MOCK TEST PAPER - 1

INTERMEDIATE (IPC): GROUP – II

PAPER – 5 : ADVANCED ACCOUNTING

*Question No. **1** is compulsory.*

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

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

Working Notes should form part of the answer.

(Time allowed: Three hours) **(Maximum Marks: 100)**

1. (a) Mohan Ltd. is in a dispute involving allegation of infringement of patents by a competitor company who is seeking damages of a huge sum of Rs. 900 lakhs. The directors are of the opinion that the claim can be successfully resisted by the company.

How would you deal with the same in the annual accounts of the Mohan Ltd. as per provisions of AS 29?

(b) Explain the concept of 'weighted average number of equity shares outstanding during the period'. State how would you compute, based on AS-20, the weighted average number of equity shares in the following case:

		No. of shares
1st April, 2016	Balance of equity shares	7,20,000
31st August, 2016	Equity shares issued for cash	2,40,000
1st February, 2017	Equity shares bought back	1,20,000
31st March, 2017	Balance of equity shares	8,40,000

(c) Omega Limited has borrowed a sum of US $ 10,00,000 at the beginning of Financial Year 2016-17 for its residential project at 4 %. The interest is payable at the end of the Financial Year. At the time of availment exchange rate was Rs. 56 per US $ and the rate as on 31st March, 2017 was
Rs. 62 per US $. If Omega Limited borrowed the loan in India in Indian Rupee equivalent, the pricing of loan would have been 10.50%.

You are required to compute Borrowing Cost and exchange difference for the year ending 31st March, 2017 as per applicable Accounting Standards.

(d) A Ltd. sold machinery having WDV of Rs. 40 lakhs to B Ltd. for Rs. 50 lakhs and the same machinery was leased back by B Ltd. to A Ltd. The lease back is operating lease. You are required to comment on the accounting treatment as per AS 19 in the following situations:

(i) Sale price of Rs. 50 lakhs is equal to fair value.

(ii) Fair value is Rs. 45 lakhs and sale price is Rs. 38 lakhs.

(iii) Fair value is Rs. 40 lakhs and sale price is Rs. 50 lakhs.

(iv) Fair value is Rs. 46 lakhs and sale price is Rs. 50 lakhs

(v) Fair value is Rs. 35 lakhs and sale price is Rs. 39 lakhs. ***(4 x 5 = 20 Marks)***

2. The following was the Balance Sheet of Omega Ltd. as on 31st March, 2018.

Equity & Liabilities	Rs. Lakhs	Assets	Rs. Lakhs
Share Capital:		Fixed Assets	14,000

Equity shares of Rs. 10 each Fully Paid Up	8,000	Investments	3,000
10% Redeemable Pref. Shares of Rs. 10 each Fully Paid Up	2,500	Cash at Bank	1,650
Reserves & Surplus		Other Current Assets	8,250
Capital Redemption Reserve	1,000		
Securities Premium	800		
General Reserve	6,000		
Profit & Loss Account	300		
Secured Loans:			
9% Debentures	5,000		
Current Liabilities:			
Trade Payables	2,300		
Sundry Provisions	1,000		
	26,900		26,900

On 1st April, 2018 the Company redeemed all its Preference Shares at a Premium of 10% and bought back 15% of its Equity Shares at Rs. 20 per Share. In order to make cash available, the Company sold all the Investments for Rs. 3,150 lakhs and raised a Bank Loan amounting to Rs. 400 lakh on the Security of the Company's Plant.

You are required to

(i) pass journal entries for the above and

(ii) prepare the Company's Balance sheet immediately thereafter. ***(16 Marks)***

3. L, M and N share profits and losses in the ratio of 5:3:2. Their firm was dissolved due to misconduct of M and their balance sheet on that date was as under:

Balance Sheet as at 31-3-2018

Liabilities		*Rs.*	*Assets*	*Rs.*
Capital Accounts :			Land and Building	2,00,000
L	3,00,000		Plants	2,00,000
M	2,00,000		Trade receivables	1,00,000
N	1,00,000	6,00,000	Inventories	1,50,000
Current Accounts:			Cash	1,00,000
L	50,000		Current Account:	
M	30,000	80,000	N	50,000
Trade payables		1,20,000		
		8,00,000		8,00,000

The whole business of the firm was sold to Preet Limited, on that day on the following terms:

(i) Preet Limited will issue the following securities in consideration for transfer of business:

10,000 equity shares @ Rs. 15 each, 15,000 preference shares @ Rs. 15 each; and 20,000 debentures @ Rs. 14.725.

(ii) The agreed value of assets and liabilities of partnership firm are as follows:

Land & Building – Rs. 3,00,000, Plants – Rs. 1,50,000, Inventory – Rs. 1,40,000, Trade Receivables – Rs. 97,500, and Trade Payables – Rs. 1,18,000.

It was mutually decided that preference shares and debentures will be distributed in profit sharing ratio and cash brought in by the partner (if any) will be shared equally by the remaining partners before distribution of equity shares. Equity shares are distributed on residual basis at the end.

You are required to prepare Realization Account, Cash Account, Partners' Current and Capital Accounts at the time of closing the books of the firm. ***(16 Marks)***

4. (a) XYZ is having its Branch at Kolkata. Goods are invoiced to the branch at 20% profit on sale. Branch has been instructed to send all cash daily to head office. All expenses are paid by head office except petty expenses which are met by the Branch Manager.

From the following particulars, you are required to prepare branch account in the books of Head Office.

	(Rs.)		(Rs.)
Stock on 1st April 2017	30,000	Discount allowed to	
(invoice price)		debtors	160
Sundry Debtors on 1st April, 2017	18,000	Expenses paid by head office:	
Cash in hand as on 1st April, 2017	800	Rent	1,800
Office furniture on 1st April, 2017	3,000	Salary	3,200
Goods invoiced from the head office (invoice price)	1,60,000	Stationery & Printing	800
Goods returned to Head Office	2,000	Petty expenses paid by the branch	600
Goods returned by debtors	960	Depreciation to be provided on	
Cash received from debtors	60,000	branch furniture at 10% p.a.	
Cash Sales	1,00,000	Stock on 31st March, 2018	
Credit sales	60,000	(at invoice price)	28,000

(b) Ganesh Ltd. has head office at Delhi (India) and branch at New York. New York branch is an integral foreign operation of Ganesh Ltd. New York branch furnishes you with its trial balance as on 31st March, 2018 and the additional information given thereafter:

	Dr. ($)	*Cr. ($)*
Stock on 1st April, 2017	300	–
Purchases and sales	800	1,500
Sundry Debtors and creditors	400	300
Bills of exchange	120	240
Sundry expenses	1,080	–
Bank balance	420	–
Delhi office A/c	–	1,080
	3,120	3,120

The rates of exchange may be taken as follows:

- on 1.4.2017 @ *Rs.* 40 per US $
- on 31.3.2018 @ *Rs.* 42 per US $
- average exchange rate for the year @ Rs. 41 per US $.

New York branch account showed a debit balance of Rs. 44,380 on 31.3.2018 in Delhi books and there were no items pending reconciliation.

You are asked to prepare trial balance of New York in Rs. in the books of Ganesh Ltd.

(c) A company has its share capital divided into shares of Rs. 10 each. On 1-1-20X1, it granted 5,000 employees stock options at Rs. 50, when the market price was Rs. 140. The options were to be exercised between 1-3-20X2 to 31-03-20X2. The employees exercised their options for 4,800 shares only; remaining options lapsed.

You are required to pass the necessary journal entries for the year ended 31-3-20X2, with regard to employees' stock options. ***(8 + 4 + 4 = 16 Marks)***

5. (a) The following facts have been taken out from the records of City Bank Ltd. as on 31st March, 2017:

	Rs.	Rs.
Rebate on bill discounted (not due on March 31st, 2016)		66,400
Discount received		3,00,000
Bill discounted	24,50,000	

An analysis of the bills discounted is as follows:

	Amount	Due date	Rate of discount
	Rs.	2017	
(i)	7,50,000	April 8	12%
(ii)	3,00,000	May 5	14%
(iii)	4,40,000	June 12	14%
(iv)	9,60,000	July 15	15%

You are required to:-

(i) Calculate Rebate on Bill Discounted (not due) on 31st March, 2017.

(ii) The amount of discount to be credited to the profit and loss account.

(b) Modern Insurance Company's Fire Insurance division provide the following information, show the amount of claim as it would appear in the Revenue Account for the year ended 31st March, 2017.

	Direct Business	Re-insurance
	Rs.	Rs.
Claim paid during the year	7,06,000	1,64,000
Claim received		64,000
Claim payable		
1st April, 2016	1,64,600	11,600
31st March, 2017	1,75,000	17,400
Claim receivable:		
1st April, 2016	-	17,000
31st March, 2017	-	28,400
Expenses of management	69,000	
(Includes Rs. 7,600 Surveyor's fee		
and Rs. 8,400 Legal expenses for settlement of claims)		

(c) F Ltd. finalized their financial statements for the year ending 31st March, 2017 and got approved by their approving authority on 30th June, 2017. A major fire broke out in the night of 31st May, 2017 destroying factory premises. Loss of property estimated to be Rs. 25 lakhs. You are required to state how to deal with this information in the annual accounts. ***(6 + 6 + 4 = 16 Marks)***

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

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

Notes to Accounts:

		Rs. in Lakhs
(1)	Share Capital	
	Authorised :	
	200 lakh shares of Rs. 10 each	2,000
	8 lakh, 8% Preference Shares of Rs. 100 each	800
		2,800
	Issued, Subscribed and paid up:	
	100 lakh Equity Shares of Rs. 10 each, full paid up	1,000
	4 lakh 8% Preference Shares of Rs. 100 each, fully paid up	400
	Total	1400
(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	300
		700
(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	200
		750
(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 Rs. 80 each and Equity Shares to Rs. 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 Rs. 2 each to be allotted.

(3) Debenture holders agreed to take one Freehold Property at its book value of Rs. 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 Rs. 400 lakh.

(6) All investments sold out for Rs. 250 lakh.

(7) 70% of Directors' loan to be waived and for the balance, Equity Shares of Rs. 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 Rs. 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 Capital Reduction Account; and

(c) Prepare notes on Share Capital and Tangible Assets to Balance Sheet, immediately after the implementation of scheme of internal reconstruction. ***(16 Marks)***

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

(a) ABC Ltd. has entered into a binding agreement with XYZ Ltd. to buy a custom-made machine amounting to Rs. 4,00,000. As on 31st March, 2016 before delivery of the machine, ABC Ltd. had to change its method of production. The new method will not require the machine ordered and so it shall be scrapped after delivery. The expected scrap value is 'NIL'.

Show the treatment of machine in the books of ABC Ltd.

(b) A liquidator is entitled to receive remuneration at 2% on the assets realized, 3% on the amount distributed to Preferential Creditors and 3% on the payment made to Unsecured Creditors. The assets were realized for Rs. 45,00,000 against which payment was made as follows:

Liquidation expenses	Rs. 50,000
Secured Creditors	Rs. 15,00,000
Preferential Creditors	Rs. 1,25,000

The amount due to Unsecured Creditors was Rs. 30,00,000. You are asked to calculate the total remuneration payable to liquidator. Calculation shall be made to the nearest multiple of a rupee.

(c) Explain the nature of Limited Liability Partnership. Who can be a designated partner in a Limited Liability Partnership?

(d) A company had issued 30,000, 14% convertible debentures of Rs. 100 each on 1st April, 2016. The debentures are due for redemption on 1st July, 2018. The terms of issue of debentures provided that they were redeemable at a premium of 5% and also conferred option to the debenture holders to convert 20% of their holding into equity shares (Nominal value Rs. 10) at a price of Rs. 15 per share. Debenture holders holding 2,500 debentures did not exercise the option. Calculate the number of equity shares to be allotted to the debenture holders exercising the option to the maximum.

(e) K Ltd. launched a project for producing product X in October, 2016. The Company incurred Rs. 40 lakhs towards Research and Development expenses upto 31st March, 2018. Due to prevailing market conditions, the Management came to conclusion that the product cannot be manufactured and sold in the market for the next 10 years. The Management hence wants to defer the expenditure write off to future years. Advise the Company as per the applicable Accounting Standard. ***(4 x 4 = 16 Marks)***

MOCK TEST PAPER - 1

INTERMEDIATE (IPC) : GROUP – II

PAPER – 5 : ADVANCED ACCOUNTING

ANSWERS

1. (a) As per para 14 of AS 29 'Provisions, Contingent Liabilities and Contingent Assets', a provision should be recognised when:

(i) An enterprise has a present obligation as a result of past event;

(ii) It is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and

(iii) A reliable estimate can be made of the amount of the obligation.

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

A contingent liability is disclosed, unless the possibility of an outflow of resources embodying economic benefits is remote. The possibility of an outflow of resources embodying economic benefits seems to be remote in the given situation, since the directors of Mohan Ltd. are of the opinion that the claim can be successfully resisted by the company. Therefore, the company shall not disclose the same as contingent liability. However, following note in this regard may be given in annual accounts of the company:

"Litigation is in process against the company relating to a dispute with a competitor who alleges that the company has infringed patents and is seeking damages of Rs. 900 lakhs. However, the directors are of the opinion that the claim can be successfully resisted by the company".

(b) As per para 16 of AS 20, "Earnings Per Share", the weighted average number of equity shares outstanding during the period reflects the fact that the amount of shareholders' capital may have varied during the period as a result of a larger or less number of shares outstanding at any time. For the purpose of calculating basic earnings per share, the number of equity shares should be the weighted average number of equity shares outstanding during the period.

Weighted average number of equity shares

7,20,000 X 5/12	= 3,00,000 shares
9,60,000 X 5/12	= 4,00,000 shares
8,40,000 X 2/12	= 1,40,000 shares
	= 8,40,000 shares

(c) (i) Interest for the period 2016-17

= US $ 10 lakhs x 4% × Rs. 62 per US$ = Rs. 24.80 lakhs

(ii) Increase in the liability towards the principal amount

= US $ 10 lakhs × Rs. (62 - 56) = Rs. 60 lakhs

(iii) Interest that would have resulted if the loan was taken in Indian currency

= US $ 10 lakhs × Rs. 56 x 10.5% = Rs. 58.80 lakhs

(iv) Difference between interest on local currency borrowing and foreign currency borrowing = Rs. 58.80 lakhs - Rs. 24.80 lakhs = Rs. 34 lakhs.

Therefore, out of Rs. 60 lakhs increase in the liability towards principal amount, only Rs. 34 lakhs will be considered as the borrowing cost. Thus, total borrowing cost would be Rs. 58.80 lakhs being the aggregate of interest of Rs. 24.80 lakhs on foreign currency borrowings plus the exchange difference to the extent of difference between interest on local currency borrowing and interest on foreign currency borrowing of Rs. 34 lakhs.

Hence, Rs. 58.80 lakhs would be considered as the borrowing cost to be accounted for as per AS 16 and the remaining Rs. 26 lakhs (60 - 34) would be considered as the exchange difference to be accounted for as per AS 11

(d) Following will be the treatment in the given cases:

(i) When sales price of Rs. 50 lakhs is equal to fair value, A Ltd. should immediately recognise the profit of Rs. 10 lakhs (i.e. 50 – 40) in its books.

(ii) When fair value of leased machinery is Rs. 45 lakhs & sales price is Rs. 38 lakhs, then loss of
Rs. 2 lakhs (40 – 38) to be immediately recognised by A Ltd. in its books provided loss is not compensated by future lease payment.

(iii) When fair value is Rs. 40 lakhs & sales price is Rs. 50 lakhs then, profit of Rs. 10 lakhs is to be deferred and amortised over the lease period.

(iv) When fair value is Rs. 46 lakhs & sales price is Rs. 50 lakhs, profit of Rs. 6 lakhs (46-40) to be immediately recognised in its books and balance profit of Rs. 4 lakhs (50-46) is to be amortised/deferred over lease period.

(v) When fair value is Rs. 35 lakhs & sales price is Rs. 39 lakhs, then the loss of Rs. 5 lakhs (40-35) to be immediately recognised by A Ltd. in its books and profit of Rs. 4 lakhs (39-35) should be amortised/deferred over lease period.

2. (i) Journal Entries in the books of Omega Ltd. (Rs. in lakhs)

	Particulars			
1	Bank A/c	Dr.	3,150	
	To Investments A/c			3,000
	To Profit and Loss A/c			150
	(Being investment sold on profit for the purpose of buy-back)			
2	10% Redeemable Preference Share Capital A/c	Dr.	2,500	
	Premium on Redemption of Preference Shares A/c	Dr.	250	
	To Preference Shareholders A/c			2,750
	(Being redemption of preference share capital at premium of 10%)			
3	Securities Premium A/c	Dr.	250	
	To Premium on Redemption of Preference Shares A/c			250
	(Being premium on redemption of preference shares adjusted through securities premium)			
4	Equity Share Capital A/c	Dr.	1,200	
	Premium on buyback	Dr.	1,200	
	To Equity buy-back A/c			2,400
	(Being Equity Share bought back, Share Capital cancelled, and Premium on Buyback accounted for)			
5	Securities Premium A/c (800-250)	Dr.	550	
	General Reserve A/c	Dr.	650	
	To Premium on Buyback A/c			1,200
	(Being premium on buyback provided first out of securities premium and the balance out of general reserves.)			

6	Bank A/c To Bank Loan A/c (Being loan taken from bank to finance buyback and redemption of shares)	Dr.	400	 400
7	Preference Shareholders A/c Equity buy-back A/c To Bank A/c (Being payment made to preference shareholders and equity shareholders)	Dr. Dr.	2,750 2,400	 5,150
8	General Reserve Account To Capital Redemption Reserve Account (Being amount transferred to capital redemption reserve account towards face value of preference shares redeemed and equity shares bought back)	Dr.	3,700	 3,700

(ii) Balance Sheet of Omega Ltd. (after Redemption and Buyback) (Rs. Lakhs)

	Particulars	*Note No*	*Amount*
	EQUITY AND LIABILITIES		*Rs.*
(I)	**Shareholders' Funds:**		
	(a) Share Capital	**1**	6,800
	(b) Reserves and Surplus	**2**	6,800
(2)	**Non-Current Liabilities:**		
	(a) Long Term Borrowings	**3**	5,400
(3)	**Current Liabilities:**		
	(a) Trade payables		2,300
	(b) Short Term Provisions		1,000
	Total		**22,300**
(II)	**ASSETS**		
(1)	Non-Current Assets		
	Property, Plant & Equipment		14,000
	Current Assets:		
	(a) Cash and Cash equivalents (W N)		50
	(b) Other Current Assets		8,250
			22,300

Notes to Accounts

				Rs. in Lakhs
1.	**Share Capital**			
	680 lakh Equity Shares of Rs. 10 each Fully Paid up (120 lakh Equity Shares bought back)			6,800
2.	**Reserves and Surplus**			
	General Reserve	6,000		
	Less: Adjustment for premium paid on buy back	(650)		
	Less: Transfer to CRR	(3,700)	1,650	

	Capital Redemption Reserve	1,000		
	Add: Transfer due to buy-back of shares from Gen. res.	3,700	4,700	
	Securities premium	800		
	Less: Adjustment for premium paid on redemption of preference shares	(250)		
	Less: Adjustment for premium paid on buy back	(550)	-	
	Profit & Loss A/c	300		
	Add: Profit on sale of investment	150	450	6,800
3.	**Long-term borrowings**			
	Secured			
	9 % Debentures		5,000	
	Term Loans – From Banks		400	5,400

Working Note

Bank Account

Receipts	*Amount*	*Payments*	*Amount*
	(Rs. Lakhs)		*(Rs. Lakhs)*
To balance b/d	1,650	By Preference Sharesholders A/c	2,750
To Investment A/c (sale Proceeds)	3,150	By Equity Shareholders A/c	2,400
To Bank Loan A/c (Loan received)	400	By Balance c/d (Balancing figure)	50
	5,200		5,200

Income tax on the above will not be included in Revenue A/c of an insurance company.

3. **Realization Account**

	Rs.	*Rs.*		*Rs.*
To Land & Building		2,00,000	By Trade Payables	1,20,000
To Plant		2,00,000	By Preet Limited (W.N.1)	6,69,500
To Inventories		1,50,000		
To Trade Receivable		1,00,000		
To Cash		1,00,000		
To Profit transferred to Capital A/c:				
L	19,750			
M	11,850			
N	7,900	39,500		
		7,89,500		7,89,500

Cash Account

	Rs.		*Rs.*
To N's Capital A/c	46,000	By L's Capital A/c	23,000
		By M's Capital A/c	23,000
	46,000		46,000

Partners' Current Accounts

	L Rs.	M Rs.	N Rs.		L Rs.	M Rs.	N Rs.
To Balance b/d	-		50,000	By Balance b/d	50,000	30,000	-
To L's Capital A/c	69,750			By Realisation A/c	19,750	11,850	7,900
To M's Capital A/c		41,850		By N's Capital A/c			42,100
	69,750	41,850	50,000		69,750	41,850	50,000

Partners' Capital Accounts

	L Rs.	M Rs.	N Rs.		L Rs.	M Rs.	N Rs.
To N's Current A/c	-	-	42,100	By Balance b/d	3,00,000	2,00,000	1,00,000
To Preference Shares in Preet Ltd. A/c	1,12,500	67,500	45,000	By L's Current A/c	69,750		
To Debentures A/c	1,47,250	88,350	58,900	By M's Current A/c		41,850	
To Cash A/c	23,000	23,000	-	By Cash A/c (bal. fig.)			46,000
To Equity Shares A/c	87,000	63,000	-				
	3,69,750	2,41,850	1,46,000		3,69,750	2,41,850	1,46,000

Working Notes:

1. Calculation of Purchase consideration

Net Payment Method

	Rs.
Equity Shares = 10,000 @ Rs. 15	1,50,000
Preference Shares = 15,000 @ Rs. 15	2,25,000
Debentures = 20,000 @ Rs. 14.725	2,94,500
	6,69,500

2. As whole business of the firm was sold to Preet Limited, cash balance of the firm Rs. 1,00,000 is also transferred to realization account. Cash brought in by N equal to Dr. balance appearing in his account, after distribution of preference shares and debentures in profit sharing ratio would be shared by L and M equally. The balance amount payable to L and M would be settled by transfer of equity shares in Preet Company.

4. (a) In the books of Head Office – XYZ

Kolkata Branch Account (at invoice)

	Rs.			Rs.
To Balance b/d		By Stock reserve (opening)		6,000
Stock	30,000	By Remittances:		
Debtors	18,000	Cash Sales	1,00,000	
Cash in hand	800	Cash from Debtors	60,000	1,60,000
Furniture	3,000	By Goods sent to branch (loading)		32,000

To Goods sent to branch	1,60,000	By Goods returned by branch (Return to H.O.)	2,000
To Goods returned by branch (loading)	400	By Balance c/d	
To Bank (expenses paid by H.O.)		Stock	28,000
Rent 1,800		Debtors	16,880
Salary 3,200		Cash (800-600)	200
Stationary & printing 800	5,800	Furniture (3,000-300)	2,700
To Stock reserve (closing)	5,600		
To Profit transferred to General Profit & Loss A/c	24,180		
	2,47,780		2,47,780

Working Note:

Debtors Account

	Rs.		Rs.
To Balance b/d	18,000	By Cash account	60,000
To Sales account (credit)	60,000	By Sales return account	960
		By Discount allowed account	160
		By Balance c/d	16,880
	78,000		78,000

Note: It is assumed that goods returned by branch are at invoice price.

(b) **In the books of Ganesh Ltd.**

New York Branch Trial Balance in (Rs.)
as on 31st March, 2018

	Conversion rate per US $ (Rs.)	*Dr. Rs.*	*Cr. Rs.*
Stock on 1.4.15	40	12,000	
Purchases and sales	41	32,800	61,500
Sundry debtors and creditors	42	16,800	12,600
Bills of exchange	42	5,040	10,080
Sundry expenses	41	44,280	
Bank balance	42	17,640	
Delhi office A/c	–		44,380
		1,28,560	1,28,560

(c) **Journal Entries in the books of company**

Date	Particulars		Dr. Rs.	Cr. Rs.
1-3-X2 to 31-3-X2	Bank A/c	Dr.	2,40,000	
	Employees compensation expenses A/c	Dr.	4,32,000	
	To Equity Share Capital A/c			48,000

	To Securities Premium A/c (Being allotment to employees 4,800 shares of Rs. 10 each at a premium of Rs. 130 at an exercise price of Rs. 50 each)		6,24,000
31-3-X2	Profit and Loss account Dr. To Employees compensation expenses A/c (Being transfer of employees compensation expenses)	4,32,000	4,32,000

Working Note:

1. Employee Compensation Expenses = Discount between Market Price and option price = Rs. 140 – Rs. 50 = Rs. 90 per share = Rs. 90 x 4,800 = Rs. 4,32,000/- in total.
2. The Employees Compensation Expense is transferred to Securities Premium Account.
3. Securities Premium Account = Rs. 50 – Rs. 10 = Rs. 40 per share + Rs. 90 per share on account of discount of option price over market price = Rs. 130 per share = Rs. 130 x 4,800 = Rs. 6,24,000/- in total.

5. (a) (i) Calculation of Rebate on bills discounted (not due) on 31.3.2017

S. No.	*Amount (Rs.)*	*Due date 2017*	*Unexpired portion*	*Rate of discount*	*Rebate on bill discounted (Rs.)*
(i)	7,50,000	April 8	8 days	12%	1,972
(ii)	3,00,000	May 5	35 days	14%	4,028
(iii)	4,40,000	June 12	73 days	14%	12,320
(iv)	9,60,000	July 15	106 days	15%	4,1820
					60,140

(ii) Amount of discount to be credited to the Profit and Loss Account

	Rs.
Transfer from Rebate on bills discount as on 31st March, 2016	66,400
Add: Discount received during the year ended 31st March, 2017	3,00,000
	3,66,400
Less: Rebate on bills discounted as on 31st March, 2017	60,140
Discount credited to the Profit and Loss Account	3,06,260

(b) Modern Insurance Company (Abstract showing the Amount of claims)

Net Claims incurred

		Rs.
Claims paid on direct business (7,06,000 + 7,600 + 8,400)		7,22,000
Add: Re-insurance	1,64,000	
Add: Outstanding as on 31.3.2017	17,400	
Less: Outstanding as on 1.4.2016	(11,600)	1,69,800
		8,91,800
Less: Claims received from re-insurance	64,000	
Add: Outstanding as on 31.3.2017	28,400	
Less: Outstanding as on 1.4.2016	(17,000)	(75,400)
		8,16,400

Add: Outstanding direct claims at the end of the year	1,75,000
	9,91,400
Less: Outstanding claims at the beginning of the year	(1,64,600)
Net claims incurred	8,26,800

(c) The event is a non-adjusting event with reference to the provisions of AS 4 "Contingencies and Events Occurring After the Balance Sheet Date" since it occurred after the year-end and does not relate to the conditions existing at the year-end. However, the event would appear to be of such significance as to require a disclosure in the report of the approving authority to enable users of the financial statements to make proper evaluation and decision, hence, such disclosure is recommended.

6. Journal Entries in the books of Lion Ltd.

	Particulars		*Debit (Rs. in lakhs)*	*Credit (Rs. in lakhs)*
(i)	8% Preference share capital A/c (Rs. 100 each)	Dr.	400	
	To 8% Preference share capital A/c (Rs. 80 each)			320
	To Capital Reduction A/c			80
	(Being the preference shares of Rs. 100 each reduced to Rs. 80 each as per the approved scheme)			
(ii)	Equity share capital A/c (Rs. 10 each)	Dr.	1,000	
	To Equity share capital A/c (Rs. 2 each)			200
	To Capital Reduction A/c			800
	(Being the equity shares of Rs. 10 each reduced to Rs. 2 each)			
(iii)	Capital Reduction A/c	Dr.	32	
	To Equity share capital A/c (Rs. 2 each)			32
	(Being 1/3rd arrears of preference share dividend of 3 years to be satisfied by issue of 8 lakhs equity shares of Rs. 2 each)			
(iv)	6% Debentures A/c	Dr.	300	
	To Freehold property A/c			300
	(Being claim of Debenture holders settled in part by transfer of freehold property)			
(v)	Accrued debenture interest A/c	Dr.	24	
	To Bank A/c			24
	(Being accrued debenture interest paid)			
(vi)	Freehold property A/c	Dr.	150	
	To Capital Reduction A/c			150
	(Being appreciation in the value of freehold property)			
(vii)	Bank A/c	Dr.	250	
	To Investments A/c			200
	To Capital Reduction A/c			50
	(Being investment sold at profit)			

(viii)	Director's loan A/c	Dr.	300	
	To Equity share capital A/c (Rs. 2 each)			90
	To Capital Reduction A/c			210
	(Being director's loan waived by 70% and balance being discharged by issue of 45 lakhs equity shares of Rs. 2 each)			
(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%)			30
	(Being certain value of various assets, penalty on cancellation of contract, profit and loss account debit balance written off through Capital Reduction Account)			
(x)	Capital Reduction A/c		286	
	To Capital reserve A/c			286
	(Being balance transferred to capital reserve account as per the scheme)			

Capital Reduction Account

		(Rs. in lakhs)			*(Rs. 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	286			
		1,290			1,290

Notes to Balance Sheet

		(Rs. in lakhs)	*(Rs. in lakhs)*
1.	Share Capital		
	Authorized:		
	200 lakhs Equity shares of Rs. 2 each		400
	8 lakhs 8% Preference shares of Rs. 80 each		640
			1,040
	Issued:		
	161 lakhs equity shares of Rs. 2 each		322
	4 lakhs Preference Shares of Rs. 80 each		320
			642
2.	Tangible Assets		
	Freehold Property	550	
	Less: Utilized to pay Debenture holders	(300)	
		250	

	Add: Appreciation	150	400
	Plant and Machinery		200
			600

7. (a) A liability is recognized when outflow of economic resources in settlement of a present obligation can be anticipated and the value of outflow can be reliably measured. In the given case, ABC Ltd. should recognize a liability of Rs.4, 00,000 payable to XYZ Ltd.

When flow of economic benefit to the enterprise beyond the current accounting period is considered improbable, the expenditure incurred is recognized as an expense rather than as an asset. In the present case, flow of future economic benefit from the machine to the enterprise is improbable. The entire amount of purchase price of the machine should be recognized as an expense.

Hence ABC Ltd. should charge the amount of Rs. 4,00,000 (being loss due to change in production method) to Profit and loss statement and record the corresponding liability (amount payable to XYZ Ltd.) for the same amount in the books for the year ended 31st March, 2016.

(b) Calculation of Total Remuneration payable to Liquidator

		Amount in Rs.
2% on Assets realised	(45,00,000 x 2%)	90,000
3% on payment made to Preferential creditors	1,25,000 x 3%	3,750
3% on payment made to Unsecured creditors (Refer W.N)		79,551
Total Remuneration payable to Liquidator		1,73,301

Working Note:

Liquidator's remuneration on payment to unsecured creditors =

Cash available for unsecured creditors after all payments including liquidation expenses, payment to secured creditors, preferential creditors & liquidator's remuneration

= Rs. 45,00,000 – Rs. 50,000 – Rs. 15,00,000 – Rs. 1,25,000 – Rs. 90,000 – Rs. 3,750

= Rs. 27,31,250

Liquidator's remuneration on payment to unsecured creditors = 3/103 x Rs. 27,31,250 = Rs. 79,551.

(c) Nature of Limited Liability Partnership: A limited liability partnership is a body corporate formed and incorporated under the LLP Act, 2008 and is a legal entity separate from that of its partners. A limited liability partnership shall have perpetual succession and any change in the partners of a limited liability partnership shall not affect the existence, rights or liabilities of the limited liability partnership.

Designated partners: Every limited liability partnership shall have at least two designated partners who are individuals and at least one of them shall be a resident in India.

In case of a limited liability partnership in which all the partners are bodies corporate or in which one or more partners are individuals and bodies corporate, at least two individuals who are partners of such limited liability partnership or nominees of such bodies corporate shall act as designated partners

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

	Number of debentures
Total number of debentures	30,000
Less: Debenture holders who have not opted for conversion	(2,500)
Debenture holders who opted for conversion	27,500
Option for conversion	20%
Number of debentures to be converted (20% of 27,500)	5,500
Redemption value of 5,500 debentures at a premium of 5% [5,500 x (100+5)]	Rs. 5,77,500
Equity shares of Rs. 10 each issued on conversion [Rs. 5,77,500/ Rs. 15]	38,500 shares

(e) As per provisions of AS 26 "Intangible Assets", expenditure on research should be recognized as an expense when it is incurred. An intangible asset arising from development (or from the development phase of an internal project) should be recognized if, and only if, an enterprise can demonstrate all of the conditions specified in para 44 of the standard. An intangible asset (arising from development) should be derecognized when no future economic benefits are expected from its use according to para 87 of the standard. Thus, the manager cannot defer the expenditure write off to future years in the given case. Hence, the expenses amounting Rs. 40 lakhs incurred on the research and development project has to be written off in the current year ending 31st March, 2018.

Test Series: March, 2019

MOCK TEST PAPER - 1

INTERMEDIATE (IPC) GROUP – II

PAPER – 6: AUDITING AND ASSURANCE

*Question No. **1** is compulsory.*

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

Time Allowed – 3 Hours **Maximum Marks – 100**

Division A- Multiple Choice Questions

Questions (1-20) carry 1 Mark each **Total 30 Marks**

Questions 21-25 carry 2 Marks each

1. The matter of difficulty, time, or cost involved is :
   (a) not in itself a valid basis for the auditor to omit an audit procedure for which there is no alternative.
   (b) in itself a valid basis for the auditor to omit an audit procedure for which there is no alternative.
   (c) not in itself a valid basis for the auditor to omit an audit procedure for which alternative exists.
   (d) not in itself a valid basis for the auditor to omit an audit procedure.
2. which of the following is incorrect :
   (a) The provisions relating to eligibility, qualifications and disqualifications of an auditor are governed by section 141 of the Companies Act, 2013
   (b) A person shall be eligible for appointment as an auditor of a company only if he is a chartered accountant.
   (c) A firm whereof majority of partners practising in India are qualified for may be appointed by its firm name to be auditor of a company.
   (d) Where a firm including a limited liability partnership is appointed as an auditor of a company, all the partners who are chartered accountants shall be authorised to act and sign on behalf of the firm.
3. SA 320 on "Materiality in Planning and Performing an Audit" requires that an auditor
   (a) should not consider materiality and its relationship with audit risk while conducting an audit.
   (b) should consider materiality and its relationship with audit risk while conducting an audit.
   (c) should not consider materiality but should consider its relationship with audit risk while conducting an audit.
   (d) should consider materiality but need not consider its relationship with audit risk while conducting an audit.
4. When planning the audit,
   (a) the auditor considers what would make the financial information materially misstated.
   (b) the auditor need not consider what would make the financial information materially misstated.
   (c) the auditor need not consider what would make the financial information materially misstated at planning stage
   (d) the auditor needs to consider what would make the financial information materially misstated while conducting audit only

5. Audit documentation provides:

   (a) evidence of the auditor’s basis for a conclusion about the achievement of the overall objectives of the auditor; or evidence that the audit was planned and performed in accordance with SAs and applicable legal and regulatory requirements.

   (b) evidence of the auditor’s basis for a conclusion about the achievement of the overall objectives of the auditor; and evidence that the audit was planned and performed in accordance with SAs and applicable legal and regulatory requirements.

   (c) evidence of the auditor’s basis for a conclusion about the achievement of the overall objectives of the auditor

   (d) evidence that the audit was planned and performed in accordance with SAs and applicable legal and regulatory requirements.

6. Which of the following is not an example of audit documentation:

   (a) Audit programmes

   (b) Summaries of significant matters

   (c) Audit file

   (d) Checklists.

7. SA 315 establishes requirements and provides guidance on identifying and assessing the risks of material misstatement -

   (a) at the financial statement levels only.

   (b) at the assertion levels only.

   (c) at the financial statement and assertion levels.

   (d) at the financial statement or assertion levels.

8. The risks of material misstatement at the assertion level consist of two components:

   (a) Inherent risk and detection risk

   (b) control risk and detection risk

   (c) audit risk and detection risk

   (d) Inherent risk and control risk

9. Which of the following is an example of inflating cash payments?

   (a) Making payments against purchase vouchers.

   (b) Teeming and lading.

   (c) Not accounting for cash sales fully.

   (d) Making payments against inflated vouchers.

10. The type of errors, existence of which becomes apparent in the process of compilation of accounts is known as-

    (a) Self-revealing errors.

    (b) Intentional errors.

    (c) Concealed errors.

    (d) Unconcealed errors.

11. The Guidance Note on Audit of Internal Financial Controls over Financial Reporting has been issued by?
    (a) ICAI
    (b) SEBI
    (c) MCA
    (d) RBI
12. The standard that requires auditors to analyse journal entries in an audit is?
    (a) SA 260
    (b) SA 230
    (c) SA 315
    (d) SA 240
13. In the case of tests of details
    (a) the projected misstatement plus anomalous misstatement, if any, is the auditor's best estimate of misstatement in the population.
    (b) the projected misstatement is the auditor's best estimate of misstatement in the population.
    (c) the anomalous misstatement is the auditor's best estimate of misstatement in the population.
    (d) the projected misstatement plus anomalous misstatement, if any, cannot be the auditor's best estimate of misstatement in the population.
14. Which of the following is correct :
    (a) When the projected misstatement exceeds tolerable misstatement, the sample does not provide a reasonable basis for conclusions about the population that has been tested.
    (b) When the projected misstatement plus anomalous misstatement, if any, exceeds tolerable misstatement, the sample does not provide a reasonable basis for conclusions about the population that has been tested.
    (c) When the anomalous misstatement exceeds tolerable misstatement, the sample does not provide a reasonable basis for conclusions about the population that has been tested.
    (d) When the projected misstatement plus anomalous misstatement, if any, exceeds tolerable misstatement, the sample provides a reasonable basis for conclusions about the population that has been tested.
15. Which of the following is correct :
    (a) As per the Standard on Auditing (SA) 520 "Analytical Procedure" 'the term "analytical procedures" means evaluations of financial information through analysis of financial data.
    (b) As per the Standard on Auditing (SA) 520 "Analytical Procedure" 'the term "analytical procedures" means evaluations of financial information through analysis of non-financial data.
    (c) As per the Standard on Auditing (SA) 520 "Analytical Procedure" 'the term "analytical procedures" means evaluations of financial information through analysis of plausible relationships among both financial and non-financial data.
    (d) As per the Standard on Auditing (SA) 520 "Analytical Procedure" 'the term "analytical procedures" means evaluations of financial information through ratio analysis.

16. **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 ___________from the date of registration of the company.

    (a) within 60 days

    (b) within 30 days

    (c) within 90 days

    (d) within 45 days

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

    (a) be filled by the Audit committee within 60 days.

    (b) be filled by the Audit committee within 30 days.

    (c) be filled by the Board of Directors within 60 days.

    (d) be filled by the Board of Directors within 30 days.

18. As per section 140(2) the auditor who has resigned from the company shall-

    (a) file within a period of 60 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

    (b) 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

    (c) 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.

    (d) file within a period of 60 days from the date of resignation, a statement in the prescribed Form ADT–3 (as per Rule 8 of CAAR) with the company.

19. Which of the following is correct :

    (a) 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.

    (b) As per section 142 of the Act, the remuneration of the auditor of a company shall be fixed in its general meeting.

    (c) As per section 142 of the Act, the remuneration of the auditor of a company shall be fixed in its extra ordinary general meeting.

    (d) As per section 142 of the Act, the remuneration of the auditor of a company shall be fixed in its Board meeting or in such manner as may be determined therein.

20. In case of a fraud involving less than ` 1 crore, the auditor shall

    (a) 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.

    (b) report the matter to the audit committee constituted under section 177 within such time and in such manner as prescribed.

    (c) report the matter to the Board within such time and in such manner as prescribed.

    (d) report the matter to the audit committee constituted under section 177 and also to the Board within such time and in such manner as prescribed. ***(20 x 1 = 20 Marks)***

Questions (21-25) carry 2 Marks each

21. If the auditor concludes that there is reasonable justification to change the engagement and if the audit work performed complied with the SAs applicable to the changed engagement, the report issued would be appropriate for the revised terms of engagement. In order to avoid confusion, the report would not include reference to:
    (a) the original engagement; or any procedures that may have been performed in the original engagement.
    (b) the original engagement;
    (c) any procedures that may have been performed in the original engagement
    (d) the original engagement and any procedures that may have been performed in the original engagement.
22. Which of the following is correct :
    (a) The auditor shall express a qualified 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.
    (b) The auditor shall express a disclaimer 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.
    (c) 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.
    (d) 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 material, but not pervasive, to the financial statements
23. Which of the following is incorrect :
    (a) 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-**
    (b) 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.
    (c) The application shall be made to the Central Government within 30 days of the resolution passed by the Board.
    (d) The company shall hold the general meeting within 30 days of receipt of approval of the Central Government for passing the special resolution.
24. which of the following is incorrect :
    (a) Inquiry consists of seeking information of unknown persons, both financial and non- financial, within the entity or outside the entity.
    (b) Inquiry is used extensively throughout the audit in addition to other audit procedures.
    (c) Inquiries may range from formal written inquiries to informal oral inquiries. Evaluating responses to inquiries is an integral part of the inquiry process.
    (d) Responses to inquiries may provide the auditor with information not previously possessed or with corroborative audit evidence.

25. Which of the following is incorrect :

(a) Written representations are necessary information that the auditor requires in connection with the audit of the entity's financial statements.

(b) Similar to responses to inquiries, written representations are audit evidence.

(c) Written representations are requested from those responsible for the preparation and presentation of the financial statements.

(d) Written representations provide necessary audit evidence and also they provide sufficient appropriate audit evidence on their own about any of the matters with which they deal.

(5 x 2 = 10 Marks)

Division B- Descriptive Questions

Question No. ***1*** *is compulsory.*

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

Total 70 Marks

1. **Examine with reasons (in short) whether the following statements are correct or incorrect: (Attempt any 7 out of 8)**

(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 we are designing audit procedures to address an inherent risk or "what can go wrong", we consider the nature of the risk of material misstatement in order to determine if a substantive analytical procedure can be used to obtain audit evidence.

(iii) According to SA 530 "Audit sampling", 'audit sampling' refers to the application of audit procedures to 100% of items within a population of audit relevance.

(iv) Inherent risk is the susceptibility of an account balance or class of transactions to misstatement assuming that there were no related internal controls.

(v) Other matter paragraph is 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.

(vi) The auditor shall express an adverse 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

(vii) The assessment of risks is a matter capable of precise measurement.

(viii) It is necessary for the auditor to maintain professional skepticism throughout the audit.

(7 x 2 = 14 Marks)

2. (a) "Statements" and "Guidance Notes" of ICAI- whether mandatory or recommendatory? Discuss

(4 Marks)

(b) Inquiry from Management is helpful for Auditor to evaluate subsequent events. Discuss specific enquiries in reference of SA 560, which might have effect on the financial statements. ***(4 Marks)***

(c) The discipline of behavioural science is closely linked with the subject of auditing. Discuss. ***(3 Marks)***

(d) What do you mean by "Written Representations"? As an auditor, how you will deal if management does not provide requested written representations? ***(3 Marks)***

3. (a) In order to achieve the objectives of the accountancy profession, professional accountants have to observe a number of prerequisites or fundamental principles Explain. ***(4 Marks)***

(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. ***(3 Marks)***

(c) 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. ***(4 Marks)***

(d) 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. ***(3 Marks)***

4. (a) Mention any four areas where surprise checks can significantly improve the effectiveness of an audit. ***(3 Marks)***

(b) In a system based audit, test checking approach provides a good base for the auditor to form his opinion on the financial statements. Give your comments. ***(4 Marks)***

(c) "It is not mandatory to send a new engagement letter in recurring audit, but sometimes it becomes mandatory to send new letter". Explain those situations where new engagement letter is to be sent. ***(4 Marks)***

(d) In a medium size trading organisation the accountant was given additional responsibility of making recoveries from the trade receivables. On one occasion, when an insurance claim of ` 45,000 was received, he credited the same to the account of a trade receivable and misappropriated the cash which he had recovered from the said trade receivable. Pinpoint weaknesses in the internal control system which led to this situation. Comment. ***(3 Marks)***

5. How will you vouch/verify the following?

(a) Foreign Travel Expenses ***(4 Marks)***

(b) Receipt of Capital subsidy ***(4 Marks)***

(c) Royalties received ***(3 Marks)***

(d) Goods sent out on Sale or Return basis ***(3 Marks)***

6. (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. ***(3 Marks)***

(b) Discuss the reporting requirements regarding Fixed Assets under CARO, 2016. ***(3 Marks)***

(c) Explain the provisions of the Companies Act, 2013 with regard to Alteration of Share Capital and auditor's duty in this regard. ***(4 Marks)***

(d) Mention any four special points which you as an auditor would look into while auditing the books of a partnership firm. ***(4 Marks)***

or

(e) What special steps will you take into consideration in auditing the receipts from entry fees of an amusement part? Mention any four points specific to the issue. ***(4 Marks)***

MOCK TEST PAPER - 1

INTERMEDIATE (IPC): GROUP – II

PAPER – 6: AUDITING AND ASSURANCE

SUGGESTED ANSWERS / HINTS

Division A-Multiple Choice Answers

1. (a)
2. (d)
3. (b)
4. (a)
5. (b)
6. (c)
7. (c)
8. (d)
9. (d)
10. (a)
11. (a)
12. (d)
13. (a)
14. (b)
15. (c)
16. (a)
17. (d)
18. (b)
19. (a)
20. (a)
21. (a)
22. (c)
23. (d)
24. (a)
25. (d)

Division B - 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) Correct: When we are designing audit procedures to address an inherent risk or "what can go wrong", we consider the nature of the risk of material misstatement in order to determine if a substantive analytical procedure can be used to obtain audit evidence. When inherent risk is higher, we may design tests of details to address the higher inherent risk. When significant risks have been identified, audit evidence obtained solely from substantive analytical procedures is unlikely to be sufficient.

(iii) Incorrect: According to SA 530 "Audit sampling", 'audit sampling' refers to the application of audit procedures to less than 100% of items within a population of audit relevance such that all sampling units have a chance of selection in order to provide the auditor with a reasonable basis on which to draw conclusions about the entire population.

(iv) 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.

(v) Incorrect*:* Emphasis of Matter paragraph is 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.

(vi) Incorrect: 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

(vii) Incorrect: The assessment of risks is based on audit procedures to obtain information necessary for that purpose and evidence obtained throughout the audit. The assessment of risks is a matter of professional judgment, rather than a matter capable of precise measurement.

(viii) 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.

2. (a) Statements and Guidance Notes of ICAI – whether Mandatory or Recommendatory:

(i) Statements: The 'Statements' have been issued with a view to securing compliance by members on matters which, in the opinion of the Council, are critical for the proper discharge of their functions. 'Statements' therefore are mandatory.

Accordingly, while discharging their attest function, it will be the duty of the members of the Institute to ensure that statements are followed and complied with.

(ii) Guidance Notes: 'Guidance Notes' are primarily designed to provide guidance to members on matters which may arise in the course of their professional work and on which they may desire assistance in resolving issues which may pose difficulty. Guidance Notes are recommendatory in nature. A member should ordinarily follow recommendations in a guidance note relating to an auditing matter except where he is satisfied that in the circumstances of the case, it may not be necessary to do so.

Similarly, while discharging his attest function, a member should examine whether the recommendations in a guidance note relating to an accounting matter have been followed or not. If the same have not been followed, the member should consider whether keeping in view the circumstances of the case, a disclosure in his report is necessary.

There are, however a few guidance notes in case of which the Council has specifically stated that they should be considered as mandatory on members while discharging their attest function.

(b) Inquiring from Management to Evaluate Subsequent Event: As per SA 560 "Subsequent Events", in inquiring of management and, where appropriate, those charged with governance, as to whether any subsequent events have occurred that might affect the financial statements, the auditor may inquire as to the current status of items that were accounted for on the basis of preliminary or inconclusive data and may make specific inquiries about the following matters-

(i) Whether new commitments, borrowings or guarantees have been entered into.

(ii) Whether sales or acquisitions of assets have occurred or are planned.

(iii) Whether there have been increases in capital or issuance of debt instruments, such as the issue of new shares or debentures, or an agreement to merge or liquidate has been made or is planned.

(iv) Whether any assets have been appropriated by government or destroyed, for example, by fire or flood.

(v) Whether there have been any developments regarding contingencies.

(vi) Whether any unusual accounting adjustments have been made or are contemplated.

(vii) Whether any events have occurred or are likely to occur which will bring into question the appropriateness of accounting policies used in the financial statements as would be the case, for example, if such events call into question the validity of the going concern assumption.

(viii) Whether any events have occurred that are relevant to the measurement of estimates or provisions made in the financial statements.

(ix) Whether any events have occurred that are relevant to the recoverability of assets.

(c) The Discipline of Behavioural Science is Closely Linked with the Subject of Auditing: The field of auditing as a discipline involves review of various assertions; both in financial as well as in non-financial terms, with a view to prove the veracity of such assertions and expression of opinion by auditor on the same. Thus, it is quite logical and natural that the function of audit can be performed if and only if the person also possesses a good knowledge about the fields in respect of which he is conducting such a review.

The discipline of behavioural science is closely linked with the subject of auditing. While it may be said that an auditor, particularly the financial auditor, deals basically with the figures contained in the financial statements but he shall be required to interact with a lot of people in the organisation. As against the financial auditor, the internal auditor or a management auditor is expected to deal with human beings rather than financial figures. One of the basic elements in designing the internal control system is personnel. Howsoever, if a sound internal control structure is designed, it cannot work until and unless the people who are working in the organisation are competent and honest. The knowledge of human behaviour is indeed very essential for an auditor so as to effectively discharge his duties.

(d) Written Representations: As per SA 580, "Written Representation" is a written statement by management provided to the auditor to confirm certain matters or to support other audit evidence. These representations are an important source of audit evidence. If management modifies or does not provide the requested written representations, it may alert the auditor to the possibility that one or more significant issues may exist. Further, a request for written, rather than oral, representations in many cases may prompt management to consider such matters more rigorously, thereby enhancing the quality of the representations.

Requested Written Representations not provided by Management: If management does not provide one or more of the requested written representations, the auditor shall-

(i) discuss the matter with management;

(ii) re-evaluate the integrity of management and evaluate the effect that this may have on the reliability of representations (oral or written) and audit evidence in general; and

(iii) take appropriate actions, including determining the possible effect on the opinion in the auditor's report.

The auditor shall disclaim an opinion on the financial statements if management does not provide the written representations.

3. (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.

(c) 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

(d) 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.

4. (a) Areas where Surprise Checks can significantly improve the effectiveness of an Audit: Surprise checks constitute an important part of normal audit procedure. An element of surprise both with regard to the time of checking and selection of items, significantly improves the effectiveness of an audit. Normally, areas over which surprise check can be employed are-

(i) Verification of cash and investments.

(ii) Inventory.

(iii) Internal control and internal checks.

(iv) Books of prime entries and statutory registers.

(b) Test Checking in System Based Audit: System-based audit is done by evaluating the accounting system and internal control and ascertaining their reliability through audit tests. Depending upon the size and nature of the business concerned, an accounting system will incorporate necessary internal control to provide assurance that-

(i) All the transactions and information have been recorded,

(ii) Fraud and errors, if any, in preparing the accounts will be identified,

(iii) All the assets and liabilities recorded in the books of account do exist and are shown at correct amounts,

(iv) There is compliance with statutory regulations.

After the auditor has ascertained the client's accounting system, he should assess it to satisfy the above-mentioned requirements. The auditor, therefore, after evaluating internal control system, tests the same to ascertain whether it is actually in operation. For this purpose, he assorts to actual testing of the system in operation. This he does on a selective basis, i.e., he adopts test checking technique. He plans this testing in such a manner that all the important areas stated above are covered. The test checking is done by application of procedural test and/or by auditing in depth. This approach is adopted in system based audit which is the modern audit approach. The system-based audit approach begins by evaluating the accounting system and internal control and then by testing them to ascertain their reliability. By this, the auditor first establishes how reliable the system is and then decides how much detailed checking of the transactions and verification of assets and liabilities he must undertake. If the system is found to be good, the detailed checking could be curtailed, but if system is week, more detailed checking would be necessary. However, checking cannot be completely eliminated; it can only be scaled down if state of the system is satisfactory. In case the initial evaluation itself shows weaknesses, extensive checking should invariably be undertaken.

(c) Issue of Audit Engagement Letter in Recurring Audits: As per SA 210, "Agreeing the Terms of Audit Engagements", on recurring audits, the auditor shall assess whether circumstances require the terms of the audit engagement to be revised and whether there is a need to remind the entity of the existing terms of the audit engagement.

It is not necessary to issue audit engagement letter each year for repetitive audit. It is enough if the same had been issued at the time of taking initial engagement. However, in the following situations it is appropriate to revise the terms of the audit engagement or to remind the entity of existing terms-

(i) Any indication that the entity misunderstands the objective and scope of the audit.

(ii) Any revised or special terms of the audit engagement.

(iii) A recent change in senior management or board of directors.

(iv) A significant change in ownership.

(v) A significant change in nature or size of the entity's business.

(vi) A change in legal or regulatory requirements.

(vii) A change in the financial reporting framework adopted in the preparation of the financial statements.

(viii) A change in other reporting requirements.

(d) Weaknesses in the Internal Control System: Following two essential features of internal control are relevant here-

(i) Breaking the chain of the work in a manner so that no single person can handle a transaction from the beginning to the end, and

(ii) Segregation of accounting and custodial functions.

Weakness in internal control system in the instant case-

(a) The accountant is receiving cash and also passing the entries in the books. The accountant should not have been allowed to effect recoveries.

(b) It also appears that system for issuing receipts for amount received - whether cash or cheque is also lacking.

(c) In a small and to some extent medium size organization, the supervision of the owner offsets the deficiencies in internal control system. But in this case, it appears, that supervision and personal control is also lacking.

Thus, in the given case, the main weakness of the system is that it is ignoring the basic requirements of a good internal control system.

5 **(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.

6. (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) 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;

(c) 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.

(d) Special Points in Audit of a Partnership Firm: Matters which should be specially considered in the audit of accounts of a partnership firm are as under-

(i) Confirming that the letter of appointment, signed by a partner, duly authorised, clearly states the nature and scope of audit contemplated by the partners, specially the limitation, if any, under which the auditor shall have to function.

(ii) Examine the partnership deed signed by all partners and its registration with the registrar of firms. Also ascertain from the partnership deed about capital contribution, profit sharing ratios, interest on capital contribution, powers and responsibilities of the partners, etc.

(iii) Studying the minute book, if any, maintained to record the policy decision taken by partners specially the minutes relating to authorisation of extraordinary and capital expenditure, raising of loans, purchase of assets, extraordinary contracts entered into and other such matters which are not of a routine nature.

(iv) Verifying that the business in which the partnership is engaged is authorised by the partnership agreement; or by any extension or modification thereof agreed to subsequently.

(v) Examining whether books of account appear to be reasonable and are considered adequate in relation to the nature of the business of the partnership.

(vi) Verifying generally that the interest of no partner has suffered prejudicially by an activity engaged in by the partnership which, it was not authorised to do under the partnership deed or by any violation of a provision in the partnership agreement.

(vii) Confirming that a provision for the firm's tax payable by the partnership has been made in the accounts before arriving at the amount of profit divisible among the partners. Also see various requirements of legislations applicable to the partnership firm like Section 44(AB) of the Income-tax Act, 1961 have been complied with.

(viii) Verifying that the profits and losses have been divided among the partners in their agreed profit-sharing ratio.

(e) Audit of receipts from Entry Fees of an Amusement Park:

(i) Evaluate the internal control system regarding entry and collection for entry tickets including rotation of staff.

(ii) Ensure that tickets are pre numbered.

(iii) Ensure that the deposit of cash collected into the bank account very same next day.

(iv) Compute analytical ratios in respect of the receipts pattern i.e. on weekends, holidays, etc. and make comparisons to draw conclusions.

Test Series: March, 2019

MOCK TEST PAPER - 1

INTERMEDIATE (IPC): GROUP – II

PAPER – 7: INFORMATION TECHNOLOGY AND STRATEGIC MANAGEMENT

SECTION – A: INFORMATION TECHNOLOGY

Time Allowed – 1½ Hours **Maximum Marks – 50**

Division A - Multiple Choice Questions

Total Marks: 15 Marks

Question Nos. 1 to 5 carries 2 marks each.

1. ABC wants to inform all his subordinates and colleagues about an urgent meeting scheduled to discuss the forthcoming office event. But, he needs to check the availability of other managers as well. Which of the following applications would help him?

   (a) FAX

   (b) Email

   (c) Video Conferencing

   (d) Electronic Calendaring

2. On a flight, there's a possibility of fuel discharge from the aircraft, this could risk the lives of hundreds of people on board. To counter such a situation, which kind of processing works best?

   (a) Batch Processing

   (b) Real-time Processing

   (c) Online Processing

   (d) Online Analytical Processing

3. ____ is a wireless technology standard for exchanging data over short distances up to 50 meters (164 feet) from fixed and mobile devices, creating PANs with high levels of security.

   (a) Wi-Fi

   (b) Bluetooth

   (c) Routers

   (d) Gateway

4. Which of the following is not a phase of Business Processes Management Life Cycle under ERP?

   (a) Analysis phase

   (b) Implementation phase

   (c) Design phase

   (d) Presentation phase

5. In _______ transmission, Start and Stop bits ensure that the sender and the receiver remain in step with one another.

   (a) Synchronous

   (b) Asynchronous

   (c) Serial

   (d) Parallel **(5 x 2 = 10 Marks)**

Question Nos. 6 to 10 carries 1 mark each.

6. Which of the following is not a benefit of Business Process Automation (BPA)?

   (a) Saving on costs:

   (b) Staying ahead in competition

   (c) Fast service to customers

   (d) Risk to jobs

7. Which of the following is not an activity under Conversion activity under "System Implementation" phase under SDLC?

   (a) Indirect Changeover

   (b) Direct Changeover

   (c) Phased Conversion

   (d) Pilot Conversion

8. In terms of Computer Network Topology, which of the following statement is incorrect?

   (a) Star network has a central unit that has a number of terminals tied into it.

   (b) In Bus network, even if one node fails, it does not affect the entire network.

   (c) Ring networks do not require a central computer to control activity nor does it need a file server.

   (d) In Mesh network, if one node fails, the whole system breaks down.

9. What does ACID Test in a Transaction Processing System (TPS) stand for?

   (a) Atomicity, Confidentiality, Isolation, Durability

   (b) Authenticity, Confidentiality, Integrity, Durability

   (c) Authenticity, Consistency, Integrity, Durability

   (d) Atomicity, Consistency, Isolation, Durability

10. Which of the following step is not involved in an Application Access Control mechanism process?

    (a) Identification

    (b) Authentication

    (c) Confidentiality

    (d) Authorization **(5 x 1 = 5 Marks)**

Division B - Descriptive Questions

Total Marks: 35 Marks

Question No. 1 is compulsory.

Attempt any three questions out of remaining four questions.

1. (a) Explain the term "Computer Network". Discuss the ways in which computer network can be distinguished in terms of how they are connected. **(3 Marks)**

   (b) Define the term Leased Applications. **(2 Marks)**

2. (a) You are asked to prepare a presentation on general categories of E-Commerce applications. Prepare the content that you would highlight in your presentation. **(6 Marks)**

   (b) Discuss Business Process Management (BPM) Practices. **(4 Marks)**

3. (a) Any management of an IT firm generally considers that the objectives of Business Process Automation (BPA) are achieved till the proposed Information systems are implemented. However, post – implementation, the phase "System maintenance and review" is also one of the major phase in System Development Life Cycle (SDLC). Determine the significance and activities involved in this phase. **(6 Marks)**

   (b) Specialized Systems provide comprehensive end to end IT solutions and services including systems integration, implementation, engineering services, software application customization and maintenance etc. to various corporations in India and other part of a world. Establish the relationship between ERP, CRM and SCM. **(4 Marks)**

4. (a) Though the primary purpose for which an enterprise implements automation may vary from enterprise to enterprise. However, there are some generic reasons for going for Business Process Automation (BPA). Prepare a list of them. **(6 Marks)**

   (b) List the examples of Office Automation Applications. **(4 Marks)**

5. (a) BPMS is a technology that delivers endless benefits to any sized organization but more importantly these benefits are unique to a company. Determine these benefits. **(6 Marks)**

   (b) Discuss about Application Layer of OSI Model. **(4 Marks)**

Test Series: March, 2019

MOCK TEST PAPER

INTERMEDIATE (IPC): GROUP – II

PAPER –7: INFORMATION TECHNOLOGY AND STRATEGIC MANAGEMENT

SECTION – B: STRATEGIC MANAGEMENT

Question 1 and 2 are compulsory.

Attempt any three questions out of remaining four questions.

Time Allowed – 1½ Hours **Maximum Marks – 50**

1. (i) The emphasis on product design is very high, the intensity of competition is low, and the market growth rate is low in the ______ stage of the industry life cycle.

   a. Maturity

   b. Introduction

   c. Growth

   d. Decline

(ii) Which one is NOT a type of strategic control?

   a. Operational control

   b. Strategic surveillance

   c. Special alert control

   d. Premise control

(iii) The reasons for acquisition are

   a. Increased market power

   b. Increased diversification

   c. Increased speed to market

   d. All of the these

(iv) Strategic management allows an organization to be more

   a. Authoritative

   b. Participative

   c. Commanding

   d. Proactive

(v) Internal __________ are activities in an organization that are performed especially well.

   a. Opportunities

   b. Competencies

   c. Strengths

   d. Weaknesses

(vi) Developing vision and mission, identifying an organization's external opportunities and threats, and determining internal strengths and weaknesses are:

   a. SBU Planning

b. Strategy Formulation

c. Strategy Implementation

d. Business Process Reengineering

(vii) In strategic management, there are two main styles of leadership. These are transformational and:

a. Transparent

b. Transitional

c. Translational

d. Transactional

(viii) Which statement should be created first and foremost?

a. Strategy

b. Vision

c. Objectives

d. Mission

(ix) Which one is NOT Michael Porter's five competitive forces?

a. New entrants

b. Rivalry among existing firms

c. Bargaining power of unions

d. Bargaining power of suppliers

(x) If suppliers are unreliable or too costly, which of these strategies may be appropriate?

a. Horizontal integration

b. Backward integration

c. Market penetration

d. Forward integration

(xi) The focus of six sigma is on:

a. Shareholders.

b. Supplier.

c. Customer.

d. Government.

(xii) GE Nine-cell Matrix is based on

a. Market attractiveness and business strength

b. Market growth rate and business strength

c. Market attractiveness and relative market share

d. Market growth rate and relative market share

(xiii) Which one of the following is totally an unrelated diversification?

a. Concentric diversification

b. Conglomerate diversification

c. Vertically integrated diversification

d. Horizontally integrated diversification

(xiv) All are elements of micro environment except:

a. Consumer.

b. Suppliers.

c. Competitors.

d. Society.

(xv) Which of the following competitive position of a firm is not as per ADL Matrix?

a. Dominant

b. Favourable

c. Difficult

d. Tenable **(15 x 1 = 15 Marks)**

2. Woodworld Ltd. is a company manufactures a variety of household furniture items. They offered traditional designs, low cost furniture items to low income group customers. During the last couple of years, the company has been observing a fall in the market share. This is due to the change in the taste and preferences, designing, better quality, increase in purchasing power of buyers towards the household furniture. The customers are switching away traditional designs and material that have been the backbone of Woodworld Ltd.

As a CEO of Woodworld Ltd., what can be the strategic options available with you. **(5 Marks)**

3. (a) Explain the factors that affect the strength of competitive pressures from substitute products.

(5 Marks)

(b) How strategic decisions differ in nature from other routine decisions taken in day-to-day working of an organization? Explain. **(5 Marks)**

4. (a) Write a short note on Product Life Cycle (PLC) and its significance in portfolio diagnosis.

(5 Marks)

(b) Distinguish between Concentric Diversification and Conglomerate Diversification. **(5 Marks)**

5. (a) Does HRM function play a role in organizational strategy? **(5 Marks)**

(b) Specify the steps that is needed to initiate & bring changes in the strategic building of any organization. **(5 Marks)**

6. (a) Being a strategic professional, analyze and redesign the work flows in the context of business process reengineering. **(5 Marks)**

(b) “A company should focus on external perspective to define its mission”. Support this statement with reasons. **(5 Marks)**

MOCK TEST PAPER - 1

INTERMEDIATE (IPC): GROUP – II

PAPER – 7: INFORMATION TECHNOLOGY AND STRATEGIC MANAGEMENT

SECTION – A: INFORMATION TECHNOLOGY

ANSWERS

MULTIPLE CHOICE QUESTIONS

1. (d) Electronic Calendaring

2. (b) Real-time Processing

3. (b) Bluetooth

4. (d) Presentation phase

5. (b) Asynchronous

6. (d) Risk to jobs

7. (a) Indirect Changeover

8. (d) In Mesh network, if one node fails, the whole system breaks down

9. (d) Atomicity, Consistency, Isolation, Durability

10. (c) Confidentiality

DESCRIPTIVE QUESTIONS

1. (a) **Computer Network** is a collection of computers and other hardware interconnected by communication channels that allow sharing of resources and information. Where at least one process in one device can send/receive data to/from at least one process residing in a remote device, then the two devices are said to be in a network. A network is a group of devices connected to each other.

In terms of how the devices are connected, the computer networks can be classified as follows:

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

(b) **Leased Application:** A new method for getting applications is being used today, i.e. leased applications, where user pays fixed rent for using the application for agreed terms. Many specialized vendors provide users with option to get their job done by paying monthly rent; this is referred to as **Outsourcing**.

2. (a) The general classes of e-Commerce applications are as follows:

(i) **Business-to-Business (B2B) e-Commerce:** B2B refers to the exchange of services, information and/or products from one business to another. B2B electronic commerce typically takes the form of automated processes between trading partners and is performed in much higher volumes than Business-to- Consumer (B2C) applications. B2B can also encompass marketing activities between businesses, and not just the final transactions that result from marketing.

(ii) **Business-to-Consumer (B2C) e-Commerce:** It is defined as the exchange of services, information and/or products from a business to a consumer, as opposed to between one business and another. Typically, a B2C e- Commerce business has a virtual store front for consumers to purchase goods and services eliminating the need to physically view or pick up the merchandise. The Business-to-Consumer (B2C) model can save time and money by doing business electronically but customers must be provided with safe and secure as well as easy-to-use and convenient options when it comes to paying for merchandise.

(iii) Consumer-to-Business (C2B) e-Commerce: In C2B e-Commerce model, consumers directly contact with business vendors by posting their project work online so that the needy companies review it and contact the consumer directly with bid. The consumer reviews all the bids and selects the company for further processing. Some examples are guru.com, rentacoder.com, getacoder.com, freelancer.com.

(iv) Consumer-to-Consumer (C2C) e-Commerce: C2C e-Commerce is an Internet- facilitated form of commerce that has existed for the span of history in the form of barter, flea markets, swap meets, yard sales and the like. C2C e-Commerce sites provide a virtual environment in which consumers can sell to one another through a third-party intermediary.

(v) Business-to-Government (B2G) e-Commerce: B2G e-Commerce, also known as e-Government, refers to the use of information and communication technologies to build and strengthen relationships between government and employees, citizens, businesses, non-profit organizations, and other government agencies.

(vi) Business-to-Employee (B2E) e-Commerce: B2E e-Commerce, from an intra-organizational perspective, has provided the means for a business to offer online products and services to its employees.

(b) Business Process Management (BPM) Practices are as follows:

- Strive for process-oriented organizational structure;
- Appoint process owners;
- Senior management needs to commit and drive BPM and execution of BPM process improvements should take a bottom-up approach;
- Put in place information technology systems to monitor, control, analyse, and improve processes;
- Work collaboratively with business partners on cross-organizational business processes;
- Continuously train the workforce and continuously improve business processes;
- Align employee bonuses and rewards to business process performance;
- Utilize both incremental (e.g., Six Sigma) and more radical (e.g., BPR) methodologies to implement process improvement.

3. (a) System Maintenance and Review phase of System Development Life Cycle (SDLC) evaluates results of solution and modifies the system to meet the changing needs. Post implementation review would be done to address:

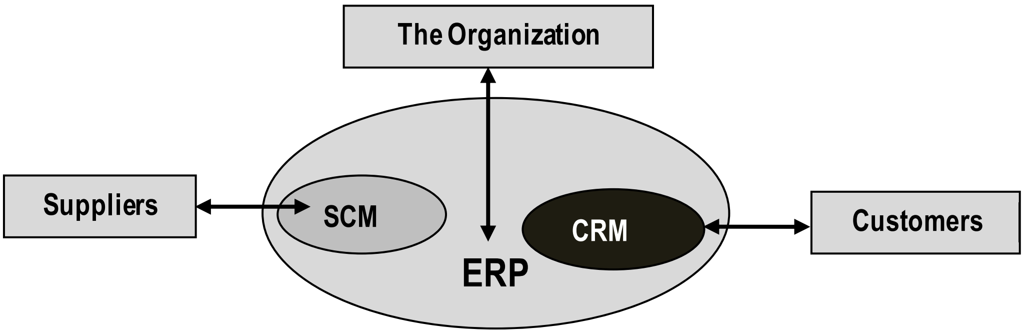
- Programming amendments,
- Adjustment of clerical procedures,
- Modification of Reports, and
- Request for new programs.

System maintenance could be with following different objectives:

- **Perfective Maintenance:** This implies that while the system runs satisfactorily, there is still room for improvement.
- **Adaptive Maintenance:** All systems will need to adapt to changing needs within a company.
- **Corrective Maintenance:** Problems frequently surface after a system has been in use for a short time, however thoroughly it was tested. Any errors must be corrected.

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

(b) CRM and SCM are two categories of enterprise software that are widely implemented in corporations and non-profit organizations. While the primary goal of ERP is to improve, and streamline internal business processes, CRM attempts to enhance the relationship with customers and SCM aims to facilitate the collaboration between the organization, its suppliers, the manufacturers, the distributors and the partners.



SCM software chugs along, ensuring that materials and information flow through the supply chain with the highest possible efficiency and the lowest possible cost. Meanwhile, CRM software focuses on the identification, targeting, acquisition and retention of customers, and on the building of strong relationships between the business and its customers. Thus, the two tools tend to sit at opposite ends of the enterprise and deal with different sets of data albeit with the same end goal.

4. (a) The primary purpose for which an enterprise implements automation may vary from enterprise to enterprise. A list of generic reasons for going for BPA may include any or combination of the following:

- Errors in manual processes leading to higher costs.
- Payment processes not streamlined, due to duplicate or late payments, missing early pay discounts, and losing revenue.
- Paying for goods and services not received.
- Poor debtor management leading to high invoice aging and poor cash flow.
- Not being able to find documents quickly during an audit or lawsuit or not being able to find all documents.
- Lengthy or incomplete new employee or new account on-boarding.
- Unable to recruit and train new employees, but where employees are urgently required.
- Lack of management understanding of business processes.
- Poor customer service.

(b) Examples of Office Automation Applications are as follows:

- **Word Processing:** Use of a computer to perform automatically many of the tasks necessary to prepare typed or printed documents.
- **Electronic mail:** Use of a computer network that allows users to send, store and retrieve messages using terminals and storage devices.
- **Voice Mail:** Requires computers with an ability to store audio messages digitally and convert them back upon retrieval.

- **Electronic Calendaring:** Use of a networked computer to store and retrieve a manager's appointment calendar. Allows other managers' calendars to be accessed and facilitates scheduling.
- **Video Conferencing:** Use of television equipment to link geographically dispersed conference participants.
- **Desktop Video Conferencing:** Video and audio equipment are attached to each workstation in the network enabling the two-way communication of picture and way communication of picture and sound.
- **FAX:** Uses special equipment that can read a document at one end of a communication channel and make a copy at the other end.
- Imaging**:** Uses Optical Character Recognition (OCR) to convert data on paper to a digital format for storage in a secondary storage device.
- **Desktop Publishing:** Uses a computer to prepare output that is very close in quality to that produced by a typesetter.

5. (a) BPMS, as a technology, can deliver endless benefits to any sized organization but more importantly these benefits are unique to a company. These benefits are as follows:

- **Automating repetitive business processes:** Processes such as report creation and distribution or the monitoring of or reporting on company's Key Performance Indicators (KPI) reduces the manual operational costs and helps employees to concentrate on activities that are important to the success of business. BPMS works by 'loosely coupling' with a company's existing applications: This enables it to monitor, extract, format and distribute information to systems and people; in line with business events or rules.
- **Operational Savings:** BPM focuses on optimization of processes. The processes that are repetitive are optimized and lead to reduced expenses which translate to immediate cost savings. By automating a task, ROI of BPM that requires six hours of manual intervention, one can expect to cut that time to half. Thus, three hours multiplied by the number of times the process is completed in a cycle will yield significant cost saving.
- **Reduction in the administration involved in Compliance and ISO Activities:** Be it a quality assurance initiative such as the ISO standards, a financial audit law, or an IT systems best-practice implementation, companies worldwide are seeing the need to manage compliance as part of their everyday business activities. The BPM is ideally suited to help support companies in their quest for process improvement and compliance/governance certification. It gives full control over process and document change, clarity of inherent risks, and ease with which process knowledge is communicated across the company.
- **Freeing-up of employee time:** While the euphuism "time is money" is often over-used, it is very relevant to this topic, because in business, for each additional hour it takes to complete a manual business process, there is a hard cost associated with employee time as well as soft costs associated with losing business or lowered productivity. Another area where time comes into play is in opportunity costs.

(b) The Application Layer of OSI layer architecture is closest to the end user, which means that both the OSI application layer and the user interact directly with the software application.

- This layer interacts with software applications and provides user services by file transfer, file sharing, etc.
- Database concurrency and deadlock situation controls are undertaken at this layer level.
- This is the layer at which communication partners are identified, quality of service is identified, user authentication and privacy are considered, and any constraints on data syntax are identified.

MOCK TEST PAPER - 1

INTERMEDIATE (IPC): GROUP – II

PAPER – 7: INFORMATION TECHNOLOGY AND STRATEGIC MANAGEMENT

SECTION – B: STRATEGIC MANAGEMENT

SUGGESTED ANSWERS/HINTS

1.

(i)	(ii)	(iii)	(iv)	(v)	(vi)	(vii)	(viii)	(ix)	(x)
b	a	d	d	c	b	d	b	c	b
(xi)	**(xii)**	**(xiii)**	**(xiv)**	**(xv)**					
c	a	b	d	c					

2. Woodworld is having a product portfolio that is evidently in the decline stage. The product is being replaced with the latest designs with better quality of the product. Strategically, the company should minimize their dependence on the existing products and identify other avenues for the survival and growth. As a CEO of Woodworld Ltd., following can be the strategic options available with the CEO:

- Invest in new product development and switchover to the latest designs. Woodworld Ltd. also need time to invest in hiring interior designers.
- They can acquire or takeover a competitor, provided they have or are able to generate enough financial resources.
- They may also consider unrelated growth and identify other areas for expansion. This will enable Woodworld Ltd. to spread their risks.
- In longer run, they should divest the existing products. However, they may continue with the existing products in a limited manner for such time there is demand for the product.

3. (a) Substitute products are a latent source of competition in an industry. In many cases, they become a major constituent of competition. With regards to substitute products, factors such as prices, easy availability, and how best they are able to satisfy the needs of customers, determine the amount of competition through them. Substitute products offering a price advantage and/or performance improvement to the consumer can drastically alter the competitive character of an industry. And they can bring it about all of a sudden. Wherever substantial investment in R&D is taking place, threats from substitute products can be expected. Substitutes, too, usually limit the prices and profits in an industry.

(b) 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 the allocation of large amounts of company resources.
- ♦ Strategic issues are likely to have a significant impact on the long term prosperity of the organisation.
- ♦ Strategic issues are future oriented.
- ♦ Strategic issues usually have major multifunctional or multi-business consequences.
- ♦ Strategic issues necessitate consideration of factors in the organisation's external environment.

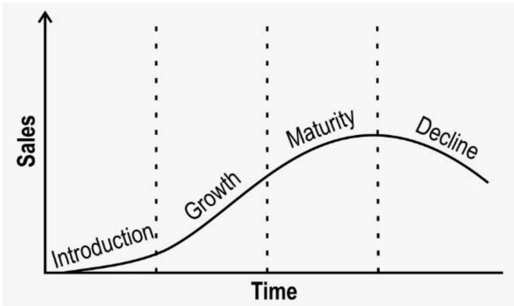
4. **(a)** Product Life Cycle is an important concept in strategic choice and S-shaped curve which exhibits the relationship of sales with respect of time for a product that passes through the four successive stages.

The first stage of PLC is the introduction stage in which competition is almost negligible, prices are relatively high and markets are limited. The growth in sales is also at a lower rate.

The second stage of PLC is the growth stage, in which the demand expands rapidly, prices fall, competition increases and market expands.

The third stage of PLC is the maturity stage, where in the competition gets tough and market gets stabilized. Profit comes down because of stiff competition.

The fourth stage is the declining stage of PLC, in which the sales and profits fall down sharply due to some new product replaces the existing product.



Product Life Cycle

PLC can be used to diagnose a portfolio of products (or businesses) in order to establish the stage at which each of them exists. Particular attention is to be paid on the businesses that are in the declining stage. Depending on the diagnosis, appropriate strategic choice can be made. For instance, expansion may be a feasible alternative for businesses in the introductory and growth stages. Mature businesses may be used as sources of cash for investment in other businesses which need resources. A combination of strategies like selective harvesting, retrenchment, etc. may be adopted for declining businesses. In this way, a balanced portfolio of businesses may be built up by exercising a strategic choice based on the PLC concept.

(b) Concentric diversification occurs when a firm adds related products or markets. On the other hand conglomerate diversification occurs when a firm diversifies into areas that are unrelated to its current line of business.

In concentric diversification, the new business is linked to the existing businesses through process, technology or marketing. In conglomerate diversification, no such linkages exist; the new business/product is disjointed from the existing businesses/products.

The most common reasons for pursuing a concentric diversification are that opportunities in a firm's existing line of business are available. However, common reasons for pursuing a conglomerate growth strategy is that opportunities in a firm's current line of business are limited or opportunities outside are highly lucrative.

5. **(a)** 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.

(b) The changes in the environmental forces often require businesses to make modifications in their existing strategies and bring out new strategies. For initiating strategic change, three steps can be identified as under:

(i) Recognize the need for change: The first step is to diagnose facets of the corporate culture that are strategy supportive or not. The idea is to determine where the lacuna lies and scope for change exists.

(ii) Create a shared vision to manage change: Objectives and vision of both individuals and organization should coincide. Senior managers need to constantly and consistently communicate the vision not only to inform but also to overcome resistance.

(iii) Institutionalize the change: Creating and sustaining a different attitude towards change is essential to ensure that the firm does not slip back into old ways of thinking or doing things. All these changes should be set up as a practice to be followed by the organization and be able to transfer from one level to another as a well settled practice.

6. (a) Business Process Reengineering (BPR) refers to the analysis and redesign of workflows and processes both within and between the organizations. The orientation of the redesign effort is radical. It involves total deconstruction and rethinking of a business process in its entirety

The workflows are studied, appraised and improved in terms of time, cost, output, quality, and responsiveness to customers. The redesign effort aims to simplify and streamline a process by eliminating all extra avoidable steps, activities, and transactions. With the help of redesigning workflows, organizations can drastically reduce the number of stages of work, and improve their performance.

(b) A business organization is a part of overall structure of society and functions within wide external environmental factors. It draws its resources from its external environment, processes them and provides output in the form of goods and services. Therefore, it is correct to say that a business enterprise should focus on external perspective to define its mission although enterprise's internal situation cannot be delinked while doing so. Bringing an external perspective justifies the very existence of company. The mission statement is a message designed to be inclusive of the expectations of all stakeholders for the performance of an enterprise / company over the long run. Some of the questions addressed by mission statement are: Why is the firm in business? What are the economic goals? What is the operating philosophy in terms of quality, firm's image and self-concept? What are the core competencies and competitive advantages? What customers do and can a company serve? How does enterprise / company view its responsibilities to stockholders, employees, communities, environment, social issues or competitors?