of duties.
- ◆ Unauthorised changes to data in master files.
- ◆ Unauthorised changes to systems or programs.
- ◆ Failure to make necessary changes to systems or programs.

- ◆ Inappropriate manual intervention.
- ◆ Potential loss of data or inability to access data as required.

(c) Control Over Input in a Computerised Accounting System:

- (i) The input fed into the computer should be authorized. The authorization levels should be checked. The authorization is effected by levels of access to the entry for the computer system. The access control is operated through use of password and logging procedures.
- (ii) The system should devise controls to check that data input are accurate.
- (iii) The input document should be reviewed and verified by another person after preparation.
- (iv) Transaction should be accurately converted into machine readable language and recorded in a computer data file.
- (v) The transactions are not lost, duplicated, or changed without authorization.
- (vi) There should be validity and cross reference checks inbuilt in the system to throw light on errors which appear in the process of feeding input.
- (vii) Incorrect transactions are thrown out by a list which must be corrected, resubmitted before the process could run on the inputs.
- (viii) The check digit total of financial information contained in the document or hash total may be used to act as a control tool.
- (ix) The serial control may be used in inputting data that are to follow serial sequence. Any deviation in serial sequence will have to be automatically signalled out.

12. (a) Refund of General Insurance Premium Paid: The refund of insurance premium may be because of earlier provisional payment of premium or may be a policy might have been cancelled at a later date. The auditor should take following steps while vouching such refunds-

- (i) Ascertain the reasons for refund of insurance premium.
- (ii) Examine insurance policy or cover note to find out the amount of premium.
- (iii) Verify advice of refund received from the insurance company. When refund is admitted, the insurance company sends the advice. This will be evidence as a covering letter to the cheque for the refund. Sometimes, a cheque is issued after a receipt is sent in advance to the insurance company.
- (iv) Scrutinise correspondence between the insurance company and the client.
- (v) Check entries in the bank book or the bank statement. If necessary, the counterfoil of the pay-in-slips can also be verified.

(b) Payment of Taxes:

- (i) Payment on account of income-tax and other taxes consequent upon a regular assessment should be verified by reference to the copy of the assessment order, assessment form, notice of demand and the receipted challan.
- (ii) Payments or advance payments of income-tax should also be verified with the notice of demand and the receipted challan acknowledging the amount paid.
- (iii) The interest allowed on advance payments of income-tax should be included as income and penal interest charged for non-payment should be debited to the interest account.
- (iv) Nowadays, electronic payment of taxes is also in trend. Electronic payment of taxes means payment of taxes by way of internet banking facility or credit or debit cards.
- (v) The assessee can make electronic payment of taxes also from the account of any other person. However, the challan for making such payment must clearly indicate the Permanent Account Number (PAN) of the assessee on whose behalf the payment is made.
- (vi) It is not necessary for the assessee to make payment of taxes from his own account in an authorized bank. While vouching such E-Payment, the auditor should cross verify the payments of taxes through the receipted challan along with PAN No./TAN No. etc.

(c) Sale Proceeds of Junk Material:

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

materials as to its reasonableness. Ensure that proper accounting has been done for it.

13 (a) Foreign Travel Expenses:

- (i) Examine Travelling Allowance bills submitted by the employees stating the details of tour, details of expenses, etc.
- (ii) Verify that the tour programme was properly authorized by the competent authority.
- (iii) Check the T.A. bills along with accompanying supporting documents such as air tickets, travel agents bill and hotel bills with reference to the internal rules for entitlement of the employees and also make sure that the bills are properly passed.
- (iv) See that the tour report accompanies the T.A. bill. The tour report will show the purpose of the tour. Satisfy that the purpose of the tour as shown by the tour report conforms to the authorization for the tour.
- (v) Check Reserve Bank of India's permission, if necessary, for withdrawing the foreign exchange. For a company, the amount of foreign exchange spent is to be disclosed separately in the accounts as per requirement of Schedule III to the Companies Act, 2013 and Accounting Standard 11 "The Effects of Changes in Foreign Exchange Rates".

(b) Receipt of Capital Subsidy:

- (i) Refer to application made for the claim of subsidy to ascertain the purpose and the scheme under which the subsidy has been made available.
- (ii) Examine documents for the grant of subsidy and note the conditions attached with the same relating to its use, etc.
- (iii) See that conditions to be fulfilled and other terms especially whether the same is for a specific asset or is for setting up a factory at a specific location.
- (iv) Check relevant entries for receipt of subsidy.
- (v) Check compliance with requirements of AS 12 on "Accounting for Government Grants" i.e. whether it relates to specific amount or in the form of promoters' contribution and accordingly accounted for as also compliance with the disclosure requirements.

(c) Royalties received:

- (i) Verify the relevant contract and ascertain the provisions relating to the conditions of royalty such as rate, mode of calculation and due date.
- (ii) Check the periodical statements received in respect of books printed, sold and inventory lying at different locations.
- (iii) Check the computation in the royalty statement and ensure that any deduction or adjustment made from the royalty due is as per agreement conditions.

(iv) Verify the provisions for the royalty to be received as at the end of the year.

(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. (a) Personal Expenses of Directors:

- (i) Check the articles of association, service contract, minutes of general meeting, etc., to check the authorisation for such payment.
- (ii) Enquire to ensure that personal expenses are not camouflaged in any other revenue items as contemplated under section 143(1) of the Companies Act, 2013.
- (iii) Ascertain compliance with disclosure according to requirements of Schedule III to the Companies Act, 2013.
- (iv) Check documentary evidences to examine the payments reimbursed.

(b) Preliminary Expenses: It is the expenditure incurred incidental to the creation, formation and floating of a company. It consists of stamp duties, registration fees, legal costs, consultants fees, expenses of printing of memorandum and articles, etc. The following should be checked-

- (i) Check Board's minutes book containing the resolution approving the expenses claimed by promoters as having been spent in formation of the company.
- (ii) Examine supporting papers and vouchers, contracts, agreements, etc. to support the promoters' claims. Also check bills and receipts issued by the printer of the memorandum and articles of association, share certificates, etc.
- (iii) Check receipt for the registration fee paid for registration of the company.
- (iv) Verify rates of stamp required to be affixed on the memorandum and articles of association.

- (v) Examine the compliance of AS 26 'Intangible Assets' with regard to treatment of such preliminary expenses in the books of account.
- (vi) Check that no expenses other than those what constitutes preliminary expenses are booked under this head, e.g. underwriting commission and brokerage paid.

(c) Advances to the Suppliers:

- (i) Obtain schedule of debit balances in trade payables' account and pay particular attention to the age of the balances. Also scrutinise the bought ledger.
- (ii) Enquiry should be made for long unadjusted outstandings and check as to whether any of them would require provisioning.
- (iii) Examine that the advances have not been shown as deposits in balance sheet as per section 143(1) of the Companies Act, 2013.
- (iv) Confirmation of balances should be obtained and reconciliation be done in case of any discrepancies.

15. (a) Removal of Auditor before Expiry of Term: According to Section 140 (1) the auditor appointed under section 139 may be removed from his office before the expiry of his term only by a special resolution of the company, after obtaining the previous approval of the Central Government.

- (1) 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.
- (2) The application shall be made to the Central Government within thirty days of the resolution passed by the Board.
- (3) The company shall hold the general meeting within sixty days of receipt of approval of the Central Government for passing the special resolution.

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

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

(b) Under sub-section (3) of section 141 along with the Companies (Audit and Auditors) Rule, 2014, a person who, or his relative or partner is holding any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company, shall not be eligible for appointment as an auditor of a company.

It may be noted that the relative may hold security or interest in the company of face value not exceeding rupees one lakh.

Where a person appointed as an auditor of a company incurs any of the disqualifications mentioned in sub-section (3) 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.

Applying the above provisions to the given problem, it may be concluded that Firm of RGS, Chartered Accountants is not eligible to continue as auditors. Firm shall vacate its office as auditor and such vacation shall be treated as casual vacancy.

- 16. (a) Appointment of Subsequent Auditors in case of Non Government Companies:** Section 139(1) of the Companies Act, 2013 provides that every company shall, at the first annual general meeting appoint an individual or a firm as an auditor who shall hold office from the conclusion of that meeting till the conclusion of its sixth annual general meeting and thereafter till the conclusion of every sixth meeting.

The following points need to be noted in this regard-

- (i) Before such appointment is made, the written consent of the auditor to such appointment, and a certificate from him or it that the appointment, if made, shall be in accordance with the conditions as may be prescribed, shall be obtained from the auditor.
- (ii) The certificate shall also indicate whether the auditor satisfies the criteria provided in section 141.
- (iii) The company shall inform the auditor concerned of his or its appointment, and also file a notice of such appointment with the Registrar within 15 days of the meeting in which the auditor is appointed.

- (b) Reporting requirements regarding Fixed Assets under CARO, 2016 are :**

- (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;
- (c) Whether the title deeds of immovable properties are held in the name of the company. If not, provide the details thereof;

- 17. (a) Authentication of Financial Statements:** Section 134(1) provides that the financial statements, including consolidated financial statement, if any, shall be approved by the board of directors before they are signed on behalf of the board at least by the following-

- (a) The chairperson of the company where he is authorised by the Board; or
- (b) By two directors out of which one shall be managing director and

- (c) The Chief Executive Officer, if he is a director in the company,
- (d) The Chief Financial Officer, wherever he is appointed; and
- (e) The company secretary of the company, wherever he is appointed.

However, in the case of a one person company, the financial statement shall be signed by only one director, for submission to the auditor for his report thereon.

As per section 134(2), the auditors' report shall be attached to every financial statement.

According to section 134(7), a signed copy of every financial statement, including consolidated financial statement, if any, shall be issued, circulated or published along with a copy each of—

- (i) Any notes annexed to or forming part of such financial statement;
- (ii) The auditor's report; and
- (iii) The Board's report.

- (b) Books of Account, etc., to be kept by Company:** The provisions in the matter of books of account which a company is required to maintain are contained in section 128 of the Companies Act, 2013 (hereinafter referred as the Act).

The term "**Book and paper**" and "**Book or paper**" has been defined under section 2(12) of the Act, which includes books of account, deeds, vouchers, writings, documents, minutes and registers maintained on paper or in electronic form.

Further, "**Books of account**", as defined under section 2(13) of the Act, includes records maintained in respect of—

- (a) all sums of money received and expended by a company and matters in relation to which the receipts and expenditure take place;
- (b) all sales and purchases of goods and services by the company;
- (c) the assets and liabilities of the company; and
- (d) the items of cost as may be prescribed under section 148 in the case of a company which belongs to any class of companies specified under that section.

- 18. (a) Alteration of Share Capital:** Section 61 of the Companies Act, 2013 lays down power of limited company to alter its share capital. According to the provision a limited company having a share capital may, if so authorised by its articles, alter its memorandum in its general meeting to—

- (a) increase its authorised share capital by such amount as it thinks expedient;
- (b) consolidate and divide all or any of its share capital into shares of a larger amount than its existing shares, however no consolidation and division which results in changes in the voting percentage of shareholders shall take effect

unless it is approved by the Tribunal on an application made in the prescribed manner;

- (c) convert all or any of its fully paid-up shares into stock, and reconvert that stock into fully paid-up shares of any denomination;
- (d) sub-divide its shares, or any of them, into shares of smaller amount than is fixed by the memorandum, so, however, that in the sub-division the proportion between the amount paid and the amount, if any, unpaid on each reduced share shall be the same as it was in the case of the share from which the reduced share is derived;
- (e) cancel shares which, at the date of the passing of the resolution in that behalf, have not been taken or agreed to be taken by any person, and diminish the amount of its share capital by the amount of the shares so cancelled.

It may be noted that the cancellation of shares shall not be deemed to be a reduction of share capital.

Section 64 of the Companies Act, 2013 provides that within 30 days of the shares having been consolidated, converted, sub-divided, redeemed, or cancelled or the stock having been reconverted, notice should be given to the Registrar in the prescribed form along with an altered memorandum.

The auditor's duties in the circumstances shall be:

- (i) to verify that the alteration of capital is authorised by the Articles;
 - (ii) to inspect the minutes of the shareholders authorising the alteration;
 - (iii) to obtain Allotment Lists containing details of the new holdings of share or stock by each member and to verify the same with the entries;
 - (iv) to inspect the directors' resolution in regard to allotment, consolidation, conversion or sub-division passed pursuant to the resolution of the members;
 - (v) to examine the cancelled share certificates, if any, and agree the same with the counterfoils of new certificates issued;
 - (vi) to see that the procedure, prescribed by the Articles in this regard, has been complied with;
 - (vii) to verify that the share capital account is correctly shown in the Balance Sheet; and
 - (viii) to see that the necessary intimation to the Registrar contemplated by Section 64 has been sent.
- (b) **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 see that the Sweat Equity Shares issued by the company are of a class of shares already issued and following conditions are fulfilled:

- (a) the issue is authorised by a special resolution passed by the company;
- (b) 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;
- (c) not less than one year has, at the date of such issue, elapsed since the date on which the company had commenced business; and
- (d) 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.

19. (a) **Government Expenditure Audit:** Audit of government expenditure is one of the major components of government audit conducted by the office of C&AG. The basic standards set for audit of expenditure are to ensure that there is provision of funds authorised by competent authority fixing the limits within which expenditure can be incurred. **Briefly, these standards are explained below:**
- (i) **Audit against Rules & Orders:** The auditor has to see that the expenditure incurred conforms to the relevant provisions of the statutory enactment and is in accordance with the financial rules and regulations framed by the competent authority.
 - (ii) **Audit of Sanctions:** The auditor has to ensure that each item of expenditure is covered by a sanction, either general or special, accorded by the competent authority, authorising such expenditure.
 - (iii) **Audit against Provision of Funds:** It contemplates that there is a provision of funds out of which expenditure can be incurred and the amount of such expenditure does not exceed the appropriations made.
 - (iv) **Propriety Audit:** It is required to be seen that the expenditure is incurred with due regard to broad and general principles of financial propriety. The auditor

aims to bring out cases of improper, avoidable, or in fructuous expenditure even though the expenditure has been incurred in conformity with the existing rules and regulations. Audit aims to secure a reasonably high standard of public financial morality by looking into the wisdom, faithfulness and economy of transactions.

- (v) **Performance Audit:** This involves that the various programmes, schemes and projects where large financial expenditure has been incurred are being run economically and are yielding results expected of them. Efficiency-cum-performance audit, wherever used, is an objective examination of the financial and operational performance of an organisation, programme, authority or function and is oriented towards identifying opportunities for greater economy, and effectiveness.
- (b) **Powers of C&AG:** The C&AG Act gives the following powers to the C&AG in connection with the performance of his duties-
 - (a) To inspect any office of accounts under the control of the Union or a State Government including office responsible for the creation of the initial or subsidiary accounts.
 - (b) To require that any accounts, books, papers and other documents which deal with or are otherwise relevant to the transactions under audit, be sent to specified places.
 - (c) To put such questions or make such observations as he may consider necessary to the person in charge of the office and to call for such information as he may require for the preparation of any account or report which is his duty to prepare.

In carrying out the audit, the C&AG has the power to dispense with any part of detailed audit of any accounts or class of transactions and to apply such limited checks in relation to such accounts or transactions as he may determine

20. Audit of Hospital: The audit points to be considered by the auditor during the audit of a Hospital are stated below:-

- (i) Vouch the Register of patients with copies of bills issued to them. Verify bills for a selected period with the patients' attendance record to see that the bills have been correctly prepared. Also see that bills have been issued to all patients from whom an amount was recoverable according to the rules of the hospital.
- (ii) Check cash collections as entered in the Cash Book with the receipts, counterfoils and other evidence for example, copies of patients bills, counterfoils of dividend and other interest warrants, copies of rent bills, etc.
- (iii) See by reference to the property and Investment Register that all income that should have been received by way of rent on properties, dividends, and interest on securities settled on the hospital, has been collected.

- (iv) Ascertain that legacies and donations received for a specific purpose have been applied in the manner agreed upon.
- (v) Trace all collections of subscription and donations from the Cash Book to the respective Registers. Reconcile the total subscriptions due (as shown by the Subscription Register and the amount collected and that still outstanding).
- (vi) Vouch all purchases and expenses and verify that the capital expenditure was incurred only with the prior sanction of the Trustees or the Managing Committee and that appointments and increments to staff have been duly authorised.
- (vii) Verify that grants, if any, received from Government or local authority has been duly accounted for. Also, that refund in respect of taxes deducted at source has been claimed.
- (viii) Compare the totals of various items of expenditure and income with the amount budgeted for them and report to the Trustees or the Managing Committee significant variations which have taken place.
- (ix) Examine the internal check as regards the receipt and issue of stores; medicines, linen, apparatus, clothing, instruments, etc. so as to ensure that purchases have been properly recorded in the Inventory Register and that issues have been made only against proper authorisation.
- (x) See that depreciation has been written off against all the assets at the appropriate rates.
- (xi) Inspect the bonds, share scrips, title deeds of properties and compare their particulars with those entered in the property and Investment Registers.
- (xii) Obtain inventories, especially of inventories and stores as at the end of the year and check a percentage of the items physically; also compare their total values with respective ledger balances.
- (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.

PAPER – 7: INFORMATION TECHNOLOGY AND STRATEGIC MANAGEMENT

SECTION – A: INFORMATION TECHNOLOGY

QUESTIONS

Multiple Choice Questions

1. In Computer Networks Open Systems Interconnection (OSI) Model, _____ defines the relationship between a device and a physical medium.
 - (a) Physical Layer
 - (b) Data Link Layer
 - (c) Network Layer
 - (d) Session Layer
2. An aspiring CA in his interview was asked to provide correct sequence of the following sub-processes that represent Procure to Pay Process Flow. The sub processes are - (1) Purchase Order, (2) Receipts, (3) Request for Quote (RFQ), (4) Purchase Requisition, (5) Payments, and (6) Quotation. What should be the sequence?
 - (a) (1)-(2)-(3)-(4)-(5)-(6)
 - (b) (4)-(3)-(6)-(1)-(2)-(5)
 - (c) (1)-(4)-(3)-(5)-(6)-(2)
 - (d) (5)-(3)-(1)-(2)-(4)-(6)
3. In real world networks, the terminology _____ refers to the ability of a network to recover from any kind of error like connection failure, loss of data etc.
 - (a) Routing
 - (b) Resilience
 - (c) Contention
 - (d) Bandwidth
4. To qualify as a Transaction Processing System (TPS), transactions made by the system must pass the ACID Test – Atomicity, Consistency, Isolation and Durability. Which feature under ACID Test refers to the pre-requisite that “Once transactions are completed, they cannot be undone”.
 - (a) Atomicity
 - (b) Consistency
 - (c) Isolation
 - (d) Durability

5. In Computer system, _____ establish the authenticity of persons and prevent the denial of messages or contracts when data is exchanged electronically.
- Plastic Cards
 - Digital Signatures
 - One Time Password
 - Encryption

Accounting Information Systems (AIS)

6. Accountants and Auditors must study and understand Accounting Information Systems (AIS) and related concepts so that they can accomplish the functions of accounting, general accounting reports and using accounting reports. Determine the three basic functions of AIS that they should build their understanding upon?

Flowchart

7. The GST of 50 items is to be calculated as per the following details. With Code No. and Value of Supply as input, draw a flowchart to calculate the Tax and print the Tax, Code No. of the Item and the Type of Item. (Note: The rates have been taken hypothetically)

Code No.(C_No)	Types of Item	Tax Rate
001	Perishable	15%
002	Textiles	10%
003	Luxury Items	20%
004	Machinery	12%

Mobile Computing

8. Mobile Computing enables enterprises to connect with their employees all times resulting in the increased productivity and a better Return on Investments (RoI). Discuss some examples of its business applications.

Information Systems Life Cycle

9. In an organization, there may come a time when the existing systems may not remain efficient and effective, thus, arising a need for the development of new Information Systems. Identify the various phases involved in the development of an Information System.

Network Architecture and Protocol

10. Discuss Network Architecture and Protocol.

E-Commerce Applications

11. As a user, determine the benefits that can be derived by using E-Commerce applications and their implementation.

Transaction Processing Systems (TPS)

12. Discuss the attributes that any Transaction Processing System (TPS) would possess.

Credit Card

13. A customer contacted a bank's customer care executive to enquire about the processing of Credit Cards. As an executive, what shall be your explanation?

Input Controls

14. Discuss Input Controls under Application Controls.

Grid Computing

15. You are deputed as an IT Administrator in ABC company. From your perspective, determine the reasons why Grid Computing should be used.

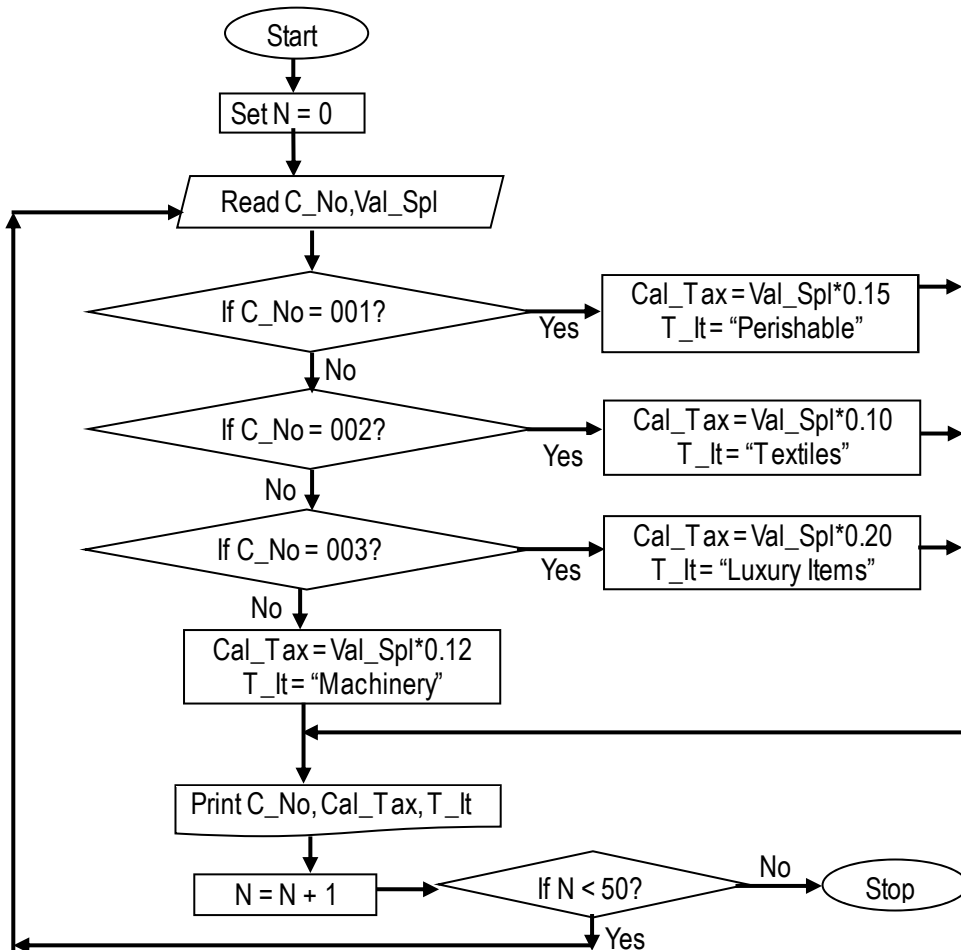
SUGGESTED ANSWERS/HINTS

1. (a) Physical Layer
2. (b) (4)-(3)-(6)-(1)-(2)-(5)
3. (b) Resilience
4. (d) Durability
5. (b) Digital Signatures
6. Accountants and Auditors must study and understand Accounting Information Systems (AIS) and related concepts so that they can accomplish the functions of accounting, general accounting reports and using accounting reports. The Accounting Information System is the mechanism that allows accountants to perform their accounting functions and tasks. As auditors, understanding of AIS is critical for collecting and evaluating evidence to provide an opinion/report on the completeness and accuracy of accounting information which is processed through AIS to produce the financial reports. The three basic functions of AIS are as under:
 - (i) **Collect and store data:** Collect and store data about organization's business activities and transactions by capturing transaction data from source documents and posting data from journals to ledgers. Source documents are special forms used to capture transaction data such as sales order, sales invoice, order processing, purchase order, etc. Control over data collection is improved by pre-numbering each source document. Accuracy and efficiency in recording transaction data can be further improved if source documents are properly designed.
 - (ii) **Record transaction:** Record transactions data into journals that present a chronological record of what occurred and provide management with information

useful for decision making. These documents are in the form of reports like financial statements, managerial reports, etc.

- (iii) **Safeguard organisational assets:** Provide adequate controls to ensure that data is recorded and processed accurately by safeguarding organizational assets (data and systems). The two important methods for accomplishing this objective are by providing adequate documentation of all business activities and an effective segregation of duties. Documentation allows management to verify that assigned responsibilities were completed correctly. Segregation of Duties refers to dividing responsibility for different portions of a transaction among several people. The functions to be performed by different people are authorizing (approval) transactions, recording (capture) transactions and maintaining custody (protect) of assets, thereby ensuring that business activities are performed efficiently and in accordance with management's objectives.

7. The required flowchart is as below:



The variables are defined as follows:

C = Code No; Val_Spl = Value of Supply; T_It = Types of Item

N = Counter; Cal_Tax = Calculated Tax after GST

8. Mobile Computing enables enterprises to connect with their employees all times resulting in increased productivity and a better Return on Investments (RoI). Some examples of business applications are as follows:
- There is an increase in workforce productivity as mobile device enables employees to work from anywhere, anytime by accessing and updating information as required. For example - employees can read/respond to emails using laptops, PDAs or smart phones from office, residence and even when on the move.
 - Customer service can be improved by responding to customer queries on site or off site. For example - customer complaints can be accessed and responded by accessing past/latest information of client as required.
 - Incident management can be improved by resolving problems faster without limitation of time as the concerned employees can attend to these regardless of their location. Further, escalations can be updated in real time which ensures timely resolution of problems. For example - Computer breakdowns can be serviced by service engineers from their desks/outside by logging into the specific computer, identify problem and resolve it online.
 - Business processes can be transformed by using mobile devices. Enterprises can reengineer core business processes. The new and reengineered processes can focus on utilizing the key features of location and time independence. Enterprises can focus on providing customers and employees with access to information in different ways and provide the latest information. This enables employees, customers, and businesses to be available to one another as per their choice. For example - billing can be done by employees using hand held devices at customer site and the information updated online and deliveries to customers can be speeded up.
 - Enterprises can dynamically modify and update their offerings and offer new products and services altogether. For example - enterprises can implement telecommuting with flexible working hours and locations allowing for cost savings and better efficiency.
 - Mobile computing gives users the freedom to roam, with access to data and services at any time and in any place. Most of the high-end ERP and business software applications for SMEs have in-built capabilities of mobile computing enabling users to access data. Used with proper security, enterprises can harness the power of this technology to create innovative opportunities for improving the quality and efficiency of business processes and services. Mobile devices are increasingly acquiring the must-have status for enterprises because the increasing acceptance as business tools.

9. Various phases that are involved in developing an Information System are as follows:
- **Phase 1: System Investigation:** This phase examines that 'What is the problem and is it worth solving'? The feasibility study under the following dimensions is as follows:
 - **Technical feasibility:** Does the technology exist to implement the proposed system or is it a practical proposition?
 - **Economic feasibility:** Is proposed system cost-effective: if benefits do not outweigh costs, it's not worth going ahead?
 - **Legal feasibility:** Is there any conflict between the proposed system and legal requirements?
 - **Operational feasibility:** Are the current work practices and procedures adequate to support the new system?
 - **Schedule feasibility:** How long will the system take to develop, or can it be done in a desired time-frame?
 - **Phase 2: System Analysis:** This phase examines that 'What must the Information System do to solve the problem'? System analyst would be gathering details about the current system and will involve:
 - **Interviewing staff:** at different levels from end-users to senior management;
 - **Examine current business:** systems documents and output including current order documents, computer system procedures and reports used by operations and senior management;
 - **Sending out questionnaires:** that must be carefully constructed to elicit unambiguous answers; and
 - **Observation of current procedures:** by spending time in various departments. A time and motion study can show where procedures could be more efficient or to detect bottlenecks.
 - **Phase 3: System Designing:** This phase examines that 'How will the Information System do that it must do to obtain the solution to the problem'? This phase specifies the technical aspects of a proposed system in terms of:
 - **Hardware platform:** Computer, network capabilities, input, storage and output devices;
 - **Software:** Programming language, package and database;
 - **Outputs:** Report layouts and screen designs;
 - **Inputs:** Documents, screen layouts and validation procedures;
 - **User interface:** How users will interact with the computer system;

- **Modular design:** Of each program in the application;
 - **Test plan:** Develop test data;
 - **Conversion plan:** How the new system is to be implemented; and
 - **Documentation:** Including systems and operations documentation. Later, a user manual will be produced.
 - **Phase 4: System Implementation:** This phase examines that 'How will the Solution be put into effect'? This phase involves the following steps:
 - Coding and testing of the system;
 - Acquisition of hardware and software; and
 - Either installation of the new system or conversion of the old system to the new one.
 - **Phase 5: System Maintenance and Review:** This phase evaluates results of solution and modifies the system to meet the changing needs. Post implementation review would be done to address:
 - Programming amendments,
 - Adjustment of clerical procedures,
 - Modification of Reports, and
 - Request for new programs.
- 10. Network Architecture:** Network Architecture refers to the layout of the network consisting of the hardware, software, connectivity, communication protocols and mode of transmission, such as wired or wireless. The diagram of the network architecture provides a full picture of the established network with detailed view of all the resources accessible. In other words, Network Architecture includes hardware components used for communication, cabling and device types, network layout and topologies, physical and wireless connections, implemented areas and future. In addition, the software rules and protocols also constitute to the network architecture. The goal of network architecture is to promote an open, simple, flexible, and efficient telecommunications environment. This is accomplished using Standard protocols; Standard communications hardware and software interfaces; and standard multilevel interface between end users and computer systems.
- 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 intercomputer 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. Thus, we can say that, Network protocols which are essentially software are sets of rules for-

- Communicating timings, sequencing, formatting, and error checking for data transmission.
- Providing standards for data communication.

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.

11. E-Commerce presents immense benefits to individual organizations, consumers, and society as a whole.

- Reduction in costs to buyers from increased competition in procurement as more suppliers are able to compete in an electronically open marketplace.
- Reduction in errors, time, and overhead costs in information processing by eliminating requirements for re-entering data.
- Reduction in costs to suppliers by electronically accessing on-line databases of bid opportunities, on-line abilities to submit bids, and on-line review of rewards.
- Reduction in time to complete business transactions, particularly from delivery to payment.
- Creation of new markets through the ability to easily and cheaply reach potential customers.

- Easier entry into new markets, especially geographically remote markets, for enterprises regardless of size and location.
 - Better quality of goods as specifications are standardized and competition is increased and improved variety of goods through expanded markets and the ability to produce customized goods.
 - Faster time to market as business processes are linked, thus enabling seamless processing and eliminating time delays.
 - Optimization of resource selection as businesses form cooperative teams to increase the chances of economic successes, and to provide the customer products and capabilities more exactly meeting the requirements.
 - Reduction in inventories and reduction of risk of obsolete inventories as the demand for goods and services is electronically linked through just-in-time inventory and integrated manufacturing techniques.
 - Reduction in overhead costs through uniformity, automation, and large-scale integration of management processes.
 - Reduction in use of ecologically damaging materials through electronic coordination of activities and the movement of information rather than physical objects).
 - Reduction in advertising costs.
12. The attributes of Transaction Processing Systems (TPS) are as follows:
- **Access Control - TPS:** Most Transaction Processing Systems come with access control to put a ceiling on users to only those allowed to accomplish so. Access Control ensures that people who are not authorized to use the system are not permissible to influence or transform the transaction process.
 - **Equivalence - TPS:** Transactions are processed in the similar format every time to ensure that full effectiveness is achieved. The TPS Interfaces are designed to get hold of identical data for each transaction, despite the consequences of the source.
 - **High Volume Rapid Processing - TPS:** In most of the transaction processing, the foremost issue is momentum. The instantaneous processing of transactions is noteworthy to the success of certain industry such as banking. TPS is designed to process transactions in an immediate effect to make confident that the transaction data is available to other users or processes that entail it.
 - **Trustworthiness - TPS:** A TPS system is designed to be robust and trustworthy. The system is capable to process transactions very rapidly, yet at the same time, conduct several checks to make certain that the data integrity is preserved.

13. **Credit Cards:** In a credit card transaction, the consumer presents preliminary proof of his ability to pay by presenting his credit card number to the merchant. The merchant can verify this with the bank, and create a purchase slip for the consumer to endorse. The merchant then uses this purchase slip to collect funds from the bank, and, on the next billing cycle, the consumer receives a statement from the bank with a record of the transaction.

Processing of Credit Card involves following steps:

- **Step 1: Authorization** – This is the first step in processing a credit card. After a merchant swipes the card, the data is submitted to merchant's bank, called an acquirer, to request authorization for the sale. The acquirer then routes the request to the card issuing bank, where it is authorized or denied, and the merchant can process the sale.
 - **Step 2: Batching** – This is the second step in processing a credit card. At the end of a day, the merchant reviews all the day's sales to ensure they were authorized and signed by the cardholder. It then transmits all the sales at once, called a batch, to the acquirer to receive payment.
 - **Step 3: Clearing** – This is the third step in processing a credit card. After the acquirer receives the batch, it sends it through the card network, where each sale is routed to the appropriate issuing bank. The issuing bank then subtracts its interchange fees, which are shared with the card network, and transfers the remaining amount through the network back to the acquirer.
 - **Step 4: Funding** – This is the fourth and final step in processing a credit card. After receiving payment from the issuer, minus interchange fees, the acquirer subtracts its discount fee and sends the remainder to the merchant. The merchant is now paid for the transaction, and the cardholder is billed.
14. **Input Controls:** These are responsible for ensuring the accuracy and completeness of data that are input into an application system. Input controls are important since substantial time is spent on inputting data which involves human intervention and are therefore prone to errors and fraud. The type of data input method used in an information system affects asset safeguarding, data integrity, system effectiveness, and system efficiency objectives. If data is keyed into an information system via a terminal, high quality screen design is important to minimizing input errors and to achieving effective and efficient input of data.
- **Source Document Control:** From a control viewpoint, a well-designed source document reduces the likelihood of data recording errors, increases the speed with which data can be recorded and controls the work flow. Source Document Controls facilitates the data entry into a computer system and subsequent reference checking.
 - **Data Coding Controls:** Data Coding Controls are put in place to reduce user error during data feeding.

- **Batch Controls:** These are put in place at locations where batch processing is being used. Batch processing is where there is a time gap between occurrence and recording of transactions, that is, transactions are not recorded at the time of occurrence but are accumulated and a set (based on number/ time) is processed.
 - **Validation Controls:** These validate the accuracy/correctness of input data. Input Validation Controls are intended to detect errors in transaction data before the data are processed.
15. From an Administrative Perspective, Grid Computing is used because of following reasons:
- **Planning:** The administrator should understand the organization's requirements for the grid to better choose the grid technologies that satisfy grid's requirements. One of the first considerations is the hardware available and how it is connected via a LAN or WAN. Next, an organization may want to add additional hardware to supplement the capabilities of the grid.
 - **Security:** Security is a much more important factor in planning and maintaining a grid where data sharing comprises the bulk of the activity. In a grid, the member machines are configured to execute programs rather than just move data. This makes an unsecured grid potentially fertile ground for viruses and Trojan horse programs. For this reason, it is important to understand the issues involved in authenticating users and providing proper authorization for specific operations.
 - **Organization:** It is important to understand how the departments in an organization interact, operate, and contribute to the whole. Often, there are barriers built between departments and projects to protect their resources in an effort to increase the probability of timely success. For example, a project that finds itself behind schedule and over budget may not be able to afford the resources required to solve the problem. A grid would give such projects an added measure of safety, providing an extra margin of resource.
 - **Installation:** First, the selected grid system must be installed on an appropriately configured set of machines. These machines should be connected using networks with sufficient bandwidth to other machines on the grid. Machines should be configured and connected to facilitate recovery scenarios. Any critical databases or other data essential for keeping track of the jobs in the grid, members of the grid, and machines on the grid should have suitable backups.
 - **Managing enrollment of donors and users:** The administrator is responsible for controlling the rights of the users in the grid. Donor machines may have access rights that require management as well. The rights of these grid user IDs must be properly set so that grid jobs do not allow access to parts of the donor machine to which the users are not entitled. As users join the grid, their identity must be positively

established and entered in the Certificate Authority. Further, procedures for removing users and machines must also be executed by the administrator.

- **Certificate Authority:** It is critical to ensure the highest levels of security in a grid because the grid is designed to execute code and not just share data. Thus, viruses, Trojan horses, and other attacks can affect the grid system. The Certificate Authority is one of the most important aspects of maintaining strong grid security. An organization may choose to use an external Certificate Authority or operate one itself.
- **Resource Management:** Another responsibility of the administrator is to manage the resources of the grid. This includes setting permissions for grid users to use the resources as well as tracking resource usage and implementing a corresponding accounting or billing system. Usage statistics are useful in identifying trends in an organization that may require the acquisition of additional hardware; reduction in excess hardware to reduce costs; and adjustments in priorities and policies to achieve better for attaining the overall goals of an organization etc.
- **Data sharing:** For small grids, the sharing of data can be fairly easy, using existing networked file systems, databases, or standard data transfer protocols. As a grid grows and the users become dependent on any of the data storage repositories, the administrator should consider procedures to maintain backup copies and replicas to improve performance. All of the resource management concerns apply to data on the grid.

SECTION – B: STRATEGIC MANAGEMENT

Multiple Choice Questions

1. (i) What do we mean by the term 'strategic change'?
 - (a) The proactive management of change to achieve strategic objectives.
 - (b) The changes that inevitably result in organisations as they evolve in a changing environment.
 - (c) An important organisational change.
 - (d) Planned change.
- (ii) Which of the following statement is correct for strategy implementation?
 - (a) Strategy implementation positions forces before the action.
 - (b) It requires intellectual skills.
 - (c) It is basically an operational process.
 - (d) It focuses on effectiveness.
- (iii) An organization's strengths and weaknesses are determined relative to
 - (a) its strategic business units
 - (b) government
 - (c) competitors
 - (d) external opportunities and threats
- (iv) Developing a vision and mission, identifying an organization's external opportunities and threats, and determining internal strengths and weaknesses are all _____ activities.
 - (a) strategy-formulation
 - (b) strategy-implementation
 - (c) long-range planning
 - (d) short-range planning
- (v) In a large organization, strategic management activities occur at what level(s)?
 - (a) Corporate and divisional only
 - (b) Divisional
 - (c) Strategic business unit only
 - (d) Functional, divisional, and corporate

- (vi) Developing new digital watch by a company manufacturing analogue watches is:
- (a) a product development strategy
 - (b) a market development strategy
 - (c) a market penetration strategy
 - (d) none of the above
- (vii) Which of the following is not a significance of SWOT analysis:
- (a) SWOT provides a logical framework of analysis
 - (b) SWOT presents a comparative account
 - (c) SWOT overemphasizes a single dimension of strategy.
 - (d) SWOT guides the strategist in strategy identification
- (viii) The scope of Financial management covers:
- (a) Sources of finance
 - (b) Financing mix
 - (c) How firm should analyze, plan and control its financial affairs
 - (d) All the above
- (ix) What action involves reconfiguring or redesigning work, jobs and processes for the purpose of improving costs, quality, service and speed?
- (a) Restructuring
 - (b) Downsizing
 - (c) Reengineering
 - (d) Benchmarking
- (x) What is not one of Michael Porter's five competitive forces?
- (a) New entrants
 - (b) Rivalry among existing firms
 - (c) Bargaining power of unions
 - (d) Bargaining power of suppliers

Differences between the two concepts

2. Distinguish between the following:
- (a) SWOT and TOWS matrix
 - (b) Operational control and Management control
 - (c) Vision and mission

Short notes

3. Write short notes on the following:
 - (a) Strategic surveillance
 - (b) Objectives of business
 - (c) Experience curve

Brief answers

4. Briefly answer the following questions:
 - (a) Under what conditions a turnaround strategy can be used in an organization?
 - (b) "Six sigma is not merely a quality initiative, it is a business initiative." Elucidate.
 - (c) Does HRM function play a role in organizational strategy?

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. How PESTLE analysis is used for analyzing the macro environment? Explain.

Chapter 2-Business Policy and Strategic Management

7. Explain in detail the term corporate strategy with its characteristics.
8. What are the major dimensions of strategic decision making?

Chapter 3-Strategic Analysis

9. How would you argue that strategic analysis is the starting point for strategic thinking?
10. How an organization analyses its business portfolio explain on market growth rate and relative market share.

Chapter 4-Strategic Planning

11. What are the various bases on which an existing firm can diversify strategically?
12. Discuss how mergers and acquisitions are used for business growth. What are the various types of mergers?

Chapter 5-Formulation of Functional Strategy

13. How Research and Development (R&D) personnel can play an integral part in strategy implementation?
14. What are the requirements for the successful implementation of supply chain management system? Discuss.

Chapter 6-Strategic Implementation and Control

15. Explain the various types of strategic control.
16. What are the leadership roles played by a strategic leader? Distinguish between a transformational leader and a traditional leader.

Chapter 7-Reaching Strategic Edge

17. What is Benchmarking? What are the areas where benchmarking can help?
18. How would you explain the managerial significance of Six Sigma in today's business world?

SUGGESTED ANSWERS / HINTS

1.

i	ii	iii	iv	v	vi	vii	viii	ix	x
a	c	c	a	d	a	c	d	c	c

2. (a) TOWS Analysis is a variant of the classic business tool, SWOT Analysis. TOWS and SWOT are acronyms for different arrangements of the words Strengths, Weaknesses, Opportunities and Threats. By analyzing the external environment (threats and opportunities), and internal environment (weaknesses and strengths), we can use these techniques to think about the strategy of a company. Following are the some basic differences between TOWS and SWOT matrix:
 - ◆ TOWS emphasise on external environment whereas SWOT emphasises on internal environment.
 - ◆ TOWS matrix is about the combinations of SO, ST, WO, WT whereas SWOT matrix is about S, W, O, T.
 - ◆ TOWS analysis is an action tool whereas SWOT analysis is a planning tool.
 - ◆ TOWS is particularly useful in evaluating the potential impact of sudden events or developments while SWOT is usually employed in evaluating a company's business plan.
- (b) Differences between Operational Control and Management Control are as under:
 - (i) The thrust of operational control is on individual tasks or transactions as against total or more aggregative management functions. When compared with operational, management control is more inclusive and more aggregative, in the sense of embracing the integrated activities of a complete department, division or even entire organisation, instead or mere narrowly circumscribed activities of sub-units. For example, procuring specific items for inventory is a matter of operational control, in contrast to inventory management as a whole.

- (ii) Many of the control systems in organisations are operational and mechanistic in nature. A set of standards, plans and instructions are formulated. On the other hand, the basic purpose of management control is the achievement of enterprise goals – short range and long range – in an effective and efficient manner.
- (c) The vision describes a future identity while the Mission serves as an ongoing and time-independent guide.

The vision statement can galvanize the people to achieve defined objectives, even if they are stretch objectives, provided the vision is specific, measurable, achievable, relevant and time bound. A mission statement provides a path to realize the vision in line with its values. These statements have a direct bearing on the bottom line and success of the organization.

A mission statement defines the purpose or broader goal for being in existence or in the business and can remain the same for decades if crafted well while a vision statement is more specific in terms of both the future state and the time frame. Vision describes what will be achieved if the organization is successful.

3. (a) **Strategic surveillance:** Contrary to the premise control, the strategic surveillance is unfocussed. It involves general monitoring of various sources of information to uncover unanticipated information having a bearing on the organizational strategy. It involves casual environmental browsing. Reading financial and other newspapers, business magazines, meetings, conferences, discussions at clubs or parties and so on can help in strategic surveillance.

Strategic surveillance may be loose form of strategic control, but is capable of uncovering information relevant to the strategy.

- (b) Enterprises pursue multiple objectives rather than a single objective. In general, we may identify a set of business objectives pursued by a large cross-section of enterprises. These relate to profitability, productive efficiency, growth, technological dynamism, stability, self-reliance, survival, competitive strength, customer service, financial solvency, product quality, diversification, employee satisfaction and welfare, and so on. Enterprises seek to balance these objectives in some appropriate manner. We may now elaborate some of the more important objectives of business

- ◆ Survival
- ◆ Stability
- ◆ Growth
- ◆ Efficiency
- ◆ Profitability

- (c) 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.

4. (a) When firms are losing their grips over market, profits due to several internal and external factors, and if they have to survive under the competitive environment they have to identify danger signals as early as possible and undertake rectification steps immediately. These conditions may be, inter alia cash flow problems, lower profit margins, high employee turnover and decline in market share, capacity underutilization, low morale of employees, recessionary conditions, mismanagement, raw material supply problems and so on.
 - (b) Six Sigma is a total management commitment and philosophy of excellence, customer focus, process improvement. Six Sigma is about making every area of the organization better able to meet the changing needs of customers, markets, and technologies - with benefits for employees, customers, and shareholders. So the six sigma is not merely a quality initiative, it is a business initiative.
 - (c) The role of human resources in enabling the organization to effectively deal with the external environmental challenges, the human resource management function has been accepted as a strategic partner in the formulation of organization's strategies and in the implementation of such strategies through human resource planning, employment, training, appraisal and rewarding of personnel. An organization's recruitment, selection, training, performance appraisal, and compensation practices can have a strong influence on employee competence is very important.
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. The term PESTLE is used to describe a framework for analysis of macro environmental factors. PESTLE analysis involves identifying the political, economic, socio-cultural, technological, legal and environmental influences on an organization and providing a way of scanning the environmental influences that have affected or are likely to affect an organization or its policy. PESTLE is an acronym for:

- P- political
- E- economic
- S- socio-cultural
- T- technological
- L- legal
- E- environmental

The PESTLE analysis is a simple to understand and quick to implement. The advantage of this tool is that it encourages management into proactive and structured thinking in its decision making.

The Key Factors

- **Political** factors are how and to what extent a government intervenes in the economy and the activities of corporate. Political factors may also include goods and services which the government wants to provide or be provided and those that the government does not want to be provided.
- **Economic** factors have major impacts on how businesses operate and take decisions. For example, interest rates affect a firm's cost of capital and therefore to what extent a business grows and expands. The money supply, inflation, credit flow, per capita income, growth rates have a bearing on the business decisions.

- **Social** factors affect the demand for a company's products and how that company operates.
- **Technological** factors can determine barriers to entry, minimum efficient production level and influence outsourcing decisions. Furthermore, technological shifts can affect costs, quality, and lead to innovation.
- **Legal** factors affect how a company operates, its costs, and the demand for its products.
- **Environmental** factors affect industries such as tourism, farming, and insurance. Growing awareness to climate change is affecting how companies operate and the products they offer.

On the basis of these, it should be possible to identify a number of key environmental influences, which are in effect, the drivers of change. These are the factors that require to be considered in matrix. A typical example is as follows:

<p>Political</p> <ul style="list-style-type: none"> • Political stability • Political principles and ideologies • Current and future taxation policy • Regulatory bodies and processes • Government policies • Government term and change • Thrust areas of political leaders. 	<p>Economic</p> <ul style="list-style-type: none"> • Economic situation & trends • Market and trade cycles • Specific industry factors • Customer/end-user drivers • Interest and exchange rates • Inflation and unemployment • Strength of consumer spending
<p>Social</p> <ul style="list-style-type: none"> • Lifestyle trends • Demographics • Consumer attitudes and opinions • Brand, company, technology image • Consumer buying patterns • Ethnic/religious factors • Media views and perception 	<p>Technological</p> <ul style="list-style-type: none"> • Replacement technology/solutions • Maturity of technology • Manufacturing maturity and capacity • Innovation potential • Technology access, licensing, patents • Intellectual property rights and copyrights

Legal	Environmental
<ul style="list-style-type: none"> • Business and Corporate Laws • Employment Law • Competition Law • Health & Safety Law • International Treaty and Law • Regional Legislation 	<ul style="list-style-type: none"> • Ecological/environmental issues • Environmental hazards • Environmental legislation • Energy consumption • Waste disposal

7. The term strategy is associated with unified design and action for achieving major goals, gaining command over the situation with a long-range perspective and securing a critically advantageous position. Strategies are formulated at the corporate, divisional and functional level. Corporate strategies are formulated by the top managers. They include the determination of the business lines, expansion and growth, vertical and horizontal integration, diversification, takeovers and mergers, new investment and divestment areas, R & D projects, and so on. These corporate wide strategies need to be operationalized by divisional and functional strategies regarding product lines, production volumes, quality ranges, prices, product promotion, market penetration, purchasing sources, personnel development and like.

In general, a corporate strategy has the following characteristics:

- It is generally long-range in nature, though it is valid for short-range situations also and has short-range implications.
- It is action oriented and is more specific than objectives.
- It is multi-pronged and integrated.
- It is flexible and dynamic.
- It is formulated at the top management level, though middle and lower level managers are associated in their formulation and in designing sub-strategies.
- It is generally meant to cope with a competitive and complex setting.
- It flows out of the goals and objectives of the enterprise and is meant to translate them into realities.
- It is concerned with perceiving opportunities and threats and seizing initiatives to cope with them. It is also concerned with deployment of limited organizational resources in the best possible manner.
- It gives importance to combination, sequence, timing, direction and depth of various moves and action initiatives taken by managers to handle environmental uncertainties and complexities.
- It provides unified criteria for managers in function of decision making.

8. Strategic decisions are different in nature than all other decisions which are taken at various levels of the organization during day-to-day working of the organizations. 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. Hence, problems calling for strategic decisions require to be considered by top management.
 - *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 number of 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 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.
10. The BCG growth-share matrix is the simplest way to portray a corporation's portfolio of investments. Growth share matrix also known for its cow and dog metaphors is popularly

used for resource allocation in a diversified company. Using the BCG approach, a company classifies its different businesses on a two-dimensional growth-share matrix. In the matrix:

- The vertical axis represents market growth rate and provides a measure of market attractiveness.
- The horizontal axis represents relative market share and serves as a measure of company strength in the market.

Using the matrix, organisations can identify four different types of products or SBU as follows:

- **Stars** are products or SBUs that are growing rapidly. They also need heavy investment to maintain their position and finance their rapid growth potential. They represent best opportunities for expansion.
- **Cash Cows** are low-growth, high market share businesses or products. They generate cash and have low costs. They are established, successful, and need less investment to maintain their market share. In long run when the growth rate slows down, stars become cash cows.

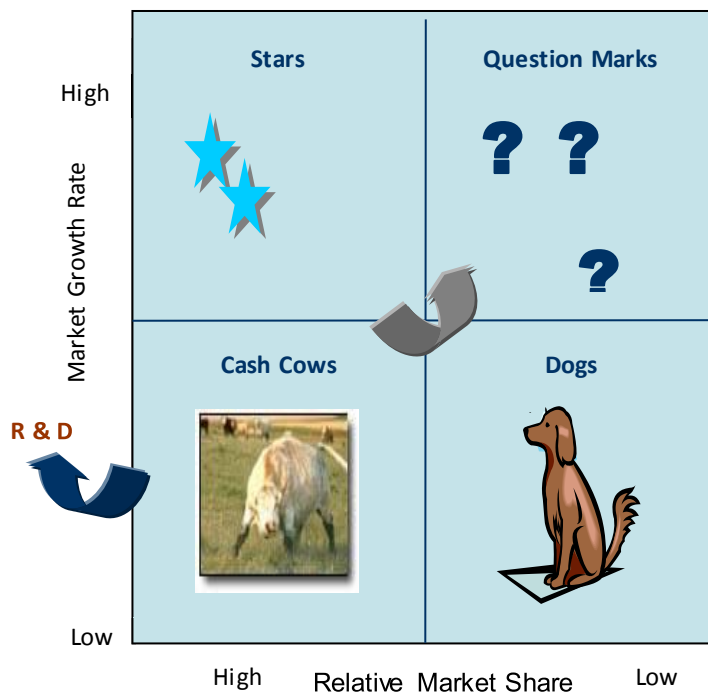


Figure: BCG Growth-Share Matrix

- **Question Marks**, sometimes called problem children or wildcats, are low market share business in high-growth markets. They require a lot of cash to hold their share. They need heavy investments with low potential to generate cash. Question marks if left unattended are capable of becoming cash traps. Since growth rate is high, increasing it should be relatively easier. It is for business organisations to turn them stars and then to cash cows when the growth rate reduces.
- **Dogs** are low-growth, low-share businesses and products. They may generate enough cash to maintain themselves, but do not have much future. Sometimes they may need cash to survive. Dogs should be minimised by means of divestment or liquidation.

Once the organisations have classified its products or SBUs, it must determine what role each will play in the future. The four strategies that can be pursued are:

- Build:** Here the objective is to increase market share, even by forgoing short-term earnings in favour of building a strong future with large market share.
- Hold:** Here the objective is to preserve market share.
- Harvest:** Here the objective is to increase short-term cash flow regardless of long-term effect.
- Divest:** Here the objective is to sell or liquidate the business because resources can be better used elsewhere.

The growth-share matrix has done much to help strategic planning study; however, there are problems and limitations with the method. BCG matrix can be difficult, time-consuming, and costly to implement. Management may find it difficult to define SBUs and measure market share and growth. It also focuses on classifying current businesses but provide little advice for future planning. They can lead the company to placing too much emphasis on market-share growth or growth through entry into attractive new markets. This can cause unwise expansion into hot, new, risky ventures or giving up on established units too quickly.

- 11. Diversification Strategy:** Diversification endeavours can be related or unrelated to existing businesses of the firm. Based on the nature and extent of their relationship to existing businesses, diversification endeavours have been classified into four broad categories:
 - Vertically integrated diversification
 - Horizontally integrated diversification
 - Concentric diversification
 - Conglomerate diversification

In vertically integrated diversification, firms opt to engage in businesses that are related to the existing business of the firm. The firm remains vertically within the same process. Sequence It moves forward or backward in the chain and enters specific product/process steps with the intention of making them into new businesses for the firm. The characteristic feature of vertically integrated diversification is that here, the firm does not jump outside the vertically linked product-process chain.

Horizontal Integrated Diversification: Through the acquisition of one or more similar business operating at the same stage of the production-marketing chain that is going into complementary products, by-products or taking over competitors' products.

Concentric Diversification: Concentric diversification too amounts to related diversification. In concentric diversification, the new business is linked to the existing businesses through process, technology or marketing. The new product is a spin-off from the existing facilities and products/processes. This means that in concentric diversification too, there are benefits of synergy with the current operations. However, concentric diversification differs from vertically integrated diversification in the nature of the linkage the new product has with the existing ones. The new product is only connected in a loop-like manner at one or more points in the firm's existing process/technology/product chain.

Conglomerate Diversification: In conglomerate diversification, no such linkages exist; the new businesses/ products are disjointed from the existing businesses/products in every way; it is a totally unrelated diversification. In process/technology/function, there is no connection between the new products and the existing ones. Conglomerate diversification has no common thread at all with the firm's present position.

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

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

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

Types of Mergers

1. **Horizontal merger:** Horizontal mergers are combinations of firms engaged in the same industry. It is a merger with a direct competitor. The principal objective behind this type of mergers is to achieve economies of scale in the production process by shedding duplication of installations and functions, widening the line of products, decrease in working capital and fixed assets investment, getting rid of competition and so on. For example, formation of Brook Bond Lipton India Ltd. through the merger of Lipton India and Brook Bond.
 2. **Vertical merger:** It is a merger of two organizations that are operating in the same industry but at different stages of production or distribution system. This often leads to increased synergies with the merging firms. If an organization takes over its supplier/producers of raw material, then it leads to backward integration. On the other hand, forward integration happens when an organization decides to take over its buyer organizations or distribution channels. Vertical merger results in operating and financial economies. Vertical mergers help to create an advantageous position by restricting the supply of inputs or by providing them at a higher cost to other players.
 3. **Co-generic merger:** In co-generic merger two or more merging organizations are associated in some way or the other related to the production processes, business markets, or basic required technologies. Such merger include the extension of the product line or acquiring components that are required in the daily operations. It offers great opportunities to businesses to diversify around a common set of resources and strategic requirements. For example, an organization manufacturing refrigerators can diversify by merging with another organization having business in kitchen appliances.
 4. **Conglomerate merger:** Conglomerate mergers are the combination of organizations that are unrelated to each other. There are no linkages with respect to customer groups, customer functions and technologies being used. There are no important common factors between the organizations in production, marketing, research and development and technology. In practice, however, there is some degree of overlap in one or more of these factors.
13. 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

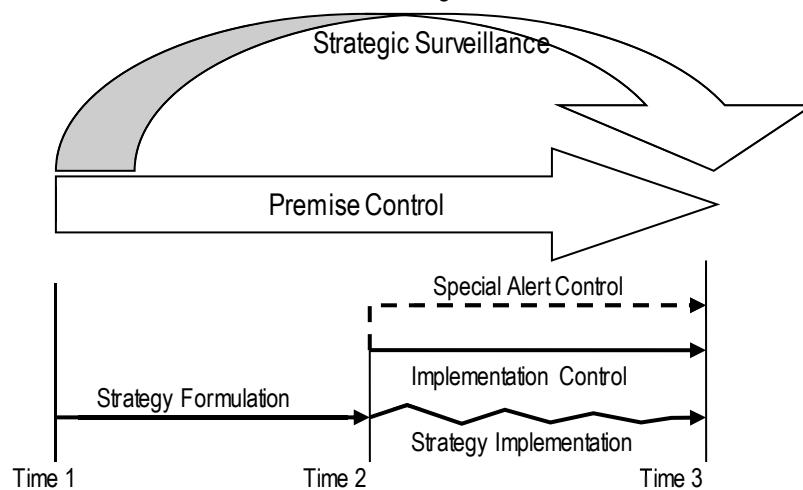
market opportunities with internal capabilities. R&D policies can enhance strategy implementation efforts to:

- ◆ 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.
14. Successful implementation of supply management system requires a change from managing individual functions to integrating activities into key supply chain processes. It involves collaborative work between buyers and suppliers, joint product development, common systems and shared information. A key requirement for successfully implementing supply chain will be network of information sharing and management. The partners need to link together to share information through electronic data interchange and take decisions in timely manner. Implementing and successfully running supply chain management system will involve:
1. **Product development:** Customers and suppliers must work together in the product development process. Right from the start the partners will have proper knowledge. Involving all partners will help in shortening the life cycles. Products are developed and launched in shorter time and help organizations to remain competitive.
 2. **Procurement:** Procurement requires careful resource planning, quality issues, identifying sources, negotiation, order placement, inbound transportation and storage. Organizations have to coordinate with suppliers in scheduling without interruptions. Suppliers are involved in planning the manufacturing process.
 3. **Manufacturing:** Flexible manufacturing processes must be in place to respond to market changes. They should be adaptive to accommodate customization and changes in the taste and preferences. Manufacturing should be done on the basis of just-in-time (JIT) and minimum lot sizes. Changes in the manufacturing process be made to reduce manufacturing cycle.
 4. **Physical distribution:** Delivery of final products to customers is the last position in a marketing channel. Availability of the products at the right place at right time is important for each channel participant. Through physical distribution processes serving the customer become an integral part of marketing. Thus supply chain management links a marketing channel with customers.
 5. **Outsourcing:** Outsourcing is not limited to the procurement of materials and components, but also include outsourcing of services that traditionally have been provided within an organization. The company will be able to focus on those activities where it has competency and everything else will be outsourced.

6. **Customer services:** Organizations through interfaces with the company's production and distribution operations develop customer relationships so as to satisfy them. They work with customer to determine mutually satisfying goals, establish and maintain relationships. This in turn help in producing positive feelings in the organization and the customers.
7. **Performance measurement:** There is a strong relationship between the supplier, customer and organisation. Supplier capabilities and customer relationships can be correlated with a firm performance. Performance is measured in different parameters such as costs, customer service, productivity and quality.
15. **Types of Strategic Control:** There are four types of strategic control as follows:
- ◆ **Premise control:** A strategy is formed on the basis of certain assumptions or premises about the complex and turbulent organizational environment. Over a period of time these premises may not remain valid. Premise control is a tool for systematic and continuous monitoring of the environment to verify the validity and accuracy of the premises on which the strategy has been built. It primarily involves monitoring two types of factors:
 - (i) Environmental factors such as economic (inflation, liquidity, interest rates), technology, social and regulatory.
 - (ii) Industry factors such as competitors, suppliers, substitutes.
 - ◆ **Strategic surveillance:** Contrary to the premise control, the strategic surveillance is unfocussed. It involves general monitoring of various sources of information to uncover unanticipated information having a bearing on the organizational strategy. It involves casual environmental browsing. Reading financial and other newspapers, business magazines, meetings, conferences, discussions at clubs or parties and so on can help in strategic surveillance.
Strategic surveillance may be loose form of strategic control, but is capable of uncovering information relevant to the strategy.
 - ◆ **Special alert control:** At times unexpected events may force organizations to reconsider their strategy. Sudden changes in government, natural calamities, terrorist attacks, unexpected merger/acquisition by competitors, industrial disasters and other such events may trigger an immediate and intense review of strategy. Organizations to cope up with these eventualities, form crisis management teams.
 - ◆ **Implementation control:** Managers implement strategy by converting major plans into concrete, sequential actions that form incremental steps. Implementation control is directed towards assessing the need for changes in the overall strategy in light of unfolding events and results associated with incremental steps and actions.
Strategic implementation control is not a replacement to operational control. Unlike operational controls, it continuously monitors the basic direction of the strategy. The

two basic forms of implementation control are:

- (i) *Monitoring strategic thrusts*: Monitoring strategic thrusts help managers to determine whether the overall strategy is progressing as desired or whether there is need for readjustments.
- (ii) *Milestone Reviews*. All key activities necessary to implement strategy are segregated in terms of time, events or major resource allocation. It normally involves a complete reassessment of the strategy. It also assesses the need to continue or refocus the direction of an organization.



Source: From book "Strategic management-formulation, Implementation and control" by John A Pearce II, Richard B Robinson, Jr. and Amita Mital.

These four strategic controls steer the organisation and its different sub-systems to the right track. They help the organisation to negotiate through the turbulent and complex environment.

16. A strategy manager has many different leadership roles to play: visionary, chief entrepreneur and strategist, chief administrator, culture builder, resource acquirer and allocator, capabilities builder, process integrator, crisis solver, spokesperson, negotiator, motivator, arbitrator, policy maker, policy enforcer, and head cheerleader. Sometimes it is useful to be authoritarian; sometimes it is best to be a perceptive listener and a compromising decision maker; sometimes a strongly participative, collegial approach works best; and sometimes being a coach and adviser is the proper role. Many occasions call for a highly visible role and extensive time commitments, while others entail a brief ceremonial performance with the details delegated to subordinates.

For the most part, major change efforts have to be top-down and vision-driven. Leading change has to start with diagnosing the situation and then deciding which of several ways to handle it. Managers have five leadership roles to play in pushing for good strategy execution:

1. Staying on top of what is happening, closely monitoring progress, ferreting out issues, and learning what obstacles lie in the path of good execution.
2. Promoting a culture and esprit de corps that mobilizes and energizes organizational members to execute strategy in a competent fashion and perform at a high level.
3. Keeping the organization responsive to changing conditions, alert for new opportunities, bubbling with innovative ideas, and ahead of rivals in developing competitively valuable competencies and capabilities.
4. Exercising ethics leadership and insisting that the company conduct its affairs like a model corporate citizen.
5. Pushing corrective actions to improve strategy execution and overall strategic performance.

Strategic leadership is the ability of influencing others to voluntarily make decisions that enhance prospects for the organisation's long-term success while maintaining short-term financial stability. Two basic approaches to leadership can be transformational leadership style and transactional leadership style. The difference between transformational and traditional leadership style can be given as follows:

1. Traditional leadership borrowed its concept from formal Top-down type of leadership such as in the military. The style is based on the belief that power is bestowed on the leader, in keeping with the traditions of the past. This type of leadership places managers at the top and workers at the bottom of rung of power.
In transformational leadership, leader motivates and empowers employees to achieve company's objectives by appealing to higher ideas and values. They use charisma and enthusiasm to inspire people to exert them for the good of the organization.
2. Traditional leadership emphasizes characteristics or behaviours of only one leader within a particular group whereas transformational leadership provides a space to have more than one leader in the same group at the same time. According to the transformational leadership style, a leader at one instance can also be a follower in another instance. Thus, there is element of flexibility in the relationships.
3. Traditional leadership is more focused in getting the work done in routine environment. Traditional leaders are effective in achieving the set objectives and goals whereas transformational leaders have behavioural capacity to recognize and react to paradoxes, contradictions and complexities in the environment. Transformational leadership style is more focus on the special skills or talents that the leaders must have to practice to face challenging situations. Transformational leaders work to change the organisational culture by implementing new ideas.
4. In traditional leadership, followers are loyal to the position and what it represents rather than who happens to be holding that position whereas in transformational leadership followers dedicate and admire the quality of the leader not of its position.

17. In simple words, benchmarking is an approach of setting goals and measuring productivity based on best industry practices. It developed out of need to have information against which performances can be measured. For example, a customer support engineer of a television manufacturer attends a call within forty-eight hours. If the industry norm is that all calls are attended within twenty-four hours, then the twenty-four hours can be a benchmark.

Benchmarking helps in improving performance by learning from best practices and the processes by which they are achieved. It involves regularly comparing different aspects of performance with the best practices, identifying gaps and finding out novel methods to not only reduce the gaps but to improve the situations so that the gaps are positive for the organization. Benchmarking can help in almost all aspect of business that are amenable to comparison and are significant to business. Typically organisations can use benchmarking process to achieve improvement in diverse range of management function like:

- ◆ Maintenance operations
- ◆ Assessment of total manufacturing costs
- ◆ Product development
- ◆ Product distribution
- ◆ Customer services
- ◆ Plant utilization levels
- ◆ Human resource management

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.

**Applicability of Standards/Guidance Notes/Legislative Amendments etc.
for May, 2019 – 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
- 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:

I. Applicability of the Companies Act, 2013 and other Legislative Amendments for May, 2019 Examination

The relevant notified Sections of the Companies Act, 2013 and legislative amendments including relevant Notifications / Circulars / Rules / Guidelines issued by Regulating Authority up to 31st October, 2018 will be applicable for May, 2019 Examination.

II. Applicability of Amendments made by the MCA in the Companies (Accounting Standards) Rules, 2006

Amendments made by MCA on 30.3.2016 in the Companies (Accounting Standards) Rules, 2006 are applicable for May, 2019 examination.

III. Non-Applicability of Ind AS for May, 2019 Examination

The Ministry of Corporate Affairs has notified Companies (Indian Accounting Standards) Rules, 2015 on 16th February, 2015, for compliance by certain class of companies. These Ind AS have not been made applicable for May, 2019 Examination.

Paper 6: Auditing and Assurance
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I. Standards on Auditing (SAs)

S.No	SA	Title of Standard on Auditing
1	SA 200	Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing
2	SA 210	Agreeing the Terms of Audit Engagements
3	SA 220	Quality Control for Audit of Financial Statements
4	SA 230	Audit Documentation
5	SA 240	The Auditor's responsibilities Relating to Fraud in an Audit of Financial Statements
6	SA 250	Consideration of Laws and Regulations in An Audit of Financial Statements
7	SA 260	Communication with Those Charged with Governance (Revised)
8	SA 265	Communicating Deficiencies in Internal Control to Those Charged with Governance and Management
9	SA 299	Joint Audit of Financial Statements (Revised)
10	SA 300	Planning an Audit of Financial Statements
11	SA 315	Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment
12	SA 320	Materiality in Planning and Performing an Audit
13	SA 330	The Auditor's Responses to Assessed Risks
14	SA 402	Audit Considerations Relating to an Entity Using a Service Organization
15	SA 450	Evaluation of Misstatements Identified during the Audits
16	SA 500	Audit Evidence
17	SA 501	Audit Evidence - Specific Considerations for Selected Items
18	SA 505	External Confirmations
19	SA 510	Initial Audit Engagements-Opening Balances
20	SA 520	Analytical Procedures
21	SA 530	Audit Sampling
22	SA 540	Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures
23	SA 550	Related Parties
24	SA 560	Subsequent Events

25	SA 570	Going Concern (Revised)
26	SA 580	Written Representations
27	SA 600	Using the Work of Another Auditor
28	SA 610	Using the Work of Internal Auditors (Revised)
29	SA 620	Using the Work of an Auditor's Expert
30	SA 700	Forming an Opinion and Reporting on Financial Statements (Revised)
31	SA 701	Communication Key Audit Matters in the Independent Auditor's Report (New)
32	SA 705	Modifications to the Opinion in the Independent Auditor's Report (Revised)
33	SA 706	Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report (Revised)
34	SA 710	Comparative Information – Corresponding Figures and Comparative Financial Statements
35	SA 720	The Auditor's Responsibilities Relating to Other Information (Revised)

II. Statements

Statement on Reporting under Section 227(1A) of the Companies Act, 1956 (Section 143(1) of the Companies Act, 2013).

III. Guidance Notes

1. Guidance Note on Audit of Inventories.
2. Guidance Note on Audit of Debtors, Loans and Advances.
3. Guidance Note on Audit of Investments.
4. Guidance Note on Audit of Cash and Bank Balances.
5. Guidance Note on Audit of Liabilities.
6. Guidance Note on Audit of Revenue.
7. Guidance Note on Audit of Expenses.
8. Guidance Note on Reporting under section 143(3)(f) and (h) of the Companies Act, 2013

IV Applicability of the Companies Act, 2013 and other Legislative Amendments for May 2019 Examination:

- (i) Students are expected to be updated with the notifications, circulars and other legislative amendments made upto 6 months prior to the examination. For instance, for May, 2019 examination, significant notifications and circulars issued upto 31st October, 2018 would be relevant.

The relevant notified Sections of the Companies Act, 2013 and legislative amendments including relevant Notifications / Circulars / Rules / Guidelines issued by Regulating Authority up to 31st October, 2018 will be applicable for May, 2019 Examination. It may be noted that the legislative and other amendments applicable for May 2019 Examination would be given as Academic Update in the Revision Test Paper for May 2019 Examination.

- (ii) Companies (Auditor's Report) Order, 2016 issued by Ministry of Corporate Affairs on 29th March, 2016 is applicable for May, 2019 Examination.