MOCK TEST PAPER – 2

INTERMEDIATE (IPC) (OLD) COURSE: GROUP – II

PAPER – 5: ADVANCED ACCOUNTING

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

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

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

Working Notes should form part of the answer.

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

1. (a) From the following information, you are required to compute the basic and adjusted Earnings per Share:

Net profit for 2017-18	Rs. 11 lakh
Net profit for 2018-19	Rs. 15 lakh
No. of shares issued before rights issue	5 lakhs
Right issue	One for every 5 held
Right issue price	Rs. 15 per share
Last date of exercising right option	1-06-2018
Fair value of shares before right issue	Rs. 21 per share

(b) 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.

(c) Sun Ltd. has entered into a sale contract of Rs. 5 crores with X Ltd. during 2015-2016 financial year. The profit on this transaction is Rs. 1 crore. The delivery of goods to take place during the first month of 2016-2017 financial year. In case of failure of Sun Ltd. to deliver within the schedule, a compensation of Rs. 1.5 crores is to be paid to X Ltd. Sun Ltd. planned to manufacture the goods during the last month of 2015-2016 financial year. As on balance sheet date (31.3.2016), the goods were not manufactured and it was unlikely that Sun Ltd. will be in a position to meet the contractual obligation.

(i) Should Sun Ltd. provide for contingency as per AS 29?

(ii) Should provision be measured as the excess of compensation to be paid over the profit?

(d) 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. ***(4 x 5 = 20 Marks)***

2. (a) From the following information as on 31st March, 2019 of Xeta Insurance Co. Ltd. engaged in fire insurance business, prepare the Revenue Account, reserving 50% of the net premiums for unexpired risks and an additional reserve of Rs. 7,00,000:

Particulars	Amount Rs.
Reserve for unexpired risk on 31st March, 2018	15,00,000
Additional reserve on 31st March, 2018	3,00,000
Claims paid	19,20,000
Estimated liability in respect of outstanding claims on 31st March, 2018	1,95,000
Estimated liability in respect of outstanding claims on 31st March, 2019	2,70,000
Expenses of management (including Rs. 90,000 incurred in connection with claims)	8,40,000
Re-insurance premium paid	2,25,000
Re-insurance recoveries	60,000
Premiums	33,60,000
Interest and dividend (gross before TDS)	1,50,000
Profit on sale of investments	30,000
Commission	50,000

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

From Department A to Department B 10% above cost

From Department A to Department D 20% above cost

From Department C to Department D 20% above cost

From Department C to Department B 20% above cost

For the year ending on 31st March, 2019 the firm had already prepared and closed the departmental Trading and Profit and Loss Account. Subsequently, it was discovered that the closing stocks of departments had included interdepartmentally transferred goods at loaded price instead of cost price. From the following information prepare a statement recomputing the departmental profit or loss:

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

(10 + 6 =16 Marks)

3. (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, 2019 and the additional information given thereafter:

	Dr. ($)	*Cr. ($)*
Stock on 1st April, 2018	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 1.4.2018 @ *Rs.* 40 per US $
- on 31.3.2019 @ *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 31.3.2019 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)***

4. 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 31-3-2019

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)***

5. The Balance Sheet of Lion Limited as on 31-03-2019 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		
Fixed Assets		
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)***

6. (a) Paper Limited comes out with a public issue of share capital on 01-01-2016 of 30,00,000 equity shares of Rs. 10 each at a premium of 5%. Rs. 2.50 is payable on application (on or before 31-01-2016) and Rs. 3 on allotment (31-3-2016) including premium.

This issue was underwritten by two underwriters namely White and Black, equally, the commission being 4% of the issue price. Each of the underwriters underwrites 60,000 shares firm. Subscriptions including firm underwriting came for 28,80,000 shares, the distribution of forms being White: 15,60,000; Black; 10,80,000 and Unmarked 2,40,000.

One of the allottees (using forms marked with name of White) for 6,000 shares fails to pay the amount due to allotment, all the other money due being received in full including any due from the shares devolving upon the underwriters. The commission due was paid separately.

6,000 shares of one allottee who failed to pay the allotment money were finally forfeited by 30-06-2016 and were re-allotted for payment in cash of Rs. 4 per share.

You are required to prepare each underwriter's liability (in shares) in statement form assuming that the benefit of firm underwriting is given to individual underwriter.

(b) SMM Ltd. has the following capital structure as on 31st March, 2017: Rs. in crore

	Particulars	
(i)	Equity share capital (shares of Rs. 10 each)	1,200
(ii)	Reserves:	

	General Reserves	1,080
	Securities Premium	400
	Profit & Loss	200
	Infrastructure Development Reserve (Statutory Reserve)	320
(iii)	Loan Funds	3,200

The company has offered buy back price of Rs. 30 per equity share. You are required to calculate maximum permissible number of equity shares that can be bought back in the above situation and also required to pass necessary Journal Entries. ***(4 + 12 = 16 Marks)***

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

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

(b) A company had issued 30,000, 14% convertible debentures of Rs. 100 each on 1st April, 2014. The debentures are due for redemption on 1st July, 2016. 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.

(c) 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.

(d) A fixed asset is purchased for Rs. 20 lakhs. Government grant received towards it is Rs. 8 lakhs. Residual Value is Rs. 4 lakhs and useful life is 4 years. Assume depreciation on the basis of Straight Line method. Asset is shown in the balance sheet net of grant. After 1 year, grant becomes refundable to the extent of Rs. 5 lakhs due to non compliance with certain conditions. Pass journal entries for second year.

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

Discuss on the accounting treatment and presentation of the said proposed dividend in the annual accounts of the company for the year ended 31st March, 2017 as per the applicable Accounting Standards and other Statutory Requirements. ***(4 x 4 = 16 Marks)***

MOCK TEST PAPER - 2

INTERMEDIATE (IPC): GROUP – II

PAPER – 5: ADVANCED ACCOUNTING

SUGGESTED ANSWERS/HINTS

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

$$\frac{\text{Fair value of all outstanding shares immediately prior to exercise of rights + Total amount received from exercise of rights}}{\text{Number of shares outstanding prior to exercise + number of shares issued in the exercise}}$$

$$\frac{(\text{Rs. } 21.00 \times 5{,}00{,}000 \text{ shares}) + (\text{Rs.}15.00 \times 1{,}00{,}000 \text{ shares})}{5{,}00{,}000 \text{ shares} + 1{,}00{,}000 \text{ shares}}$$

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

(a) **Computation of adjustment factor**

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

Computation of earnings per share

	Year 2017-18	Year 2018 -19
EPS for the year 2017-18 as originally reported: (Rs. 11,00,000/5,00,000 shares)	Rs. 2.20	
EPS for the year 2017-18 restated for rights issue: [Rs. 11,00,000/ (5,00,000 shares x 1.05)]	Rs. 2.10	
EPS for the year 2018-19 including effects of rights issue $\frac{₹\,15{,}00{,}000}{(5{,}00{,}000 \times 1.05 \times 2/12) + (6{,}00{,}000 \times 10/12)}$		Rs. 2.55

(b) 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.

(c) (i) AS 29 "Provisions, Contingent Liabilities and Contingent Assets" provides that when an enterprise has a present obligation, as a result of past events, that probably requires an outflow of resources and a reliable estimate can be made of the amount of obligation, a provision should be recognised. Sun Ltd. has the obligation to deliver the goods within the scheduled time as per the contract. It is probable that Sun Ltd. will fail to deliver the goods within the schedule and it is also possible to estimate the amount of compensation. Therefore, Sun Ltd. should provide for the contingency amounting Rs. 1.5 crores as per AS 29.

(ii) Provision should not be measured as the excess of compensation to be paid over the profit. The goods were not manufactured before 31st March, 2016 and no profit had accrued for the financial year 2015-2016. Therefore, provision should be made for the full amount of compensation amounting Rs. 1.50 crores.

(d) **(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.

2. (a) Name of the Insurer: Xeta Insurance Company Limited

Registration No. and Date of registration with IRDA: ……………………..

Revenue Account for the year ended 31st March, 2019

Particulars	*Schedule*	*Amount (Rs.)*
Premium earned (net)	1	26,67,500
Profit on sale of investment		30,000
Others		–
Interest and dividend (gross)		1,50,000
Total (A)		28,47,500
Claims incurred (Net)	2	20,25,000
Commission	3	50,000
Operating expenses related to insurance	4	7,50,000
Total (B)		28,25,000
Operating profit from insurance business (A) – (B)		22,500

Schedule –1 Premium earned (net)

	Rs.
Premium received	33,60,000
Less: Premium on reinsurance ceded	(2,25,000)
Net Premium	31,35,000

Less: Adjustment for change in Reserve for Unexpired risk (as per W.N.)	(4,67,500)
Total premium earned	26,67,500

Schedule -2 Claims incurred (net)

	Rs.
Claims paid	19,20,000
Add: Expenses regarding claims	90,000
	20,10,000
Less: Re-insurance recoveries	(60,000)
	19,50,000
Add: Claims outstanding as on 31st March, 2019	2,70,000
	22,20,000
Less: Claims outstanding as on 31st March, 2018	(1,95,000)
	20,25,000

Schedule -3 Commission

	Rs.
Commission paid	50,000

Schedule-4 Operating expenses related to Insurance Business

	Rs.
Expenses of management (Rs. 8,40,000 – Rs. 90,000)	7,50,000

Working Note:

Calculation for change in Reserve for Unexpired risk:

		Rs.
Reserve for Unexpired Risk as on 31st March, 2019	15,67,500	
Additional Reserve as on 31st March, 2019	7,00,000	22,67,500
Less: Reserve for Unexpired Risk as on 31st March, 2018	15,00,000	
Additional Reserve as on 31st March, 2018	3,00,000	(18,00,000)
		4,67,500

(b) Statement showing the re-computation of Departmental Profit or Loss

	Particulars	Dept. A Rs.	Dept. B Rs.	Dept. C Rs.	Dept. D Rs.
A	Final Profit/(Loss) (Computed earlier)	(38,000)	50,400	72,000	1,08,000
B	*Add:* Departmental Manager's Commission @ 10% of Deptt. Profit subject to a minimum of Rs. 6,000 [Working Note (i)]	6,000	6,000	8,000	12,000
C	Profit before Deptt. Manager's commission (A+B)	(32,000)	56,400	80,000	1,20,000
D	*Less:* Profit earned through transfer of goods at loaded price remaining in stock at transfer department (W.N. 2)	(2,200)	-	(8,600)	-

E	Correct Departmental Profit (before manager's commission) (C-D)	(34,200)	56,400	71,400	1,20,000
F	*Less:* Manager's commission @ 10% of profit subject to a minimum of Rs. 6,000	(6,000)	(6,000)	(7,140)	(12,000)
G	Departmental Profit after Manager's commission (E-F)	(40,200)	50,400	64,260	1,08,000

Working Note:

1. **Manager's Commission:**

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

2. **Unrealised Profit on stock transfer:**

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

3. (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
			Debtors		16,880
			Cash (800-600)		200
Rent	1,800		Furniture (3,000-300)		2,700
Salary	3,200				
Stationary & printing	800	5,800			

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, 2019

	Conversion rate per US $ (Rs.)	*Dr. (Rs.)*	*Cr. (Rs.)*
Stock on 1.4.18	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			6,24,000
	(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)			
31-3-X2	Profit and Loss account	Dr.	4,32,000	
	To Employees compensation expenses A/c			4,32,000
	(Being transfer of employees compensation expenses)			

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.

4. **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.

5. 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

6. (a) Statement showing liability of underwriters

	Particulars	Basis	White	Black
A	Gross Liability [No. of Shares)	1:1	15,00,000	15,00,000
B	*Less:* Marked Applications {Net of firm underwriting}		(15,00,000)	(10,20,000)
C	Balance [A-B]		-	4,80,000
D	*Less:* Unmarked Applications	1:1	(1,20,000)	(1,20,000)
E	Balance [C-D]		(1,20,000)	3,60,000
F	*Less:* Firm Underwriting		(60,000)	(60,000)
G	Balance		(1,80,000)	3,00,000
H	Credit for White 's Oversubscription		1,80,000	(1,80,000)
I	Net Liability		-	1,20,000
J	*Add:* Firm Underwriting		60,000	60,000
K	Total Liability [No. Shares]		60,000	1,80,000

(b) Statement determining the maximum number of shares to be bought back

Number of shares (in crore)

Particulars	When loan fund is Rs. 3,200 crore
Shares Outstanding Test (W.N.1)	30
Resources Test (W.N.2)	24
Debt Equity Ratio Test (W.N.3)	32
Maximum number of shares that can be bought back [least of the above]	24

Journal Entries for the Buy Back

			Debit	Credit
				Rs. in crore
(a)	Equity share buyback account	Dr.	720	
	To Bank account			720
	(Being payment for buy back of 24 crores equity shares of Rs. 10 each @ Rs. 30 per share)			
(b)	Equity share capital account	Dr.	240	
	Premium Payable on buyback account	Dr.	480	
	To Equity share buyback account			720
	(Being cancellation of shares bought back)			

	Securities Premium account Dr. General Reserve / Profit & Loss A/c Dr. To Premium Payable on buyback account (Being Premium Payable on buyback account charged to securities premium and general reserve/Profit & Loss A/c)	400 80	 480
(c)	General Reserve / Profit & Loss A/c Dr. To Capital redemption reserve account (Being transfer of free reserves to capital redemption reserve to the extent of nominal value of share capital bought back out of redeemed through free reserves)	240	 240

Working Notes:

1. Shares Outstanding Test

Particulars	*(Shares in crores)*
Number of shares outstanding	120
25% of the shares outstanding	30

2. Resources Test

Particulars	
Paid up capital (Rs. in crores)	1,200
Free reserves (Rs. in crores) (1,080 + 400 +200)	1,680
Shareholders' funds (Rs. in crores)	2,880
25% of Shareholders fund (Rs. in crores)	Rs. 720 crores
Buy back price per share	Rs. 30
Number of shares that can be bought back	24 crores shares

3. Debt Equity Ratio Test: Loans cannot be in excess of twice the Equity Funds post Buy Back

	Particulars	
(a)	Loan funds (Rs.)	3,200
(b)	Minimum equity to be maintained after buy back in the ratio of 2:1 (Rs.) (a/2)	1,600
(c)	Present equity shareholders fund (Rs.)	2,880
(d)	Future equity shareholders fund (Rs.) (see W.N.4)	2,560 (2,880-320)
(e)	Maximum permitted buy back of Equity (Rs.) [(d) – (b)]	960
(f)	Maximum number of shares that can be bought back @ Rs. 30 per share	32 crore shares
	As per the provisions of the Companies Act, 2013, company	Qualifies

4 **Amount transferred to CRR and maximum equity to be bought back will be calculated by simultaneous equation method**

Suppose amount transferred to CRR account is 'x' and maximum permitted buy-back of equity is 'y' Then

Equation 1: (Present Equity- Transfer to CRR)- Minimum Equity to be maintained = Maximum Permitted Buy Back

= (2,880 – x) – 1,600 = y

= 1280 – x =y (1)

Equation 2: Maximum Permitted Buy Back *X* Nominal Value Per Share/Offer Price Per Share

= $\left(\frac{y}{30}\times 10\right)$ = x Or 3x = y (2)

by solving the above two equations we get

x= Rs. 320

y = Rs. 960

7. (a) **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

(b) **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

(c) A liability is recognized when outflow of economic resources in settlementof 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.

(d) **Journal Entries**

Year	*Particulars*		*Rs. in lakhs (Dr.)*	*Rs. in lakhs (Cr.)*
2nd	Fixed Asset Account	Dr.	5	
	To Bank Account			5
	(Being government grant on asset partly refunded which increased the cost of fixed asset)			
	Depreciation Account (W.N.)	Dr.	3.67	
	To Fixed Asset Account			3.67
	(Being depreciation charged on SLM on revised value of fixed asset prospectively)			
	Profit & Loss Account	Dr.	3.67	
	To Depreciation Account			3.67
	(Being depreciation transferred to Profit and Loss Account at the end of year 2)			

Working Note:

Depreciation for Year 2

	Rs. in lakhs
Cost of the Asset	20
Less: Government grant received	(8)
	12
Less: Depreciation for the first year $\left[\frac{12-4}{4}\right]$	2
	10
Add: Government grant refundable	5
	15
Depreciation for the second year $\left[\frac{15-4}{3}\right]$	3.67

(e) As per the amendment in AS 4 "Contingencies and Events Occurring After the Balance Sheet Date" vide Companies (Accounting Standards) Amendments Rules, 2016 dated 30th March, 2016, the events which take place after the balance sheet date, are sometimes reflected in the financial statements because of statutory requirements or because of their special nature. However, dividends declared after the balance sheet date but before approval of financial statements are not recognized as a liability at the balance sheet date because no statutory obligation exists at that time. Hence such dividends are disclosed in the notes to financial statements.

Provision for proposed dividends is not required to be made as per the amendment in AS 4. Such proposed dividends are to be disclosed in the notes to financial statements. Accordingly, the dividend of Rs. 4 crores recommended by New Graphics Ltd. in its Board meeting on 18th April, 2017 shall not be accounted for in the books for the year 2016-17 irrespective of the fact that it pertains to the year 2016-17 and will be paid after approval in the Annual General Meeting of the members/shareholders.

MOCK TEST PAPER – 2

INTERMEDIATE (IPC) GROUP – II

PAPER – 6: AUDITING AND ASSURANCE

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

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

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

Division A- Multiple Choice Questions

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

Questions 21-25 carry 2 Marks each

1. 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.

2. Which of the following is correct :
   (a) The auditor is not expected to, and cannot, reduce audit risk to zero and cannot therefore obtain absolute assurance that the financial statements are free from material misstatement due to fraud or error.
   (b) The auditor is expected to and can reduce audit risk to zero and can therefore obtain absolute assurance.
   (c) The auditor is not expected to, and cannot, reduce audit risk to zero and cannot therefore obtain reasonable assurance that the financial statements are free from material misstatement due to fraud or error.
   (d) The auditor is expected to and can reduce audit risk to zero and can therefore obtain reasonable assurance that the financial statements are free from material misstatement due to fraud or error.

3. With reference to SA 300, the auditor shall document:
   (a) The overall audit strategy
   (b) The audit plan
   (c) Any significant changes made during the audit engagement to the overall audit strategy or the audit plan, and the reasons for such changes.
   (d) All of the above

4. Determining a percentage to be applied to a chosen benchmark (in relation to materiality) involves the exercise of ___________
   (a) Independence
   (b) Professional Judgement
   (c) Professional skepticism
   (d) All of the above
5. Which of the following is correct :
   (a) The auditor shall assemble the audit documentation in an audit file and complete the administrative process of assembling the final audit file on a timely basis after the date of the auditor's report.
   (b) The auditor shall assemble the audit documentation in an audit file and shall not complete the administrative process of assembling the final audit file.
   (c) The auditor shall assemble the audit documentation in an audit file and complete the administrative process of assembling the final audit file on a timely basis before the date of the auditor's report.
   (d) The auditor shall not assemble the audit documentation in an audit file.
6. Audit evidence includes
   (a) information contained in the accounting records underlying the financial statements
   (b) both information contained in the accounting records underlying the financial statements and other information.
   (c) other information.
   (d) information contained in the accounting records underlying the financial statements or other information.
7. Most of the auditor's work in forming the auditor's opinion consists of :
   (a) obtaining audit evidence.
   (b) evaluating audit evidence.
   (c) obtaining or evaluating audit evidence.
   (d) obtaining and evaluating audit evidence.
8. Audit risk is a function of the
   (a) risks of material misstatement and detection risk.
   (b) audit risk and detection risk.
   (c) control risk and detection risk.
   (d) inherent risk and detection risk.
9. Risk of material misstatement may be defined as the risk
   (a) that the financial statements are materially misstated after audit.
   (b) that the financial statements are materially misstated during audit.
   (c) that the financial statements are materially misstated prior to audit.
   (d) All of the above.

10. ____________refers to a difference between the amount, classification, presentation, or disclosure of a reported financial statement item and the amount, classification, presentation, or disclosure that is required for the item to be in accordance with the applicable financial reporting framework.

(a) Misstatement

(b) Error

(c) Fraud

(d) Any of the above

11. The auditor has no obligation to perform any audit procedures regarding the financial statements after the date of the auditor's report. However, when, after the date of the auditor's report but before the date the financial statements are issued, a fact becomes known to the auditor that, had it been known to the auditor at the date of the auditor's report, may have caused the auditor to amend the auditor's report, the auditor shall:

(a) Discuss the matter with management and, where appropriate, those charged with governance.

(b) Determine whether the financial statements need amendment.

(c) Inquire how management intends to address the matter in the financial statements.

(d) All of the above.

12. A request that the confirming party respond directly to the auditor only if the confirming party disagrees with the information provided in the request is-

(a) Positive confirmation request

(b) Non-response

(c) Exception

(d) Negative confirmation request

13. The auditor shall design and perform audit procedures in order to identify litigation and claims involving the entity which may give rise to a risk of material misstatement, including:

(a) Inquiry of management and, where applicable, others within the entity, including in-house legal counsel.

(b) Reviewing minutes of meetings of those charged with governance and correspondence between the entity and its external legal counsel.

(c) Reviewing legal expense accounts.

(d) All of the above.

14. If the auditor is unable to obtain sufficient appropriate audit evidence regarding the opening balances, the auditor shall express :

(a) a disclaimer opinion

(b) a qualified opinion

(c) a qualified opinion or a disclaimer of opinion, as appropriate, in accordance with SA 705.

(d) unmodified opinion

15. If, as a result of a misstatement resulting from fraud, the auditor encounters exceptional circumstances that bring into question his ability to continue performing the audit, he shall-

(a) Withdraw from the engagement immediately.

(b) Report to Audit team regarding withdrawal.

(c) Determine the professional and legal responsibilities applicable in the circumstances.

(d) Ask the management for his withdrawal.

16. It is a type of value-weighted selection in which sample size, selection and evaluation results in a conclusion in monetary amounts :

(a) Haphazard sampling

(b) Monetary Unit Sampling

(c) Stratified Sampling

(d) Interval sampling

17. Which of the following is correct :

(a) A firm whereof all the partners practising anywhere are qualified for appointment may be appointed by its firm name to be auditor of a company.

(b) A firm whereof majority of partners practising anywhere are qualified for appointment may be appointed by its firm name to be auditor of a company.

(c) A firm whereof all the partners practising in India are qualified for appointment may be appointed by its firm name to be auditor of a company.

(d) A firm whereof majority of partners practising in India are qualified for appointment may be appointed by its firm name to be auditor of a company.

18. As per **Section 139(6),** the first auditor of a company, other than a Government company, shall be appointed

(a) by the Board of Directors within 30 days from the date of registration of the company.

(b) by the audit committee within 30 days from the date of registration of the company.

(c) by the Managing Director within 30 days from the date of registration of the company.

(d) by the shareholders within 30 days from the date of registration of the company.

19. Where a company is required to constitute an Audit Committee under section 177,

(a) all appointments, including the filling of a casual vacancy of an auditor under this section shall be made after taking into account the recommendations of such committee.

(b) all appointments, excluding the filling of a casual vacancy of an auditor under this section shall be made after taking into account the recommendations of such committee.

(c) appointment of first auditors shall be made after taking into account the recommendations of such committee.

(d) appointment of subsequent auditors shall be made after taking into account the recommendations of such committee.

20. which of the following is incorrect :

(a) In terms of the general principles of law, any person having the lawful possession of somebody else's property, on which he has worked, may retain the property for non-payment of his dues on account of the work done on the property.

(b) Under section 128 of the Act, books of account of a company must be kept at the registered office. These provisions ordinarily make it impracticable for the auditor to have possession of the books and documents.

(c) The company provides reasonable facility to auditor for inspection of the books of account by directors and others authorised to inspect under the Act.

(d) working papers not being his own property, auditor can exercise lien on working papers.

(20 x 1 = 20 Marks)

Questions (21-25) carry 2 Marks each

21. You are at the planning stage for one of your firm's client XYZ Bank for the year ended 31 March 2018. The bank is a commercial bank that provides a number of products and services to the general public and other segments of the economy in the area of South Mumbai. You are assigned the audit of one of the branches of XYZ Bank. The audit engagement team was called to have a detailed discussion on the following matters. Which one of the following should not be included in the discussion for the audit of banks?

    (a) Discuss on the error of last year in the application of accounting policies of the bank.

    (b) Discuss on the method of fraud if any perpetrated by the bank employee within particular balances and/or disclosures

    (c) Discuss with the team the appointment and remuneration to be received on this bank audit.

    (d) Discuss the effect of the results of the risk assessment procedures on other aspects to decide the nature, timing and extent of further audit procedures.

22. Which of the following is correct :

    (a) When reporting on prior period financial statements in connection with the current period's audit, if the auditor's opinion on such prior period financial statements differs from the opinion the auditor previously expressed, the auditor need not disclose the substantive reasons for the different opinion.

    (b) When reporting on prior period financial statements in connection with the current period's audit, if the auditor's opinion on such prior period financial statements differs from the opinion the auditor previously expressed, the auditor shall disclose the substantive reasons for the different opinion in an Other Matter paragraph in accordance with SA 706.

    (c) When reporting on prior period financial statements in connection with the current period's audit, if the auditor's opinion on such prior period financial statements differs from the opinion the auditor previously expressed, the auditor shall disclose the substantive reasons for the different opinion in an emphasis of Matter paragraph in accordance with SA 706.

    (d) When reporting on prior period financial statements in connection with the current period's audit, if the auditor's opinion on such prior period financial statements differs from the opinion the auditor previously expressed, the auditor shall disclose the substantive reasons for the different opinion in an Other Matter paragraph or emphasis of matter paragraph in accordance with SA 706.

23. Which of the following is incorrect :

    (a) 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;

(b) Communicating key audit matters in the auditor's report is not a substitute for the auditor expressing a modified opinion when required by the circumstances of a specific audit engagement in accordance with SA 705 (Revised);

(c) Communicating key audit matters in the auditor's report is not a substitute for reporting in accordance with SA 570 when a material uncertainty exists relating to events or conditions that may cast significant doubt on an entity's ability to continue as a going concern;

(d) Communicating key audit matters in the auditor's report is a substitute for the auditor expressing a modified opinion when required by the circumstances of a specific audit engagement in accordance with SA 705 (Revised);

24. One of your junior audit team members is confused with the term 'material misstatement'. You explain him that a material misstatement is untrue information in a financial statement that could affect the financial decisions of one who relies on the statement. Which of the following would constitute material misstatement?

(1) An error of Rs.5,000 in relation to assets of Rs.20 lakhs.

(2) A payroll fraud of Rs.100 in a company where profit before tax is Rs.11,000.

(3) Non-disclosure of a material uncertainty.

(4) Financial statements have been prepared on a going concern basis when the company is in the process of being liquidated.

(a) 1 and 2

(b) 3 and 4

(c) 2 and 3

(d) 1 and 4

25. Springfield Hospital located in the rural area of Lonawala region is a government hospital run by the local doctors who are appointed by the government. The hospital was registered on 1 October 2018. Which of the following is correct in respect of the appointment of the first auditor for Springfield Hospital?

(a) The Board of Directors of the hospital have appointed the first auditor on 5th November 2018.

(b) The Comptroller Auditor-General of India appointed the first auditor on 15th December 2018.

(c) Since the Comptroller Auditor-General of India did not appoint the first auditor, the Board of Director appointed the first auditor on 15th December 2018.

(d) Since the Comptroller Auditor-General of India did not appoint the first auditor, the Board of Director appointed the first auditor on 10th November 2018. **(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) The objective of audit is to obtain absolute assurance about whether the financial statements as a whole are free from material misstatement.

(ii) The preparation of financial statements does not involve judgment by management in applying the requirements of the entity's applicable financial reporting framework to the facts and circumstances of the entity.

(iii) There is no need to put the nature of engagement to writing.

(iv) Few members of the Board of Directors oppose the appointment of Mr. N, an employee of the company, as an Internal Auditor, stating that Mr. N is not a chartered accountant and further he is an employee of the company.

(v) PQR & Co., Chartered Accountants, resigned from the audit of a Government Company and filed the resignation with the company and the registrar within 30 days. Comment, whether PQR & Co. has complied with the provisions of the Companies Act, 2013.

(vi) The statutory auditor of ABC Ltd. is of the opinion that communicating key audit matters in the auditor's report constitutes a substitute for disclosure in the financial statements.

(vii) Sample size is not a valid criterion to distinguish between statistical and non-statistical approaches.

(viii) The risk of not detecting a material misstatement resulting from fraud is higher than the risk of not detecting one resulting from error. **(7 x 2 = 14 Marks)**

2. Discuss the following:

(a) The auditor shall comply with relevant ethical requirements, including those pertaining to independence, relating to financial statement audit engagements. **(3 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) M & Co. was appointed as auditor of IGI Ltd. As an auditor what are the factors that would be considered in the development of overall audit plan? **(4 Marks)**

(d) The Auditor is fully satisfied with the audit of an entity in respect of its systems and procedures and wants to issue a report without any hesitation. What type of opinion can be given and give reasoning. **(3 Marks)**

3. (a) State the matters to be included in the auditor's report as per CARO, 2016, regarding:

(i) Private Placement of Preferential Issues. **(2 Marks)**

(ii) Utilisation of IPO and further public offer. **(2 Marks)**

(b) Briefly discuss the limitations of Internal Control. **(4 Marks)**

(c) What are the provisions prescribed under Companies Act, 2013 in respect of ceiling on number of audits in a company to be accepted by an auditor? **(3 Marks)**

(d) While planning the audit of S Ltd. you want to apply sampling techniques. What are the risk factors you should keep in mind? **(3 Marks)**

4. (a) During the audit of PQR Ltd. you as an auditor requested officers of the company to have access to secretarial records and correspondence which they refused to provide. Comment. **(4 Marks)**

(b) Substantive analytical procedures are generally more applicable to large volumes of transactions that tend to be predictable over time. Explain. **(4 Marks)**

(c) Write the circumstances that indicate the possibility of fraud due to problematic or unusual relationship between the auditor and management. **(6 Marks)**

5. (a) The auditor P of PAR and Co., a firm of Chartered Accountants is conducting audit of AB Industries Ltd. The auditor requests management to provide Banker's certificate in support of Fixed deposits whereas management provides only written representation on the matter.

   Discuss how would you deal as an auditor. **(3 Marks)**

   (b) What are the special steps involved in conducting the audit of an Educational Institution? **(8 Marks)**

   (c) Audit evidence includes both information contained in the accounting records underlying the financial statements and other information. Discuss. **(3 Marks)**

6. (a) How will you vouch/verify Rental Receipts. **(4 Marks)**

   (b) 'In vouching payments, the auditor does not merely check proof that money has been paid away.' Discuss. **(4 Marks)**

OR

   (c) The auditor's report shall include a section with a heading "Responsibilities of Management for the Financial Statements." SA 200 explains the premise, relating to the responsibilities of management and, where appropriate, those charged with governance, on which an audit in accordance with SAs is conducted. Explain **(4 Marks)**

   (d) How will you vouch and/or verify the following:

   (i) Purchase of quoted investment. **(3 Marks)**

   (ii) Discounted bill receivable dishonoured. **(3 Marks)**

MOCK TEST PAPER – 2

INTERMEDIATE (IPC) OLD COURSE: GROUP – II

PAPER – 6 : AUDITING AND ASSURANCE

SUGGESTED ANSWERS/HINTS

Division A - Multiple Choice Questions

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

Division B - Descriptive Answers

1. (i) **Incorrect:** The objective of audit is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement. In auditing, reasonable assurance can be given which is high level assurance but not absolute assurance. The auditor is not expected to, and cannot, reduce audit risk to zero and cannot therefore obtain absolute assurance that the financial statements are free from material misstatement due to fraud or error. This is because there are inherent limitations of an audit.

(ii) Incorrect: The preparation of financial statements involves judgment by management in applying the requirements of the entity's applicable financial reporting framework to the facts and circumstances of the entity. In addition, many financial statement items involve subjective decisions or assessments or a degree of uncertainty, and there may be a range of acceptable interpretations or judgments that may be made.

(iii) Incorrect: It is important, both for the auditor and client, that each party should be clear about the nature of the engagement. It must be reduced to writing and should exactly specify the scope of the work.

(iv) Incorrect: As per section 138, the internal auditor shall either be a chartered accountant or a cost accountant (whether engaged in practice or not), or such other professional as may be decided by the Board to conduct internal audit of the functions and activities of the companies. The internal auditor may or may not be an employee of the company.

(v) Incorrect: As per **section 140(2)** the auditor who has resigned from the company shall file within a period of 30 days from the date of resignation, a statement in the prescribed **Form** with the company and the Registrar, and in case of the companies referred to in **section 139(5)** i.e. Government company, the auditor shall also file such statement with the Comptroller and Auditor-General of India, indicating the reasons and other facts as may be relevant with regard to his resignation. In this case, the PQR & Co., was also required to file prescribed Form with C & AG of India but it did not file the same. Therefore, it did not comply with the provisions of the Companies Act, 2013.

(vi) Incorrect*:* 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.

(vii) Correct: The decision whether to use a statistical or non-statistical sampling approach is a matter for the auditor's judgment; however, sample size is not a valid criterion to distinguish between statistical and non-statistical approaches.

Whatever may be the approach non-statistical or statistical sampling, the sample must be representative. This means that it must be closely similar to the whole population although not necessarily exactly the same. The sample must be large enough to provide statistically meaningful results.

(viii) Correct: The risk of not detecting a material misstatement resulting from fraud is higher than the risk of not detecting one resulting from error. This is because fraud may involve sophisticated and carefully organized schemes designed to conceal it, such as forgery, deliberate failure to record transactions, or intentional misrepresentations being made to the auditor. Such attempts at concealment may be even more difficult to detect when accompanied by collusion

2. (a) Ethical Requirements Relating to an Audit of Financial Statements: The auditor shall comply with relevant ethical requirements, including those pertaining to independence, relating to financial statement audit engagements. Relevant ethical requirements ordinarily comprise the Code of Ethics for Professional Accountants (IESBA Code) related to an audit of financial statements.

The Code establishes the following as the fundamental principles of professional ethics relevant to the auditor when conducting an audit of financial statements :

(a) Integrity;

(b) Objectivity;

(c) Professional competence and due care;

(d) Confidentiality; and

(e) Professional behavior.

(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) **Development of an Overall Plan:** The auditor should consider the following matters in developing his overall plan for the expected scope and conduct of the audit-

- The terms of his engagement and any statutory responsibilities.
- The nature and timing of reports or other communication.
- The applicable legal or statutory requirements.
- The accounting policies adopted by the client and changes in those policies.
- The effect of new accounting or auditing pronouncements on the audit.
- The identification of significant audit areas.
- The setting of materiality levels for audit purposes.
- Conditions requiring special attention, such as the possibility of material error or fraud or the involvement of parties in whom directors or persons who are substantial owners of the entity are interested and with whom transactions are likely.
- The degree of reliance he expects to be able to place on accounting system and internal control.
- Possible rotation of emphasis on specific audit areas.
- The nature and extent of audit evidence to be obtained.
- The work of internal auditors and the extent of their involvement, if any, in the audit.
- The involvement of other auditors in the audit of subsidiaries or branches of the client.
- The involvement of experts.
- The allocation of work to be undertaken between joint auditors and the procedures for its

control and review.

- Establishing and coordinating staffing requirements.

(d) Unqualified Opinion:

1. An unqualified opinion should be expressed when the auditor concludes that the financial statements give a true and fair view in accordance with the financial reporting framework used for the preparation and presentation of the financial statements.
2. An unqualified opinion indicates, implicitly, that any changes in the accounting principles or in the method of their application, and the effects thereof, have been properly determined and disclosed in the financial statements.
3. An unqualified opinion also indicates that:
   (i) the financial statements have been prepared using the generally accepted accounting principles, which have been consistently applied;
   (ii) the financial statements comply with relevant statutory requirements and regulations; and
   (iii) there is adequate disclosure of all material matters relevant to the proper presentation of the financial information, subject to statutory requirements, where applicable.

3. (a) (i) The auditor is required to report as per clause xiv of paragraph 3 of CARO 2016, whether the company has made any preferential allotment or private placement of shares or fully or partly convertible debentures during the year under review and if so, as to whether the requirement of section 42 of the Companies Act, 2013 have been complied with and the amount raised have been used for the purposes for which the funds were raised. If not, provide the details in respect of the amount involved and nature of non-compliance;

(ii) It is duty of the auditor to report as per clause ix of paragraph 3 of CARO 2016, whether moneys raised by way of initial public offer or further public offer (including debt instruments) and term loans were applied for the purposes for which those are raised. If not, the details together with delays or default and subsequent rectification, if any, as may be applicable, be reported.

(b) Limitations of Internal Control:

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

(ii) Human judgment in decision-making: Realities that human judgment in decision-making can be faulty and that breakdowns in internal control can occur because of human error.

(iii) Lack of understanding the purpose: Equally, the operation of a control may not be effective, such as where information produced for the purposes of internal control (for example, an exception report) is not effectively used because the individual responsible for reviewing the information does not understand its purpose or fails to take appropriate action.

(iv) Collusion among People: Additionally, controls can be circumvented by the collusion of two or more people or inappropriate management override of internal control. **For example**, management may enter into side agreements with customers that alter the terms and conditions of the entity's standard sales contracts, which may result in improper revenue recognition. Also, edit checks in a software program that are designed to identify and report transactions that exceed specified credit limits may be overridden or disabled.

(v) Judgements by Management: Further, in designing and implementing controls, management may make judgments on the nature and extent of the controls it chooses to implement, and the nature and extent of the risks it chooses to assume.

(vi) Limitations in case of Small Entities: Smaller entities often have fewer employees due to which segregation of duties is not practicable. However, in a small owner-managed entity, the owner-manager may be able to exercise more effective oversight than in a larger entity. This oversight may compensate for the generally more limited opportunities for segregation of duties.

On the other hand, the owner-manager may be more able to override controls because the system of internal control is less structured. This is taken into account by the auditor when identifying the risks of material misstatement due to fraud.

(c) Ceiling on number of Audits:

1. Section 141(3)(g) of the Companies Act, 2013 prescribes that a person shall not be eligible for appointment as an auditor of a company namely – a person who is in full time employment elsewhere or a person or a partner of a firm holding appointment as its auditor, if such person or partner is at the date of such appointment or reappointment holding appointment as auditor of more than twenty companies other than one person companies, dormant companies, small companies and private companies having paid-up share capital less than ` 100 crore.

2. In the case of a firm of auditors, it has been further provided that 'specified number of companies' shall be construed as the number of companies specified for every partner of the firm who is not in full time employment elsewhere. This limit of 20 company audits is per person. In the case of an audit firm having 3 partners, the overall ceiling will be 3 × 20 = 60 company audits.

3. Sometimes, a chartered accountant is a partner in a number of auditing firms. In such a case, all the firms in which he is partner or proprietor will be together entitled to 20 company audits on his account. Subject to the overall ceiling of company audits, how they allocate the 20 audits between themselves is their affairs.

(d) Risk Factors while applying Sampling Techniques: As per SA 530 "Audit Sampling", sampling risk is the risk that the auditor's conclusion based on a sample may be different from the conclusion if the entire population were subjected to the same audit procedure. Sampling risk can lead to two types of erroneous conclusions-

(i) In the case of a test of controls, that controls are more effective than they actually are, or in the case of tests of details, that a material misstatement does not exists when in fact it does. The auditor is primarily concerned with this type of erroneous conclusion because it affects audit effectiveness and is more likely to lead to an inappropriate audit opinion.

(ii) In the case of test of controls, the controls are less effective than they actually are, or in the case of tests of details, that a material misstatements exists when in fact it does not. This type of erroneous conclusion affects audit efficiency as it would usually lead to additional work to establish that initial conclusions were incorrect.

4. (a) Right of Access to secretarial records and correspondence:

1. Section 143(1) of the Companies Act, 2013 grants powers to the auditor that every auditor has a right of access, at all times, to the books of account and vouchers of the company kept at Registered or Head Office, branches and subsidiaries in the case of a Holding Company for conducting the audit.

2. Further, he is also entitled to require from the officers of the company such information and explanations which he considers necessary for the proper performance of his duties as Auditor. Therefore, he has a statutory right to inspect the secretarial records and

correspondence.

3. In order to verify actions of the company and to vouch and verify some of the transactions of the company, it is necessary for the auditor to refer to the decisions of the shareholders and/or the directors of the company. It is, therefore, essential for the auditor to refer to the secretarial records and correspondence which also includes Minute book. In the absence of the same, the auditor may not be able to vouch/verify certain transactions of the company.

4. The refusal to provide access to secretarial records and correspondence shall constitute limitation of scope as far as the auditor's duties are concerned.

5. The auditor may examine whether by performing alternative procedures, the auditor can substantiate the assertions or else he shall have to either qualify the report or give a disclaimer of opinion.

(b) Substantive Analytical Procedure: Substantive analytical procedures are generally more applicable to large volumes of transactions that tend to be predictable over time. The application of planned analytical procedures is based on the expectation that relationships among data exist and continue in the absence of known conditions to the contrary. However, the suitability of a particular analytical procedure will depend upon the auditor's assessment of how effective it will be in detecting a misstatement that, individually or when aggregated with other misstatements, may cause the financial statements to be materially misstated.

In some cases, even an unsophisticated predictive model may be effective as an analytical procedure. For example, where an entity has a known number of employees at fixed rates of pay throughout the period, it may be possible for the auditor to use this data to estimate the total payroll costs for the period with a high degree of accuracy, thereby providing audit evidence for a significant item in the financial statements and reducing the need to perform tests of details on the payroll. The use of widely recognised trade ratios (such as profit margins for different types of retail entities) can often be used effectively in substantive analytical procedures to provide evidence to support the reasonableness of recorded amounts.

(c) Problematic or unusual relationships between the auditor and management, including:

1. Denial of access to records, facilities, certain employees, customers, vendors, or others from whom audit evidence might be sought.

2. Undue time pressures imposed by management to resolve complex or contentious issues.

3. Complaints by management about the conduct of the audit or management intimidation of engagement team members, particularly in connection with the auditor's critical assessment of audit evidence or in the resolution of potential disagreements with management.

4. Unusual delays by the entity in providing requested information.

5. Unwillingness to facilitate auditor access to key electronic files for testing through the use of computer-assisted audit techniques.

6. Denial of access to key IT operations staff and facilities, including security, operations, and systems development personnel.

7. An unwillingness to add or revise disclosures in the financial statements to make them more complete and understandable.

8. An unwillingness to address identified deficiencies in internal control on a timely basis.

9. Unwillingness by management to permit the auditor to meet privately with those charged with governance

10. Accounting Policy that appears to be variance with industry norms

11. Frequent changes in accounting estimates that do not appear to result from changed

circumstances

12. Tolerance of variations in the entity's code of conduct

5. (a) Although written representations provide necessary audit evidence, they do not provide sufficient appropriate audit evidence on their own about any of the matters with which they deal. Furthermore, the fact that management has provided reliable written representations does not affect the nature or extent of other audit evidence that the auditor obtains about the fulfillment of management's responsibilities, or about specific assertions.

Applying the above to the given problem, the auditor would further request the management to provide him with the Banker's certificate in support of fixed deposits held by the company.

(b) The Special Steps Involved in the Audit of an Educational Institution are the following:

(i) Examine the Trust Deed, or Regulations in the case of school or college and note all the provisions affecting accounts. In the case of a university, refer to the Act of Legislature and the Regulations framed thereunder.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

(c) Audit evidence may be defined as the information used by the auditor in arriving at the conclusions on which the auditor's opinion is based. Audit evidence includes both information contained in the accounting records underlying the financial statements and other information.

Explaining this further, audit evidence includes:-

(1) Information contained in the accounting records: Accounting records include the records of initial accounting entries and supporting records, such as checks and records of electronic fund transfers; invoices; contracts; the general and subsidiary ledgers, journal entries and other adjustments to the financial statements that are not reflected in journal entries; and records such as work sheets and spreadsheets supporting cost allocations, computations, reconciliations and disclosures.

(2) Other information that authenticates the accounting records and also supports the auditor's rationale behind the true and fair presentation of the financial statements: Other information which the auditor may use as audit evidence includes, for example minutes of the meetings, written confirmations from trade receivables and trade payables, manuals containing details of internal control etc. A combination of tests of accounting records and other information is generally used by the auditor to support his opinion on the financial statements.

6. (a) Rental Receipts:

(i) Check copies of bills or rent receipt issued to the tenant with reference to tenancy agreement and bills of charges paid by the landlord on behalf of tenants.

(ii) The entries in the rental register in respect of rent accrued should be traced with reference to copies of rental bills.

(iii) Scrutinize the account of collecting agent when the rent is collected by such agent.

(iv) Vouch the entries for rent received in advance and ensure proper adjustment is made.

(v) Investigate into abnormal rent outstanding.

(vi) Reconcile the outstanding rent and see that proper provision is made if unrecoverable.

(vii) If rent is received net of TDS, see that rent income is shown at gross and TDS is shown in Balance Sheet as advance Tax.

(b) Vouching- Backbone of Auditing: Vouching is a substantive audit procedure which aims at verifying the genuineness and validity of a transaction contained in the accounting records. It involves examination of documentary evidence to support the genuineness of transaction. Thus the object of vouching is not merely to ascertain that money has been paid away; but the auditor aims to obtain reasonable assurance in respect of following assertions in regard to transactions recorded in the books of account that –

(i) a transaction is recorded in the proper account and revenue or expense is properly allocated to the accounting period;

(ii) a transaction pertains to entity and took place during the relevant period;

(iii) all transactions which have actually occurred have been recorded;

(iv) all transactions were properly authorised; and

(v) transactions have been classified and disclosed in accordance with recognised accounting policies and practices.

Thus, it is through vouching that the auditor comes to know the genuineness of transactions recorded in the client's books of account wherefrom the financial statements are drawn up.

Apart from genuineness, vouching also helps the auditor to know the regularity and validity of the transaction in the context of the client's business, nature of the organisation and organisational rules.

Thus, the auditor's basic duty is to examine the accounts, not merely to see its arithmetical accuracy but also to see its substantial accuracy and then to make a report thereon.

This substantial accuracy of the accounts and emerging financial statements can be known principally by examination of vouchers which are the primary documents relating to the transactions. If the primary document is wrong or irregular, the whole accounting statement would, in turn, become wrong and irregular. Precisely auditor's role is to see whether or not the financial statements are wrong or irregular, and for this, vouching is simply imperative. Thus, vouching which has traditionally been the backbone of auditing does not merely involve checking arithmetical accuracy but goes much beyond and aims to check the genuineness as well as validity of transactions contained in accounting records.

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

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

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

(a) **Preparing the financial statements** in accordance with the applicable financial reporting framework, **and for such internal control** as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error;[because of the possible effects of fraud on other aspects of the audit, materiality does not apply to management's acknowledgement regarding its responsibility for the design, implementation, and maintenance of internal control (or for establishing and maintaining effective internal control over financial reporting) to prevent and detect fraud.] and

(b) **Assessing the entity's ability to continue as a going concern** and whether the use of the going concern basis of accounting is appropriate as well as disclosing, if applicable, matters relating to going concern. The explanation of management's responsibility for this assessment shall include a description of when the use of the going concern basis of accounting is appropriate.

(d) (i) Purchase of Quoted Investment:

(i) Ascertain the date of purchase, rate of purchase, nature of investments purchased and nature of transaction, i.e., error cum-dividend/ interest/right/bonus.

(ii) Compare the rate of purchase with quotation available. Obtain suitable explanations in case of significant variations.

(iii) Verify the amount paid towards purchase of investments.

(iv) Trace the amount in the cheque book counterfoils and bank statements.

(v) Obtain a schedule of investment from Management for physical verification at the year end.

(vi) Verify the investment certificate to confirm title.

(vii) Confirm compliance with statutory provisions such as 143(1) of the Companies Act, 2013.

(viii) Verify whether investments are duly disclosed in financial statements in accordance with recognized accounting policies and practices and relevant statutory requirements.

(ii) Discounted Bill Receivable Dishonoured:

(i) Obtain the schedule of discounted bills receivable dishonoured.

(ii) Check the entry in bank statement regarding the amount of bills dishonoured and see that the bank has debited the account of client.

(iii) Verify the bills receivable returned by the bank along with bank's advice.

(iv) See that the dishonoured bills have been noted and protested by following the proper procedure and the account of the drawee or the trade receivable is also debited.

(v) Check that bank commission, if any, charged by the bank has been recovered from the party.

Test Series: April, 2019

MOCK TEST PAPER – 2

INTERMEDIATE (IPC) OLD COURSE: GROUP – II

PAPER – 7: INFORMATION TECHNOLOGY AND STRATEGIC MANAGEMENT

SECTION – A: INFORMATION TECHNOLOGY

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

Multiple Choice Questions

Question Nos. 1 to 5 carries 2 Marks each.

1. Which of the following is not a part of DMAIC in Six Sigma Life Cycle?

   (a) Define

   (b) Measure

   (c) Audit

   (d) Control

2. The process that brings tasks that exist across multiple computers and different business departments or branches under one umbrella is called as _______.

   (a) Automation

   (b) Integration

   (c) Orchestration

   (d) Orientation

3. In computer networks, Protocol defines the following aspects of digital communication except _______.

   (a) Source

   (b) Semantics

   (c) Timing

   (d) Syntax

4. Arrange sequentially following steps that are involved during the processing of Credit card.

   (i) Authorization (ii) Clearing (iii) Funding (iv) Batching

   (a) (i), (iv), (ii), (iii)

   (b) (i), (ii), (iii), (iv)

   (c) (iv), (iii), (ii), (i)

   (d) (ii), (iii), (i), (iv)

5. Evaluation of examination answer sheets, ticket checking by railway staff in trains and billing done by small medical shops are all types of ___________processing.

   (a) Computerised

   (b) Manual

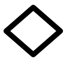
   (c) Paper based

   (d) Real time Processing **(5 x 2 = 10 Marks)**

Question Nos. 6 to 10 carries 1 Marks each.

6. Entity-Relationship (ER) Diagram, Data Flow Diagram, Flowcharts all use graphical symbols. All symbols given are used in all three except one.

   (a) 

   (b) 

   (c) 

   (d) 

7. Which of the following is not true about Secondary Storage memory devices?

   (a) Random Access Memory (RAM) is an example of Secondary Storage device.

   (b) Greater capacity (they are available in large size).

   (c) Non-volatile (contents are permanent in nature).

   (d) Slow speed (slower in speed compared to registers or primary storage).

8. In Open Systems Interconnection (OSI) Model, _____________ provides for full-duplex, half-duplex or simplex operation; and establishes check pointing; adjournment, termination, and restart procedures.

   (a) Network Layer

   (b) Presentation Layer

   (c) Transport Layer

   (d) Session Layer

9. 5 Right's, namely; Right Time, Right Customer, Right Price, Right Place and Right Product are part of __________.

   (a) ERP

   (b) CRM

   (c) SCM

   (d) CBS

10. A system that triggers action on its own without user control is best classified as _____.

   (a) Batch Process System

   (b) Online Process System

   (c) Real-time Process System

   (d) Immediate Process System **(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) Discuss the architecture of Cloud Computing. **(3 Marks)**

   (b) Define the objectives of Business Process Automation (BPA). **(2 Marks)**

2. (a) Client/Server networks have become predominate information architecture of enterprise computing that satisfies the business need by appropriate allocating the application processing between the client and the server processors. Determine its working. **(6 Marks)**

(b) Explain the steps involves in the Data Processing Cycle. **(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, the phase "System Implementation" is also one of the major phase in System Development Life Cycle (SDLC). Determine the major activities involved in this phase. **(6 Marks)**

   (b) Identify the benefits of Business Reporting for micro-businesses and small to medium enterprises. **(4 Marks)**

4. (a) Usually auditors cannot examine and evaluate all the data processing carried out within an organization. They need guidelines that will direct them toward those aspects of the information systems function in which material losses or account misstatements are most likely to occur. Prepare an extensive list of all the Communication Controls under Boundary Systems that an Auditor can refer to while performing IS Audit. **(6 Marks)**

   (b) Identify the differences between Explicit Knowledge and Tacit Knowledge. **(4 Marks)**

5. (a) Research has identified some key factors for Business Process Reengineering (BPR) projects to succeed. Determine the factors that are considered vital for the success of the BPR Projects. **(6 Marks)**

   (b) Discuss about Anti-Malware. **(4 Marks)**

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) Select the correct statement out of the following:

    (a) Environmental factors are totally beyond the control of a single industrial enterprise.

    (b) Environmental factors are largely beyond the control of a single industrial enterprise.

    (c) Environmental factors are totally within the control of a single industrial enterprise.

    (d) None of the above.

    (ii) The three stages of strategic management are:

    (a) Strategy assessment, strategy execution, and strategy evaluation.

    (b) Strategy formulation, strategy implementation, and strategy evaluation.

    (c) Strategy formulation, strategy implementation, and strategy execution.

    (d) Strategy formulation, strategy execution, and strategy assessment.

    (iii) Which of the following does "B" stand for in the BCG Matrix?

    (a) Boom

    (b) Balance

    (c) Bankruptcy

    (d) Boston

    (iv) Focus strategies are _________ when consumers have _________ preferences and when rival firms are not attempting to specialize in the same target segment.

    (a) effective, no

    (b) effective, distinctive

    (c) ineffective, clear

    (d) fragmented, fragmented

    (v) A core competence is a ________ of an organization which may not be shared by others.

    (a) Unique strength

    (b) Unique opportunity

    (c) Unique product

    (d) None of the above

    (vi) When strategic management is ineffective and operational management is efficient, organization will:

    (a) Thrive.

    (b) Survive.

    (c) Die Slowly.

    (d) Die Quickly.

    (vii) The following statistical technique forms base of six sigma:

    (a) Mean and Median.

(b) Correlation.

(c) Standard deviation.

(d) Probability and normal distribution.

(viii) Read the following three statements:

(i) The environment is constantly changing in nature.

(ii) Various environmental constituents exist in isolation and do not interact with each other.

(iii) The environment has a far reaching impact on organizations.

From the combinations given below select an alternative that represent statements that are true:

(a) (i) and (ii).

(b) (ii) and (iii)

(c) (i) and (iii)

(d) (i), (ii) and (iii)

(ix) The first step of strategy formulation in strategic management model is:

(a) Undertake internal analysis.

(b) Undertake external analysis.

(c) Set major objectives.

(d) Determine vision and mission.

(x) In BCG matrix, the cash cows represents:

(a) High market share and Low market growth

(b) High market share and High market growth

(c) Low market share and Low market growth

(d) Low market share and High market growth

(xi) If a firm attempts to gain a competitive advantage primarily by reducing its economic costs below its competitor, it is pursuing:

(a) Cost leadership strategy

(b) Differentiation strategy

(c) Divisionalization

(d) None of these

(xii) Functional managers need ________ from the business strategy in order to _______.

(a) to function, control

(b) guidance, make decisions

(c) money, purchase raw material.

(d) None of the above

(xiii) Strategic implementation activities includes:

(a) Accomplishing annual objectives

(b) Measuring performance

(c) Preparing a TOWS matrix

(d) Conducting research

(xiv) Which of the following statements is true:

(a) Internet has no strategic relation with an organisation engaged in manufacturing.

(b) Internet has no strategic relation with an organisation in service sector.

(c) Internet has opened up new opportunities for organisations engaged in manufacturing activities.

(d) Use of Internet is restricted to sending and receiving mails in business organisations.

(xv) An important activity in __________ is taking corrective action.

(a) Strategy evaluation

(b) Strategy implementation

(c) Strategy formulation

(d) Strategy leadership ***(15 x 1 = 15 Marks)***

2. Airlines industry in India is highly competitive with several players. Businesses face severe competition and aggressively market themselves with each other. Luxury Jet is a private Delhi based company with a fleet size of 9 small aircrafts with seating capacity ranging between 6 seats to 9 seats. There aircrafts are chartered by big business houses and high net worth individuals for their personalised use. With customised tourism packages their aircrafts are also often hired by foreigners. Identify and explain the Michael Porter's Generic Strategy followed by Luxury Jet. ***(5 Marks)***

3. (a) "Business environment exhibits many characteristics." Explain. ***(5 Marks)***

(b) What does corporate strategy ensure? Explain. ***(5 Marks)***

4. (a) Explain the concept of Experience Curve and highlight its relevance in strategic management. ***(5 Marks)***

(b) Distinguish between Top-Down and Bottom-Up Strategic Planning. ***(5 Marks)***

5. (a) Enlist the components of marketing mix. ***(5 Marks)***

(b) Write a short note on importance of corporate culture. ***(5 Marks)***

6. (a) "Firms can use benchmarking process to achieve improvement in diverse range of management functions." Elucidate. ***(5 Marks)***

(b) Distinguish between Inbound logistics and outbound logistics. ***(5 Marks)***

Test Series: April, 2019

MOCK TEST PAPER – 2

INTERMEDIATE (IPC) OLD COURSE: GROUP – II

PAPER – 7: INFORMATION TECHNOLOGY AND STRATEGIC MANAGEMENT

SECTION – A: INFORMATION TECHNOLOGY

ANSWERS

MULTIPLE CHOICE QUESTIONS

1. (c) Audit

2. (c) Orchestration

3. (a) Source

4. (a) (i), (iv), (ii), (iii)

5. (b) Manual

6. (b) ◇

7. (a) Random Access Memory (RAM) is an example of Secondary Storage device.

8. (d) Session Layer

9. (c) SCM

10. (c) Real-time Process System

DESCRIPTIVE QUESTIONS

1. (a) A Cloud Computing architecture consists of two parts - **Front End** and a **Back End** that connect to each other through a network, usually the Internet. The front end is the side the computer user, or client, sees. The back end is the "cloud" section of the system.

- **Front End:** The Front End of the cloud computing system comprises of the client's devices (or it may be a computer network) and some applications are needed for accessing the cloud computing system. All the cloud computing systems do not give the same interface to users. For example-Web services like electronic mail programs use some existing web browsers such as Firefox, Microsoft's internet explorer or Apple's Safari. Other types of systems have some unique applications which provide network access to its clients.
- **Back End:** The Back End refers to some physical peripherals. In cloud computing, the back end is cloud itself which may encompass various computer machines, data storage systems and servers. Groups of these clouds make a whole cloud computing system. Theoretically, a cloud computing system can include practically any type of web application program such as video games to applications for data processing, software development and entertainment residing on its individual dedicated server for services. There are some set of rules, generally called as Protocols which are followed by this server and it uses a special type of software known termed as Middleware that allow computers that are connected on networks to communicate with each other.

(b) The success of any Business Process Automation shall only be achieved when BPA ensures the following:

- **Confidentiality:** To ensure that data is only available to persons who have right to see the same;
- **Integrity:** To ensure that no un-authorized amendments can be made in the data;

- ♦ **Availability:** To ensure that data is available when asked for; and
- ♦ **Timeliness:** To ensure that data is made available in at the right time.

2. (a) **Client:** A client is a single-user workstation that provides a presentation services and the appropriate computing, connectivity and the database services relevant to the business need.

Server: A server is one or more multi-user processors with shared memory providing computing, connectivity and the database services and the interfaces relevant to the business need.

Working of a Client/Server Network is discussed below:

- Servers are typically powerful computers running advanced network operating systems. Servers can host e-mail; store common data files and serve powerful network applications such as Microsoft's SQL Server. As a centerpiece of the network, the server validates login to the network and can deny access to both networking resources as well as client software.
- End user Personal Computer or Network Computer workstations are the Clients.
- Clients are interconnected by local area networks and share application processing with network servers, which also manage the networks. Client and Server can operate on separate computer platforms.
- Either the client platform or the server platform can be upgraded without having to upgrade the other platform.
- The server is able to service multiple clients concurrently; in some client/server systems, clients can access multiple servers.
- Action is usually initiated at the client end, not the server end.
- The network system implemented within the client/server technology is commonly called by the computer industry as **Middleware**. Middleware is all the distributed software needed to allow clients and servers to interact. General Middleware allows for communication, directory services, queuing, distributed file sharing, and printing.

(b) The Data Processing Cycle consists of following basic steps with alerts, controls and feedback at each step:

- **Data input** - Involves the activities like capturing the data, implementing control procedures, recording in journals, posting to ledgers and preparation of reports.
- **Data storage** - Involves organizing the data in master file or reference file of an automated system for easy and efficient access.
- **Data processing** - Involves addition, deletion and updating of the data in the transaction file, master file or reference file.
- **Information output** - Involves generation of documents and managerial reports in printable or electronic form for addressing queries, to control operational activities and help the management in decision making.

The controls on the data are maintained using Audit Trials. This is done by capturing snapshots or by tracing the flow of data. This provides a means to check the accuracy and validity of ledger postings.

3. (a) The Phase **"System Implementation"** in System Development Life Cycle (SDLC) examines that 'How will the Solution be put into effect'? This phase involves the following steps:

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

In **Installation**, there are following major activities:

- Installing the new hardware, which may involve extensive re-cabling and changes in office layouts;
- **Training** the users on the new system; and
- **Conversion** of master files to the new system or creation of new master files.

In **Conversion**, there are following major activities:

- **Direct Changeover:** The user stops using the old system one particular day and starts using the new system from thereon, usually over a weekend or during a slack period.
- **Parallel Conversion:** The old system continues alongside the new system for a few weeks or months.
- **Phased Conversion:** Used with larger systems that can be broken down into individual modules which can be implemented separately at different times.
- **Pilot Conversion:** New system will first be used by only a portion of the enterprise, for example at one branch or factory.

(b) Benefits for micro-businesses and small to medium enterprises are as follows:

- **Paperless lodgment -** Eliminates the hassle of paper work and associated costs;
- **Electronic record keeping –** Stores the reports securely in the accounting or bookkeeping system;
- **Pre-filled forms -** Reports are automatically pre-filled with information existing in the accounting or bookkeeping system, as well as from information held by government, saving valuable time;
- **Ease of sharing –** Sharing between client, accountant, tax agent or bookkeeper for checking;
- **Secure AUSkey authentication -** AUSkey is a common authentication solution for business-to-government online services.
- **Same-time validation -** receive a fast response that any lodgment has been received.

4. (a) Communication Controls: Components in the communication subsystem are responsible for transporting data among all the other subsystems within a system and for transporting data to or receiving data from another system. Three types of exposure arise in the communication subsystem.

- o As data is transported across a communication subsystem, it can be impaired through attenuation, delay distortion, and noise.
- o The hardware and software components in a communication subsystem can fail.
- o The communication subsystem can be subjected to passive or active subversive attacks.

- **Physical Component Controls:** One way to reduce expected losses in the communication subsystem is to choose physical component that have characteristics that make them reliable and that incorporate features or provide controls that mitigate the possible effects of exposures. These controls involve Transmission Media - Guided Media or Unguided Media; Communication Lines – Private (Leased) or Public; Modems; Port Protection Devices; Multiplexors and Concentrators.
- **Line Error Controls:** Whenever data is transmitted over a communication line, it can be received in error because of attenuation, distortion, or noise that occurs on the line. Error Detection (using Parity Checking, Cyclic Redundancy Checks (CRC) and Loop Check) and

Error Correction (using forward Error Correcting Codes and Backward Error Correction) are the two major approaches under Line Error Controls.

- **Flow Controls:** These are needed because two nodes in a network can differ in terms of the rate at which they can send receive and process data. The simplest form of flow control is "Stop-and-Wait Flow Control" in which the sender transmits a frame of data only when the receiver is ready to accept the frame.
- **Link Controls:** This involves two common protocols – HDLC (Higher Level Data Control) and SDLC (Synchronous Data Link Control); the study of these is beyond the scope of this book.
- **Topological Controls:** A communication network topology specifies the location of nodes within a network, the ways in which these nodes will be linked, and the data transmission capabilities of the links between the nodes. Some of the four basic topologies include Bus, Ring, Star and Tree Topology.
- **Channel Access Controls:** Two different nodes in a network can compete to use a communication channel. Whenever the possibility of contention for the channel exists, some type of channel access control technique must be used. These techniques fall into two classes – **Polling methods** and **Contention methods**. Polling techniques establish an order in which a node can gain access to channel capacity; whereas in Contention methods, nodes in a network must compete with each other to gain access to a channel.
- **Internetworking Controls:** Internetworking is the process of connecting two or more communication networks together to allow the users of one network to communicate with the users of other networks. Three types of devices are used to connect sub-networks in an Internet: Bridge, Router and Gateway.

(b) **Explicit Knowledge:** Explicit knowledge is that which can be formalized easily and as a consequence is easily available across the organization. Explicit knowledge is articulated, and represented as spoken words, written material and compiled data. This type of knowledge is codified, easy to document, transfer and reproduce. For example – Online tutorials, Policy and procedural manuals.

Tacit Knowledge: Tacit knowledge, on the other hand, resides in a few often-in just one person and hasn't been captured by the organization or made available to others. Tacit knowledge is unarticulated and represented as intuition, perspective, beliefs, and values that individuals form based on their experiences. It is personal, experimental and context-specific. It is difficult to document and communicate the tacit knowledge. For example – hand-on skills, special know-how, employee experiences.

5. **(a)** BPR implies not just change but dramatic change in the way a business functions. It would potentially impact every aspect of the business and the changes would be of a scale that could result in either drastic improvement or massive failures. Research has identified some key factors for BPR projects to succeed. These factors are as follows:

(i) **Organization wide commitment:** Changes to business processes would have a direct impact on processes, organizational structures, work culture, information flows, infrastructure & technologies and job competencies. This requires strong leadership, support and sponsorship from the top management. Top management not only has to recognize the need for change but also has to convince every affected group about the potential benefits of the change to the organization as a whole and secure their commitment.

(ii) **BPR team composition:** A BPR team is formed which would be responsible to take the BPR project forward and make key decisions and recommendations. The BPR team would include active representatives from top management, business process owners, technical experts and users. It is important that the teams must be kept of manageable size to ensure well-coordinated, effective and efficient completion of the entire BPR process.

(iii) **Business needs analysis:** It is important to identify exactly what current processes need reengineering. This would help determine the strategy and goals for BPR. A series of sessions are held with the process owners and stakeholders and all the ideas would be evaluated to outline and conceptualize the desired business process. The outcome of this analysis would be BPR project plan – identifying specific problem areas, setting goals and relating them to key business objectives. This alignment of the BPR strategy with the enterprise strategy is one of the most important aspects.

(iv) **Adequate IT infrastructure:** Adequate investment in IT infrastructure in line is of vital importance to successful BPR implementation. An IT infrastructure is a set of hardware, software, networks, facilities, etc. (including all of the information technology), in order to develop, test, deliver, monitor, control or support IT services. Effective alignment of IT infrastructure to BPR strategy would determine the success of BPR efforts.

(v) **Effective change management:** BPR involves changes in people behavior and culture, processes and technologies. Hence, resistance would be a natural consequence which needs to be dealt with effectively. An effective change management process would consider the current culture to foster a change in the prevailing beliefs, attitudes and behaviors effectively. The success of BPR depends on how effectively management conveys the need for change to the people.

(vi) **Ongoing continuous improvement:** BPR is an ongoing process hence innovation and continuous improvement are key to the successful implementation of BPR.

(b) Anti – Malware: Malware, short for malicious software, is any software used to disrupt computer operation, gather sensitive information, or gain access to private computer systems. It is an umbrella term used to refer to a variety of forms of hostile or intrusive software, including computer viruses, worms, trojan horses etc. and other malicious programs. Anti-malware network tools help administrators identify block and remove malware. They enable the IT department to tailor its anti-malware policies to identify known and unknown malware sources. Malware is always on the lookout for network vulnerabilities - in security defences, operating systems, browsers, applications and popular targets such as Adobe Flash, Acrobat and Reader - that they can exploit to fully access a victim's network. Best practices call for a multipronged defence that might also include IP blacklisting, data loss prevention (DLP) tools, anti-virus and anti-spyware software, web browsing policies, egress filtering, and outbound-traffic proxies.

SECTION – B: STRATEGIC MANAGEMENT

SUGGESTED ANSWERS/HINTS

1.

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

2. The Airlines industry faces stiff competition. However, Luxury Jet has attempted to create a niche market by adopting focused differentiation strategy. A focused differentiation strategy requires offering unique features that fulfil the demands of a narrow market.

Luxury Jet compete in the market based on uniqueness and target a narrow market which provides business houses, high net worth individuals to maintain strict schedules. The option of charter flights provided several advantages including, flexibility, privacy, luxury and many a times cost saving. Apart from conveniences, the facility will provide time flexibility. Travelling by private jet is the most comfortable, safe and secure way of flying your company's senior business personnel.

Chartered services in airlines can have both business and private use. Personalized tourism packages can be provided to those who can afford it.

3. **(a)** Business environment exhibits many characteristics as follows:

- **Environment is complex:** The environment consists of a number of factors, events, conditions and influences arising from different sources and is complex because it is somewhat easier to understand in parts but difficult to grasp in totality.
- **Environment is dynamic:** The environment is constantly changing in nature. Due to the many and varied influences operating; there is dynamism in the environment causing it to continuously change its shape and character.
- **Environment is multi-faceted:** What shape and character an environment assumes depends on the perception of the observer. A particular change in the environment, or a new development, may be viewed differently by different observers, i.e. as an opportunity for one company and a threat for another.
- **Environment has a far reaching impact:** The growth and profitability of an organization depends critically on the environment in which it exists. And thus any environmental change has an impact on the organization in several different ways.

(b) Corporate strategy in the first place ensures the growth of the organisation and ensures the correct alignment of the organization with its environment. It serves as the design for filling the strategic planning gap. It also helps build the relevant competitive advantages. It works out the right fit between the organization and its external environment. Basically the purpose of corporate strategy is to harness the opportunities available in the environment, countering the threats embedded therein.

Corporate strategy brings methodical responses to the environment. Strategy is the opposite of adhoc responses to the changes in the environment in competition, consumer tastes, technology and other variables. It amounts to long-term, well thought-out and prepared responses to the various environment forces.

4. **(a)** Experience curve is similar to learning curve which explains the efficiency gained by workers through repetitive productive work. Experience curve is based on the commonly observed phenomenon that unit costs decline as a firm accumulates experience in terms of a cumulative volume of production. The implication is that larger firms in an industry would tend to have lower unit costs as compared to those of smaller organizations, thereby gaining a competitive cost advantage. Experience curve results from a variety of factors such as learning effects, economies of scale, product redesign and technological improvements in production.

The concept of experience curve is relevant for a number of areas in strategic management. For instance, experience curve is considered a barrier for new firms contemplating entry in an industry. It is also used to build market share and discourage competition.

(b) **Top-Down and Bottom-Up Strategic Planning:** Strategic planning determines where an organization is going over the next year or more and the ways for going there. The process is organization-wide or focused on a major function such as a division. As such strategic planning is a top level management function. The flow of planning can be from corporate to divisional level or vice-versa. There are two approaches for strategic planning - top down or bottom up.

Top down strategic planning describes a centralized approach to strategy formulation in which the corporate centre or head office determines mission, strategic intent, objectives and strategies for the organization as a whole and for all parts. Unit managers are seen as implementers of pre-specified corporate strategies.

Bottom up strategic planning is the characteristic of autonomous or semi-autonomous divisions or subsidiary companies in which the corporate centre does not conceptualize its strategic role as being directly responsible for determining the mission, objectives, or strategies of its operational activities. It may prefer to act as a catalyst and facilitator, keeping things reasonably simple and confining itself to perspective and broader strategic intent.

5. **(a)** Marketing mix is a systematic way of classifying the key decision areas of marketing management. It is the set of controllable marketing variables that the firm blends to produce the response it wants in the target market. The original framework of marketing mix comprises of 4Ps- product, price, place and promotion. These are subsequently expanded to highlight certain other key decision areas like people, processes, and physical evidence. The elements of original framework are:

- **Product**: It stands for the “goods-and-service” combination the company offers to the target market.
- **Price**: It stands for the amount of money customers have to pay to obtain the product.
- **Place:** It stands for company activities that make the product available to target consumers and include marketing channel, distribution policies and geographical availablity.
- **Promotion:** It stands for activities that communicate the merits of the product and persuade target consumers to buy it.

(b) A culture where creativity, embracing change, and challenging the status quo are pervasive themes is very conducive to successful execution of a product innovation and technological leadership strategy. A culture built around such business principles as listening to customers, encouraging employees to take pride in their work, and giving employees a high degree of decision-making responsibility is very conducive to successful execution of a strategy of delivering superior customer service.

A strong strategy-supportive culture nurtures and motivates people to do their jobs in ways conducive to effective strategy execution; it provides structure, standards, and a value system in which to operate; and it promotes strong employee identification with the company's vision, performance targets, and strategy. All this makes employees feel genuinely better about their jobs and work environment and the merits of what the company is trying to accomplish. Employees are stimulated to take on the challenge of realizing the company's vision, do their jobs competently and with enthusiasm, and collaborate with others as needed to bring the strategy to success.

6. **(a)** Benchmarking is a process of finding the best practices within and outside the industry to which an organisation belongs. Knowledge of the best practices helps in setting standards and finding ways to match or even surpass own performances with the best performances.

Benchmarking is a process of continuous improvement in search for competitive advantage. Firms can use benchmarking process to achieve improvement in diverse range of management function such as mentioned below:

- Maintenance operations,
- Assessment of total manufacturing costs,
- Product development,
- Product distribution,
- Customer services,
- Plant utilisation levels; and
- Human resource management.

(b) Inbound logistics are the activities concerned with receiving, storing and distributing the inputs to the product/service. It includes all activities such as materials handling, stock control, transport, etc.

Outbound logistics relate to collection, storage and distribution of the product to customers. It includes all activities such as storage/warehousing of finished goods, order processing, scheduling deliveries, operation of delivery vehicles, etc.