AA

Total No. of Questions: 6 | **Max Marks: 100**
No.of Pages : 4 | **Time Allowed: 3 Hours**

Answer all Questions
All workings should be form part of the answer

1. X,Y and Z sharing profits and losses equally agreed upon dissolution of their partnership on 31st December 2008 on which date their Balance Sheet was as under:

Liabilities		**Rs.**	**Assets**	**Rs.**
Capital Accounts			Goodwill	18,000
X	35,000		Furniture & fittings	23,000
Y	30,000		Investments	20,000
Z	20,000	85,000	Joint life Policy	21,000
Loan from Mrs.X		10,000	Stock in trade	21,000
Investment fluctuation fund		8,100	Debtors	13,500
Creditors		22,400	Cash at Bank	9,000
		1,25,500		**1,25,500**

The Joint life policy is surrendered. The investments of Rs.18,000 are taken over by X for Rs.15,000. X agrees to discharge his wife's loan. Y decides to continue the business and takes up stock at Rs.15,000 and debtors amounting to Rs.7,500 at Rs.5,000 and also agrees to pay Rs.16,000 for goodwill. Furniture & fittings are sold for Rs.26,000. The remaining debtors realize 60% of book value. The expenses of realization amounted Rs.2,500. Remaining investments are taken over ob one of the creditors at 90% of its value. Show the necessary ledger accounts in the books of the firm on dissolution. **(16 MARKS)**

2. **Balance sheet of Sona Limited as on 31st December 2007 is as follows:**

Liabilities	**Rs.**	**Assets**	**Rs.**
Paid up capital:		Fixed assets:	
1,000 6 percent preference		Land and Building	2,00,000
Shares of Rs.100 each	1,00,000	Plant and Machinery	2,20,000
2,000 equity shares of Rs.100		current assets:	
each fully paid	2,00,000	stock	1,00,000
3,000 equity shares of Rs.100		Debtors	1,00,000
each Rs.50 paid	1,50,000	cash at bank	30,000
Secured Loans :		Miscellaneous Expenditure:	
6% debentures(floating charge		profit & loss account	1,00,000
on all assets)	1,00,000		
Others(mortgage on land and			
Building)	1,00,000		
Current liabilities:			
Sundry creditors	90,000		
Income tax	10,000		
	7,50,000		**7,50,000**

The company went into liquidation in 1st January, 2008. The preference dividends were in arrears for three years, The arrears are payable on liquidation.
The assets were realized as follows:

Land and Building	2,40,000
Plant and machinery	1,80,000
Stock	70,000
Debtors	60,000

The expenses of liquidation amounted to Rs.8,000. The liquidator is entitled to a commission at 2% on all assets realized and 3% on amount distributed to unsecured creditors. All payments were made on 30th June, 2008. Prepare liquidator's statement of account. **(16 marks)**

3. A. The following balances were extracted from the books of M/s. Sai ram stores. Prepare the departmental trading and profit and loss account for the year ended December 31, 2007, after adjusting the unrealized profit on stock, if any:

	Dept X Rs.	Dept Y Rs.
Opening stock	8,000	6,400
Purchases	1,04,000	1,45,600
Sales	1,60,000	2,40,000

Selling expenses incurred by both departments were Rs.32,000 and you get the following information:

a. Closing stock of Department X is Rs.16,000 including goods from Department Y Rs.3,200, at cost to Department X.

b. Closing stock of Department Y is Rs.32,000 including goods from Department X for Rs.4,800, at cost to Department Y.

c. Opening stock of Department X and Department Y include goods of the value of Rs.1,600 and Rs.2,400, taken from Department Y and Department X respectively, at cost to transferee department.

d. The Gross Profit is uniform from Year to year. **(8 marks)**

B. Naveena Industries Ltd., Salem has a branch at Coimbatore to which goods are invoiced at cost Plus 25%. The branch makes sales both for cash and credit. Branch expenses are paid direct from head office and the branch remits all cash to head office. From the following particulars, prepare necessary ledger accounts in Head Office books to ascertain branch profits as per the stock and Debtors Method.

	Rs.
Branch Stock on January 1, 2007	7,200
Branch stock on December 31, 2007	14,400
Branch debtors on January 1, 2007	8,640
Goods received from H.O. at invoice price	72,000
Returns to H.O. at invoice price	1,440
Cash sales	24,000
Credit sales	43,200
Cash collected from Debtors	38,400
Discount allowed to debtors	720
Bad debts in the year	480
Goods returned by debtors to branch	960
Rent and taxes	2,160
Branch office expenses	720

(8 marks)

4. The following are the changes in the account balances taken from the Balance Sheets of PQ Ltd. as at the beginning and end of the year:

	Changes in Rupees in Debit or [credit]
Equity share capital 30,000 shares of Rs.10 each issued and fully paid	0
Capital reserve	[49,200]
8% debentures	[50,000]
Debenture discount	1,000
Freehold property at cost/revaluation	43,000
Plant and machinery at cost	60,000

Depreciation on plant and machinery	[14,400]
Debtors	50,000
Stock and work-in-progress	38,500
Creditors	[11,800]
Net profit for the year	[76,500]
Dividend paid in respect of earlier year	30,000
Provision for doubtful debts	[3,300]
Trade investments at cost	47,000
Bank	[64,300]

You are informed that:

(a) Capital reserve as at the end of the year represented realized profits on sale of one free hold property together with surplus arising on the revaluation of balance of freehold properties.

(b) During the year plant costing Rs.18,000 against which depreciation provision of Rs.13,500 was lying, was sold for Rs.7,000.

(c) During the middle of the year Rs.50,000 debentures were issued for cash at a discount of Rs.1,000.

(d) The net profit for the year was after crediting the profit on sale of plant and charging debenture interest.
You are required to prepare a statement which will explain, why bank borrowing has increased by Rs.64,300 during the year end. Ignore taxation. **(16 marks**)

5. **Answer any 8 Questions**

Ashok and Bhushan started business on 1st July, 2007, without any partnership deed. They introduced capital of Rs.40,000 and Rs.70,000 respectively. On 1st October, 2007, Bhushan advanced Rs.30,000 as loan to the firm. The profit & loss account for the year ending 31st March, 2008, discloses a profit of Rs.24,900, but the partners cannot be agree upon the question of interest and profit sharing ratio. You are requested to distribute the profit between them as per the partnership Act, 1932.

a. Arun and Barun are partners in the ratio of 3:2. They admit Chaman for 1/4th share. In future the ratio between Arun and Barun would be 1:1. Calculate new profit sharing ratio and sacrificing ratio.

b. Pass journal entries both at the time of Issue and Redemption of Debentures in the case: E Ltd. issued Rs.2,00,000, 14% Debentures at a discount of 6% but redeemable at a premium of 6%.

c. How would you disclose the following items in the Balance Sheet of a limited company?
(i) Stock
(ii) Goodwill
(iii) Bills payable
(iv) Preliminary Expenses, and
(v) Unclaimed Dividend.

d. Ramu traders have taken out a fire policy of Rs.2,40,000 covering its stock-in-trade. A fire occurs on 31st March 2008 and stock was destroyed with the exception of the value of Rs.62, 040. Following particulars are available from the books of accounts of the firm:

	Rs.
Stock on 31st December 2007	90,000
Purchases to the date of fire	3,90,000
Sales to the date of fire	2,70,000
Commission paid to the purchase	2%
Carriage paid on purchase	2,400
Average gross profit on cost	50%

The Policy was subject to average clause. You are required to arrive at the
i) total loss of stock and
ii) amount of claim to be made against the insurance company.

e. From the following particulars compute the amount of subscription to be shown in 2007-2008 in the Income and Expenditure account:

Life membership subscription received in 2007-2008	Rs.10,000
Subscription received in 2007-2008 are as follows:	
2005-2006	50,000
2006-2007	4,50,000
2007-2008	40,000
Subscriptions outstanding	
In 2006-2007	75,000
In 2007-2008	1,00,000
Subscriptions received in advance in 2006-2007	
For 2007-2008	65,000
For 2008-2009	20,000

f. Dilip purchased a car for a cash price of Rs.2,56,000, which sold on hire purchase system for Rs.3,20,000. The amount is payable in four equal yearly installments of Rs.80,000 each. The first payment is made at the end of the first year. Calculate the amount of interest to be charged every year.

g. Garden Ltd. acquired fixed assets viz. plant and machinery for Rs.20 lakhs. During the same year it sold its furniture and fixtures for Rs. 5 lakhs. Can the company disclose, net cash outflow towards purchase of fixed assets in the cash flow statement as per AS-3?

h. ABC Ltd. gave 50,000 equity shares of Rs.10 each (fully paid up) in consideration for supply of certain machinery by X & co. The shares exchanged for machinery are quoted on Bombay Stock Exchange (BSE) at Rs.15 per share, at the time of transaction. In the absence of fair market value of the machinery acquired, how the value of machinery would be recorded in the books of the company?

i. A company took a construction contract for Rs.100 lakhs in January, 2006. IT was found that 80% of the contract was completed at a cost of Rs.92 lakhs on the closing date i.e. on 31.3.2007. The company estimated further expenditure of Rs.23 lakhs for completing the contract. The expected loss would be Rs.15 lakhs. Can the company recognize the loss in the financial statements prepared for the year ended 31.3.2007?

(8*2 = 16 marks)

6. **ANSWER ANY FOUR**

a. What are the advantages and disadvantages of "ERP" packages.

b. Explain the accounting treatment of donation received for specific purpose in the case of charitable society.

c. Explain rebate on bills discounted

d. Explain reserve for unexpired risk

e. Explain disposal of surplus

f. What are the qualitative characteristics of the financial statements which improve the usefulness of the information furnished therein?

(4 x 5 = 20 Marks)

1

Answers

M/s XYZ

Realisation account

Dr. Particulars	Amount Rs	Particulars		Amount Cr. Rs.
To goodwill	18,000	By loan from Mrs.X		10,000
To furniture & fittings	23,000	By investment fluctuation fund		8,100
To investment	20,000	By creditors		22,400
To joint life policy	21,000	By bank A/c:		
To stock in trade	21,000	JLP	21,000	
To debtors	13,500	Furniture & fittings	26,000	
To X's capital A/c(Mrs.X's loan)	10,000	Debtors	3,600	50,600
To Bank A/c(creditors)	20,600	By X's capital A/c(investment)		15,000
To Bank A/c (realization expenses)	2,500	By Y's capital A/c:		
		Stock	15,000	
		Debtors	5,000	
		Goodwill	16,000	36,000
		By loss :		
		X	2,500	
		Y	2,500	
		Z	2,500	7,500
	1,49,600			**1,49,600**

Partners' capital account

Dr. Particulars	X Rs.	Y Rs.	Z Rs.	Particulars	X Rs.	Y Rs.	Z Cr. Rs.
To realization	15,000	36,000	_	By balance b/d	35,000	30,000	20,000
To realization A/c	2,500	2,500	2,500	By realization A/c	10,000	_	_
To Bank A/c	27,500	_	17,500	By bank A/c	_	8,500	_
	45,000	**38,500**	**20,000**		**45,000**	**38,500**	**20,000**

Bank Account

Dr. Particulars	Amount	Particulars	Amount Cr.
To Balance b/d	9,000	By realization A/c	20,600
To realization A/c	50,600	By realization A/c	2,500
To Y's capital A/c	8,500	By X's capital A/c	27,500
		By Z's capital A/c	17,500
	68,100		**68,100**

Working notes:

		Rs.
(i) Amount payable to creditors	22,400	
Less : 90% of remaining investment i.e. Rs. 2,000	1,800	
		20,600
(ii) Total debtors	13,500	
Less : debtors taken over by Y	7,500	

Remaining debtors	6,000	
Amount realized 60%		3,600

Preparing Memorandum Balance sheet

Sometimes, complete balance sheet is not given in the questions. Any item, like sundry assets or capital may be missing. In this case first of all old balance sheet is prepared to find out the missing item-sundry assets or capital of the partners. This balance sheet is called 'memorandum Balance sheet' . Accounting for dissolution will follow only after this.

2.

LIQUIDATORS STATEMENT OF ACCOUNT

From 1st jan.2008 to 30th june 2008

Receipts Estimated Value

Payments	Rs.	Rs.	Realized	Rs.	Rs.
Assets realized:			Liquidator's remuneration:		
Cash at bank		30,000	2% on Rs.5,50,000 realised		11,000
Sundry debtors		60,000	3% on Rs.1,00,000 distributed		
Stock in trade		70,000	among unsecured creditors		3,000
Plant and machinery		1,80,000	liquidation expenses		
8,000					
Surplus from securities		1,40,000	debenture holders:		
			Principal	1,00,000	
			Interest upto 30th june	3,000	1,03,000
			Creditors:		
			Pref. creditors	10,000	
			Unsecured creditors	90,000	1,00,000
			Return to contributories:		
			Preference share holders:		
			Capital	1,00,000	
			Arrears of dividend	18,000	1,18,000
			Equity shareholders:		
			Rs.57.40 on 2,000 shares		1,14,800
			Rs.7.40 on 3,000 shares		22,200
		4,80,000			**4,80,000**

Working notes:

(i) debenture holders are entitled to interest upto the date of payment since the company is solvent.

(ii) Preference dividend is payable only upto December 31,

(iii) Amount payable to equity share holders:

Balance after payment of Pref. shareholders	1,37,000
Notional payment by equity shareholders on 3,000 shares @ Rs.50 per share	1,50,000
Total amount available	2,87,000
Refund to each shareholder, 2,87,000/5,000	57.40
Amount payable on fully paid shares	57.40
Amount payable on partly paid shares(Rs.57.40 – 50.00)	7.40

3. A.

DEPARTMENTAL TRADING AND PROFIT AND LOSS ACCOUNT

For the year ended 31st December 2007

Dr. Cr.

Particulars	Dept.X Rs.	Dept. Y Rs.	Particulars	Dept.X Rs.	Dept.Y Rs.
To Opening stock	8,000	6,400	By sales	1,60,000	2,40,000
To purchases	1,04,000	1,45,600	By closing stock	16,000	32,000
To gross profit c/d	64,000	1,20,000			
	1,76,000	2,72,000		1,76,000	2,72,000
To selling expenses (sales ratio 2:3)	12,800	19,200	By gross profit b/d	64,000	1,20,000

To net profit to be Transferred to General P & L A/c	51,200	1,00,800		
	64,000	1,20,000	64,000	1,20,000

GENERAL PROFIT AND LOSS ACCOUNT
For the year ended……………

Dr.	Rs.	Rs.		Rs.	Rs. Cr.
To stock reserve on Closing stock of			By net profit		
			dept. X	51,200	
Dept. X	1,600		dept. Y	1,00,800	
Dept.Y	1,920				1,52,000
		3,520	By stock reserve on opening stock of		
To net profit to be Transferred to Balance sheet		1,50,240	Dept.X	800	
			Dept.Y	960	
					1,760
		1,53,760			**1,53,760**

Working notes:

1. calculation of stock reserve on opening and closing stock of department X:
   To calculate the stock reserve on opening and closing of department X, the rate of Gross profit of Department Y is needed as the goods are from Dept.Y. Thus,

   Gross profit ratio of Dept.Y = $\frac{\text{Gross profit}}{\text{Sales}} * 100$

   $= \frac{1,20,000}{2,40,000} * 100 = 50\%$

   stock reserve on opening stock of Dept.X = Rs.1,600 x 50% = Rs.800
   stock reserve on closing stock dept.X = Rs.3,200 x 50% = Rs.1,600

2. Calculation of stock reserve on opening and closing stock of department Y :
   To calculate the stock reserve on opening and closing of department Y, the rate of Gross profit of Department X is needed as the goods are from Dept.X. Thus,

   Gross profit ratio of Dept.X = $\frac{\text{Gross profit}}{\text{Sales}} * 100$

   $= \frac{64,000}{1,60,000} * 100 = 40\%$

   stock reserve on opening stock of Dept.Y = Rs.2,400 x 40% = Rs.960
   stock reserve on closing stock dept.Y = Rs.4,800 x 40% = Rs.1,920

3.B. Profit = 25% on cost
= 25/100 on cost = ¼ on cost
or = 25/125 on sales = 1/5 on sales

In the books of Naveena Industries Ltd.
Salem Branch stock A/c(at invoice price)

Dr. Cr.

Date	Particulars	Rs.	Date	Particulars	Rs.
2007					
Jan.1	To balance b/d	7,200	Dec.31	By cash A/c(cash sales)	24,000
Dec.31	To goods sent to Branch A/c (credit sales)	72,000	Dec.31	By branch debtors	43,200
			Dec.31	To branch debtors A/c -returns by debtors-returns to H.O.	960
Dec.31	By goods sent to branch A/c	1,440			
Dec.31	To branch adjustment A/c -surplus	2,880	Dec.31	By balance c/d	14,400
		83,040			**83,040**
2008					

Jan.1	To balance b/d	14,400

Salem Branch expenses A/c

Dr. Cr.

Date	Particulars	Rs.	Date	Particulars	Rs.
2007			2007		
Dec.31	To branch debtors A/c		Dec.31	By branch adjustment A/c	4,080
	-discount allowed	720		-transfer	
	-Bad debts	480			
Dec.31	To cash				
	-rent & rates	2,160			
	-office expenses	720			
		4,080			**4,080**

Salem Branch Debtors A/c

Dr. Cr.

Date	Particulars	Rs.	Date	Particulars	Rs.
		2007			
Jan.1	To Balance b/d	8,640	Dec.31	By cash A/c	38,400
Jan.1	To Branch stock (credit sales)	43,200	Dec.31	By branch expenses A/c	
				-discount allowed	620
				-Bad debts	480
			Dec.31	By branch stock A/c -returns	960
			Dec.31	By balance c/d	11,280
		51,840			**51,840**
2008					
Jan.1	To balance b/d	11,280			

Salem Branch Adjustment A/c

Dr. Cr.

Date	Particulars	Rs.	Date	Particulars	Rs.
2007					
Jan.1	To branch stock Reserve A/c -loading on closing stock(14,400*1/5)	2,880	Dec.31	By branch stock reserve A/c -loading on opening stock(7,200*1/5)	1,440
Dec.31	To Gross profit c/d	13,248	Dec.31	By goods sent to branch A/c-loading on goods Sent to branch less returns (7,200-1,440)*1/5	14,112
			Dec.31	By branch stock A/c -loading on surplus	576
		16,128			**16,128**
Dec.31	To branch expenses	4,080	Dec.31	By gross profit b/d	13,248
Dec.31	To net profit transferred To general P & L A/c	11,472	Dec.31	By branch stock A/c	2,304
		15,552			**15,552**

Working notes:

1. From the Branch Stock Account, it is found that surplus is Rs.2,880 at invoice price. To know the gross profit or loss and net profit or loss, the branch adjustment Account is to be prepared. For that purpose, the surplus is to be split into the cost element and profit element (loading). Profit element will be shown on the first division and cost element will be shown on the second division of the Branch Adjustment Account.

Invoice price = cost price + profit
Cost price = invoice price - profit

Surplus at invoice price	= Rs.2,880
Less: profit element (2,880 x1/5)	= Rs. 576
Cost element in surplus	= Rs.2,304

4.

PQ Ltd
CASH FLOW STATEMENT FOR THE YEAR ENDED

	Rs.	
1 Cash flows from operating Activities		
Net profit	76,500	
Adjustment for:		
Depreciation	27,900	
Profit on sale of plant	(2,500)	
Interest expenses	2,000	
Operating profit before working capital changes	1,03,900	
Increase in debtors(less provision)	(46,700)	
Increase in stock and work in progress	(38,500)	
Increase in creditors	11,800	
Net cash from operating activities	30,500	
2.Cash flow from investing activities		
purchase of plant and machinery	(78,000)	
proceeds from sale of plant	7,000	
proceeds from sale of free hold property	6,200	
increase in trade investments	(47,000)	
net cash used in investing activities		(1,11,800)
3.cash flows from financing activities		
proceeds from issue of debentures at discount	49,000	
debenture interest paid	(2,000)	
dividend paid in respect of earlier year	(30,000)	
Net cash from financing activities		17,000
Excess of outflows over inflows		64,300

Working notes:

1. plant and machinery

amount of increase (at cost)	60,000	
add : disposal (at cost)	18,000	
acquisition during the year		78,000
disposal of plant:		
proceeds from sale		7,000
net book value(18,000-13,500)		4,500
profit on sale		2,500

Plant and machinery account

To balance b/d		By bank(sale proceeds)	7,000
To profit & loss A/c(profit on sale)	2,500	By provision for depreciation	13,500
To Bank(purchase) (balancing figure)	78,000	By balance c/d	60,000
	80,500		**80,500**

provision for depreciation (plant and machinery) account

	Rs.		Rs.
To plant & machinery A/c	13,500	By balance b/d	
To balance c/d	14,400	by profit and loss A/c	27,900
	27,900		27,900

2. free hold property

	Rs.
capital reserve	49,200
less: increase in free hold property(closing balance minus opening balance)	43,000
proceeds from sale of free hold property	**6,200**

Free hold property account

	Rs.		Rs.
To balance c/d		By bank A/c(balancing figure)	6,200
To capital reserve	49,200	by balance c/d	43,000
	49,200		**49,200**

In there absence of information about the opening balances, the entire amount of change has been considered under the closing balances for the purpose of computing of missing figures.

Notes:

1. Income from investment and dividend pertaining to the current year have not been considered in the absence of any related information.
2. Debenture interest has been computed for 6 months @ 8% on Rs.50,000.
3. The statement required in the question has been prepared in accordance with AS – 3 (revised):cash flow statements.

5. a.

Profit and loss Appropriation Account
For the year ending 31st March, 2008

Dr.			Cr.
Particulars	Rs.	Particulars	Rs.
To Bhushan's Capital A/c (interest on loan)	900	By profit for the year	24,900
To Ashok's capital A/c(profit)	12,000		
To Bhushan's capital A/c(profit)	12,000		
	24,900		**24,900**

Working note:

(i) In absence of partnership deed no interest is allowed on partner's capital.

(ii) In absence of partnership deed interest on partner's loan to the firm is allowed @ 6% p.a.. Therefore Bhushan is allowed 6% interest on Rs.30,000 for 6 months.

(iii) In absence of partnership deed, profit or loss is distributed equally.

b. Old profit sharing ratio of Arun and Barun = 3:2
Chaman's share = ¼
Remaining share for Arun and Barun = 1-1/4 = ¾
New ratio of Arun = ½ x ¾ = 3/8
Barun = ½ x ¾ = 3/8
New profit sharing ratio of Arun, Barun and Chaman = 3/8 : 3/8 : ¼ = 3:3:2

c.

Particulars		L.F.	Debit(Rs.)	Credit(Rs.)
On issue				
Bank A/c	Dr.		1,88,000	
Loss on Issue of debentures A/c	Dr.		24,000	
To 15% debentures A/c				2,00,000
To premium on redemption of debenture A/c				12,000
(Being the issue of debentures at 6% discount & redeemable at 6% premium)				
On redemption				
15% debentures A/c	Dr.		2,00,000	
Premium on redemption of debenture A/c	Dr.		12,000	
To debenture holders' A/c				2,12,000
(being the amount due on redemption)				
Debenture holders' A/c	Dr.		2,12,000	
To Bank A/c				2,12,000
(being the payment made to debenture holders)				

d.

Item	**heading**	**sub-heading (if any)**
(i) stock	current assets & loans & advances	Loans & Advances
(ii) goodwill	fixed assets	
(iii) bills payable	current liabilities & provisions	current liabilities
(iv) preliminary expenses	Miscellaneous expenditure	
(v) Unclaimed dividend	current liabilities & provisions	current liabilities

e.

Memorandum Trading Account of Ramu Traders
For the period ending 31st March 2008

Liabilities	Rs.	Assets	Rs.
To opening stock	90,000	By sales	2,70,000
To purchases	3,90,000	By stock on the date of fire	3,10,000
Add: commission @2%	7,800		
Add: carriage	2,400		4,00,200
To gross profit (50% on cost)			
½ on cost = 1/3 on sales			
270000 x 1/3	90,000		
	5,80,200		5,80,200

Stock on the date of fire	3,10,200
Less: stock salvaged	62,040
Stock destroyed by fire	2,48,160

$$\text{Claim on average basis} = \frac{\text{value of the policy}}{\text{value of stock on the date of fire}} \times \text{stock destroyed by fire}$$

$$= \frac{2,40,000}{3,10,200} \times 2,48,160$$

= Rs.1,92,000

f. subscriptions received during 2007-2008

(50,000+4,50,000+40,000)		Rs.5,40,000
Add : subscriptions received in advance		
(Balance at the start)		
2007-2008	65,000	
2008-2009	20,000	
Subscriptions outstanding		
(Balance at the end)		
2007-2008	75,000	
2006-2007	25,000	Rs.1,85,000
		Rs.7,25,000
Less: outstanding subscriptions		
(Balance at the start)		
2006-2007	75,000	
Subscriptions received in		
Advance (Balance at the end)	60,000	
	Rs.1,35,000	Rs.5,90,000

Alternatively, subscription Account can be prepared.

Subscription A/c

	Rs.			Rs.
To subscription o/s(2006-2007	75,000	By subscription received in advance for		
To subscription received in Advance for 2008-2009	60,000[2]	2007-2008	65,000	
To income & expenditure A/c (Balancing figure)	5,90,000	2008-2009	20,000	
		By Cash (50000+450000+40000)		
		By subscription o/s		
		For 2007-2008	75,000	
		For 2006-2007	25,000[1]	
	7,25,000			7,25,000

g. Life membership subscription of Rs.10,000 is to be capitalized and will be shown on the liabilities side of the Balance Sheet.

a. Interest = Hire purchase price – Cash price
= Rs.3,20,000 – Rs.2,56,000
= Rs.64,000

Table showing calculation of interest

Total hire Purchase Price	particulars	Instalments outstanding Rs.	ratio of outstanding Instalments	Interest to be charged Rs.
3,20,000	at the end of 1st year	3,20,000	4 (4/10 x 64,000)	25,600
	at the end of 2nd year (3,20,000-80,000)	2,40,000	3 (3/10 x 64,000)	19,200
	at the end of 3rd year (2,40,000-80,000)	1,60,000	2 (2/10 x 64,000)	12,800
	at the end of 4th year (1,60,000-80,000)	80,000	1 (1/10 x 64,000)	6,400

Total	3,20,000	10	64,000

j. According to para 21 of AS 3 (revised) 'cash flow statements', an enterprise should report separately major classes of gross cash receipts and gross cash payments arising from investing and financing activities, except to the extent that cash flows described in paragraphs 22 and 24 are reported on a net basis. Acquisition and disposal of fixed assets is not prescribed in para 22 and 24 of the standard. Hence, the company cannot disclose net cash flow in respect of acquisition of plant and machinery and disposal of furnitures and fixtures.

k. As per paragraph 22 of AS 10 'Accounting for Fixed Assets', fixed asset acquired in exchange for shares or other securities in the enterprise should be recorded at its fair market value, or the fair market value of the securities issued, whichever is more clearly evident. Since, the market value of the shares exchanged for the asset is more clearly evident, the company should record the value of machinery at Rs.7,50,000(i.e.50,000 shares x Rs.15 per share being the market price)

l. As per paragraphs 31 and 35 of As 7 on Construction Contracts, an expected loss on the construction contract should be recognized as an expense immediately irrespective of

(i) Whether or not the work has commenced on the contract;

or (ii) the stage of completion of the contract;

or (iii) the amount of profits expected to arise in other contracts. Hence, the company must recognize the loss immediately.

6.

a. Larger organization often go for an ERP package where finance comes as a module. An ERP is an integrated software package that manages the business process across the entire enterprise.

Advantages of using an ERP

The advantages of using an ERP for maintaining accounts are as follows:

1. Standardized processes and procedures: An ERP is a generalized package which covers most of the common functionalities of any specific module.
2. Standardised reporting: Majority of the desired reports are available in an ERP package. These reports are standardized across industry and are generally acceptable to the users.
3. Duplication of data entry is avoided as it is an integrated package.
4. Greater information is available through the package.

Disadvantages of an ERP

The disadvantages of an ERP are the following:

1. Lesser flexibility : The user may have to modify their business procedure at times to be able to effectively use the ERP.

2. implementation hurdles : Many of the consultants doing the implementation of the ERP may not be able to fully appreciate the business procedure to be able to do a good implementation of an ERP.

3. Very expensive : ERP are normally priced at an amount which is often beyond the reach of small and medium sized organization. However, there are some ERP coming into the market which are moderately priced and may be useful to the small businesses.

4. Complexity of the software : Generally an ERP package has large number of options to choose from. Further the parameter settings and configuration makes it a little complex for the common users.

b. Donations may have been raised either for meeting some revenue or capital expenditure; those intended for the first mentioned purpose are credited directly to the Income and Expenditure Account but others, if the donors have declared their specific intention, are credit to special fund account and in the absence thereof, to the Capital Fund Account. If any investments are purchased out of a special fund or an asset is acquired there from, these are disclosed separately. Any income received from such investments or any donations collected for a special purpose are credited to an account indicating the purpose and correspondingly the expenditure incurred in carrying out the purpose of the fund is debited to this account. On no account any such expense is charged to the Income and Expenditure Account. The term "Fund" is strictly applicable to the amounts collected for a special purpose when these are invested, e.g. Scholarship Fund, Prize Fund etc. In other cases, when the amounts collected are not invested in securities or assets distinguishable from those belonging to the institution, the word "Account" is mote appropriate e.g. Building Account, Tournament Account etc.

c. This refers to unexpired discount. A banking company charges discount in advance for the full period of the bill of exchange or promissory note discounted with it. The accounting entry made is as follows :

Bills Discounted and Purchased A/c Dr.
To customer's A/c
To Discount A/c

Customer's account is credited with the net amount remaining after deducting the amount of discount. The amount credited to the discount account represents the earning of the bank. However, it may be possible that the bills discounted may mature after the close of the financial year. It will not be appropriate to take to the credit of the profit and loss account that part of the discount charged which relates to the next year. An accounting entry is, therefore, passed for unearned discount in the following manner :

Discount A/c Dr.
To rebate on Bills Discounted
(with the amount of unearned discount relating to the next period)

Rebate on bills discounted, if already appears in the trial balance, is taken to the balance sheet on the "liabilities side". However, if adjustment has to be done after preparation of the trial balance in respect of rebate on bills discounted, the amount of such rebate (i.e., the unearned discount) will be deducted from the total discount in the profit and loss account and will also appear as a liability in the balance sheet.

d. In case of general insurance business, in order to ascertain the profit a "reserve for unexpired risk" is created every year. Such reserve simply represents the income received by the insurance company in advance in the form of insurance premiums. Since the insurance company charges premium in advance while the risk may happen on any day in future, it is but appropriate to carry forward a part of the premium income received by the insurance company during a particular year to the next year for meeting any loss that may arise in respect of policies issued during the preceding year. The Executive Committee of the General Insurance Council, lset up under the Insurance Act to supervise general insurance companies, has provided that in case of marine insurance business, the provision against unexpired risk should be 100% of the net premium income and in the case of other business(such as accident, fire, theft, etc.) it should be 40% of the net premium income. However, the Income Tax Authorities allow even a provision of 50% of net premium income as such the practice is to maintain this provision at 50% of the premium income. Moreover, an insurance company may keep additional reserve if it so feels necessary.

e. As stated earlier an electricity company must adjust the rates so that the clear profit in any year does not exceed the reasonable return by more than 20% of the reasonable return. In case, it exceeds, it should be credited to Customers Rebate (or Benefit) Reserve. Moreover, even the surplus within 20% of the reasonable return has to be disposed of as follows:

(i) 1/3 of the surplus not exceeding 5% of the reasonable return will be at the disposal of the undertaking.
(ii) Of the balance ½ will be transferred to the Tariff and Dividend Control Reserve.
(iii) The balance left will be distributed among consumers by way of reductions of rates or by way of special rebate.

f. The qualitative characteristics are attributes that improve the usefulness of information provided in financial statements. The framework suggests that the financial statements should observe and maintain the following four qualitative characteristics as far as possible within limits of reasonable cost/benefit.

1. Understandability :

The financial statements should present information in a manner as to be readily understandable by the users with reasonable knowledge of business and economic activities. It is not right to think that more disclosures are always better. A mass of irrelevant information creates confusion and can be even more harmful than non-disclosure. No relevant information can be however withheld on the grounds of complexity.

2. Relevance:

The financial statements should contain relevant information only. Information, which is likely to influence the economic decisions by the users, is said to be relevant. Such information may help the users to evaluate past, present or future events or may help in confirming or correcting past evaluations. The relevance of a piece of information should be judged by its materiality. A piece of information is said to be material if its omission or misstatement can influence economic decisions of a user.

3. Reliability:

To be useful, the information must be reliable; that is to say, they must be free from material error and bias. The information provided are not likely to be reliable unless:

a. Transactions and events reported are faithfully represented.

b. Transactions and events are reported in terms of their substance and economic reality not merely on the basis of their legal form. This principle is called the principle of 'substance over form'.

c.The reporting of transactions and events are neutral, i.e.free from bias.

d.Prudence is exercised in reporting uncertain outcome of transactions or events.

4. Comparability:

Comparison of financial statements is one of the most frequently used and most effective tools of financial analysis. The financial statements should permit both inter-firm and intra -firm comparison. One essential requirement of comparability is disclosure of financial effect of change in accounting policies.

5. True and fair view:

Financial statements are required to show a true and fair view of the performance, Financial position and cash flows on an enterprise. The conceptual frame work does not deal directly with this concept of true and fair view, yet the application of the principal qualitative characteristics and of appropriate accounting standards normally results in financial statements portraying true and fair view of information about an enterprise.

AG

Total No. of Questions: 8 **Max Marks: 100**
No.of Pages : 2 **Time Allowed: 3 Hours**

Answer all the questions

1. **(Answer any Ten):** State with reasons (in short) whether the following statements are true or false

i) Auditor's lien on his client's books and record is not unconditional.

ii) An adverse report is one where and auditor gives an opinion subject to certain reservation.

iii) Cut-off procedures are generally applied to trading transactions.

iv) Components of Audit Risk does not includes sampling risk.

v) As per As-13, Investment should be classified into Current Investments and Marketable investments.

vi) CARO' 2004 does not applies to a Foreign company.

vii) Test checks refers to the out of routine checks that are carried out on the normal course of audit.

viii) If the auditor believes that the concern will not continues as going concern, he should issue disclaimer of opinion.

ix) An unexplained decrease in the Gross profit ratio may result due to fictitious sales.

x) If the auditor appointed at the AGM refuses to accept the same, the Company can appoint another person by holding General Meeting.

xi) An auditor is considered to lack independence, if the partner of the audit firm owns the building in which the client's business is situated.

xii) As per AAS-2, one of the objective of the audit is to defect fraud.

(10 X 2 = 20)

2. As an auditor comment on the following situations:

a) As an auditor of PQR Ltd., you have asked your audit assistant to draw the audit programme. The assistant drew up the audit programme without going through the monthly report of the International Auditor on the plea that he is a Chartered Accountant and have found no serious irregulaties and internal control system is running perfectly.
(8 Marks)

b) Mr. T. a Chartered Accountant, was first time appointed the Auditor of XYZ Ltd. Mr. T. carried the audit procedure for verifying the opening balances only, but not the previous year's accounting policies as it is not needed.
(6 Marks)

c) Mr. K. auditor of ABC Ltd. is of the opinion that "Auditing and Assurance Standards" are meant only for references and it is not necessary to follow such Auditing and Assurance Standards.
(6 Marks)

3. Explain the following in brief:
a) Relationship between materiality and audit risk
b) Relationship between Statutory Auditor and Internal Auditor.

(5 + 5 = 10)

4. Distinguish between the following:

a) Reserve and Provisions

b) Internal Control Questionnaire and Internal Control Evaluation.

(5 + 5 = 10)

5. a) State the basic elements of the Auditor's Report with illustration of Opening and Opinion paragraphs.

(7 Marks)

b) Explain in brief, the utility of Working Paper to an auditor.

(3 Marks)

6. a) State the circumstances where the auditing through the computer must be used.
(5 Marks)

b) You are approached by a partnership firm to list out the advantages that will accrue to them, if the accounts are audited. State five important advantages.

(5 Marks)

7. **(Answer any two)**: How would vouch/verify the following?

a) Rental Receipts

b) Assets acquired on Hire-purchase

Or

Cash Sales.

c) Contingent Liabilities.

(5 + 5 = 10)

8. **(Answer any two)**: Write short notes on the following
(5 + 5 = 10)

a) Government Expenditure Audit

b) Management Representations

Or

Audit Techniques.

c) Supervision of Audit work.

PRIME ACADEMY

27 –Session PCC AUDITING AND ASSURANCE

Suggested Answers

1.

(i) **True:** The auditor can exercise his lien on client's books records subject to the following conditions:

(a) Document retained must belong to the client who owes the money.

(b) Such retained must have come into auditor's possession with the client's authority.

(c) Some work must have been done and fees for work performed must be outstanding.

(ii) **False:** An adverse report is given when the auditor concludes that based on his examination he does not agree with the affirmation made in the financial statements.

(iii) **True:** They cover the areas of purchases, sales, inventories to ensure that transaction of one year do not get recorded in the following year or preceding year to ensure 'matching' and true and fair view of the accounts.

(iv) **True:** As per AAS-6, three components of audit risk are Inherent risk, Control risk and Detection risk.

(v) **False:** As per AS-13, Investments are classified into current and long term investment Marketable investments are short term and classified as current.

(vi) **False:** CARO' 2004 applies to all companies including foreign companies except Banking, Insurance, Sec.25 Companies and Private Ltd. Companies subject to certain conditions.

(vii) **False:** Test checks refers to an audit procedure wherein only a part is checked to form an opinion instead of checking all the transactions.

(viii) False: As per AAS-16, if the auditor believes that going concern assumption is inappropriate and the entity will not be able to continue its operation in future, he should express an adverse opinion.

(ix) False: A fictitious sale will increase the gross profit ratio instead of decreasing it. G.P Ratio normally comes down if there are unrecorded sales or fictitious purchase or decrease in closing stock.

(x) False: this is not a casual vacancy. Since the newly appointed auditor has refused to accept the appointment, no appointment can be have been made at the AGM. U/s 224(3) of the Companies Act, 1956, the power vests with the Central Govt. to make the appointment.

(xi) False: According to the Guidance Note issued by the ICAI on "Independence of Auditors", "Independence implies that the judgment of a person is not subordinate to the wishes or directions of another person who might have engaged him or to his own self interest." In this case of renting of building to the client does not affect the independence.

(xii) False: As per AAS-2, objective of an audit is to express an opinion on financial statements to help the users of the financial statements to determine the true and fair view.

2. (a) The contention of the audit assistant is not valid and contrary to the view and guidelines given in AAS-1.

As per AAS-1, the basic principles governing an audit are integrity, objectivity and independence. Objectivity implies that Auditor's opinion should be based on facts and evidences collected through audit procedure.

Skill and competence also requires an auditor to exercise due professional care in performing the audit.

The AAS also requires auditor to rely on internal control only after studying and evaluating them.

In the instant case all those basic principles have not been followed by the auditor.

Reliance based on position of the person and blindly accepting the soundness of the internal control violates the basic principles.

Only by evaluation the auditor will know whether the internal audit and related internal control is effective or not.

(b) Contention of Mr. T, the auditor, is not correct and contrary to the AAS-22 on "Initial Engagement – opening balance".

As per the said AAS it is the duty of the auditor, auditing the financial statements first time, to verify and obtain appropriate audit evidence that:

(a) The closing balances of the preceding period are correctly brought forward to the current period.
(b) Whether any misstatement in opening balances is materially affecting the financial statements of the current period and
(c) Accounting policies followed in the preceding period are also being followed in current period.

Hence, in view of the above guidelines of AAS-22 Mr. T should verify the accounting policies also to ensure its continuity.

(c) Contention of Mr. K is totally wrong and is against the fundamental assumptions and guidelines governing auditing and assurance standards.

As per ICAI, while discharging their attest function, it will be the duty of the members of the Institute to ensure that the AASs are followed. The AASs will apply whenever an independent financial audit is carried out to express an opinion thereon.

The member of the Institute must follow the AAss. The auditors must draw attention to the material departures from AAS in their audit report alongwith the reasons for such departure.
Auditors in their report has to mention that audit was conducted in accordance with "Generally accepted auditing standards" in Indian context.

Hence Mr. 'K' is duty bound to follow the AAS.

3. (a) **Relationship between materiality and audit risk:** AAS-13 on 'Audit Materiality' requires that the auditor should consider materiality and its relationship with audit risk when conducting an audit. Materiality depends on the size and the nature of the items judged in the particular circumstances of its misstatement.

The audit should be planned so that audit risk is kept at an acceptably low level. There is an inverse relationship between Materiality and the degree of audit risk. Higher the materiality level the lower the audit risk and vice-versa. After the auditor has assessed the inherent and control risks, he should consider the level of detection risk that he is prepared to accept and, based upon his judgment, select appropriate substantive audit procedures. If the auditor does not perform any substantive procedures, detection risk, that is, the risk that the auditor will fail to detect a misstatement, will be high.

The auditor's assessment of audit risk may change during the course of an audit according to the need and development of the circumstances.

(b) **Relationship between Statutory Auditor and internal Auditor:** The function of an internal auditor being an integral part of the system of internal control, it is obligatory for a statutory auditor to examine the scope, independence and effectiveness of the work carried out by the internal auditor. CARO, 2004 also requires the statutory auditor to comment on the internal audit system.

Though the roles and primary objectives of internal and statutory audit differs, some of their means of achieving their respective objectives are similar. Thus, much of the work of the internal auditor may be useful to the statutory auditor in determining the nature, timing and extent of his audit procedures. Depending upon such evaluation, the statutory auditor may be able adopt less extensive procedures.

If the statutory auditor is satisfied on an examination of the work of the internal auditor, that the internal audit has been efficient and effective, he may accept the checking/evaluation carried out by the internal auditor in the area of internal control verification of assets and liabilities etc.

It must however be mentioned that the area of co-operation between the statutory and internal auditor is limited by the fact that both owe their allegiance to separate authorities, the shareholders in the case of statutory auditor and the management in the case of internal auditor.

4. (a) Reserves and Provisions

(i) Reserve is an appropriation of provision is a charge against Profit.

(ii) Reserves are not intended to meet any liability, contingency or diminution in the value of assets. Provisions are made to provide for depreciation, renewal or a known liability or a disputed claim.

(iii) Reserves cannot be created unless there is a profit except revaluation reserve and capital subsidy. Provisions must be created whether or not there is profit.

(iv) Reserves are generally optional except in certain situations – Capital Redemption reserve, Debenture Redemption Reserve, Declaration of dividend higher than 10% etc. provisions are not optional and have to be made as per generally accepted accounting principles.

(v) Reserves are shown on the liability side. Provisions for depreciation and provision for doubtful debts are shown as deduction from respective assets. Provision for liability is shown on the liability side.

(b) Internal Control Questionnaire (ICQ) and Internal Control Evaluation (ICE) : the internal control questionnaires show the area where weakness occur or likely to occur. They do not give any idea of the importance of those weaknesses. The Internal Control Evaluation brings to light importance of those weakness disclosed by ICQ.

Main points of distinction are:

(i) ICQ incorporates a large number of detailed questions but does not attempt to distinguish their relation in materiality. ICE isolates the main control objectives within the area of review.

(ii) Weaknesses are highlighted a weakness "Yes" on ICE compared with 'No' on ICQ.

(iii) Answer 'no' ICQ indicates a weakness real or potential, but its significance is not revealed. Whereas ICE requires audit personnel to state whether, an apparent weakness may prove to be material in relation to the accounts as a whole.

(iv) The 'Control Checklist' in ICE is more than a summary of key control factory, and is no substitute for ICQ.

5 (a) Basic elements of the Auditor's Report: The auditor's reports includes the following basic elements:

(i) Title: The report should have an appropriate title. It is appropriate to use the term 'Auditor's Report'.

(ii) Addressee: It should be addressed appropriately like appointing authority.

(iii) Opening paragraph: It should identify the financial statement of the entity that have been audited with date and period covered and responsibility of auditor and management.

IIIustration of opening paragraph is:-

"We have audited the attached Balance Sheet of M/s---------------- as at 31st March ------------- and also the profit and loss account for the year ended on that date annexed thereto. These financial statements are the responsibility of the entity's management. Our responsibility is to express an opinion on these financial statements based on our audit".

(iv) Scope Paragraph: It describes the scope of audit and assurance that the audit has been carried out in accordance with established standards.

(v) Opinion Paragraph: It expresses the auditor's opinion on the financial statements.

IIIustration of opening paragraph is:-

"In our opinion and to the best of our information and according to the explanations given to us, financial statement gives a true and fair view in conformity with the accounting principles generally accepted in India:-

(a) in the case of Balance Sheet, of the state of affairs of the M/s _____________ as at 31st March _________________

(b) in the case of Profit and Loss Account of the profit/loss for the year ended on that date.

(vi) Date of Report : Date on which the auditor signs the report.

(vii) Place of Signature: Location, where the audit report is signed.

(viii) Auditor's Signature: Report should be signed by the auditor in his personal name.

(b) Utility of Working Paper: Audit working papers are very useful to the auditor in the following way:

(i) It provides guidance to the audit staff with regard to manner of checking the schedules.

(ii) The auditor is able to fix responsibility on the staff members who signs each schedule.

(iii) It acts as an evidence in the court of law when a charge of negligence is brought against the auditor.

(iv) It acts as the process of planning for the auditor so that he can estimate the time that may be required for checking the schedules.

6 (a) Auditing Through the Computer: There are several circumstances where auditing through the Computer must be used:

(i) The application system processes large volumes of input and produces large volumes of output that makes extensive direct examination of the validity of input and output difficult.

(ii) Significant parts of the internal control system are embodied in the computer system.

(iii) The logic of the system is complex and there are portions that facilitate use of the system or efficient processing.

(iv) Because of cost-benefit considerations, there are substantial gaps in the visible audit trail.

(b) Advantage of audit of accounts of a partnership firm: advantages are as follows (any five):

(i) Audited accounts provide a convenient and reliable means of setting accounts between the partners and thereby possibility of dispute among them is mitigated.

(ii) On the retirement/death of a partner, audited accounts constitutes a reliable evidence for computing the amount due to the retiring partner or representative of deceased partner.

(iii) Audited accounts are generally accepted by the Income tax authorities for computing the assessable Income.

(iv) Audited accounts are relied upon by banks for advancing loan.

(v) Audited accounts can be helpful in the negotiation for sale or admission of a new partner.

(vi) It is an effective safeguard against any undue advantage being taken by a working partner as against the non working partners.

7. [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] Assets acquired on Hire purchase

(i) Inspect the hire purchase agreement to ascertain the terms and condition, the installment and amount of interest included in the installment.

(ii) Ensure that these are treated as assets acquired under finance lease as per AS- 19.

(iii) Verify that initial recognition of lease should be as an asset and a liability at equal amounts.

(iv) If it reasonably certain that lessee will get ownership at the end of the term, see that asset is depreciated over its useful life. Otherwise confirm that asset is depreciated over the shorter of its useful life and the lease term.

(v) Ensure that it is shown separately in the Balance Sheet.

OR

Cash Sales

(i) Examine the system of internal check to ascertain any loopholes therein.

(ii) Ascertain the practice followed in the matter of issuing cash memos and trace the memos into cash sale summary.

(iii) Ensure that the date of cash memos tally with the entry in the cash book/summary.

(iv) Verify that prices of goods sold have been correctly recorded and check the calculation.

(v) Verify the entry in the goods outward book with the sales summary.

(vi) See that the cancelled cash memos are not removed from the receipt book.

(c) Contingent Liabilities

(i) Review minutes of the meetings of the Board of Directors or other similar bodies.

(ii) Review contracts, agreements and arrangements.

(iii) Review list of pending law suits and obtain a certificate and opinion of the lawyer dealing with the cases.

(iv) Review of records relating to contingent liabilities maintained by the company.

(v) Review of terms and condition of grants and subsidy availed.

(vi) Obtain representation fro the management.

(vii) Ensure that proper disclosure is made of all the contingent liabilities.

8 (a) Government Expenditure Audit: It is one of the major components of Government audit. The mains aim is
to ensure that:

(i) The expenditure incurred conforms to the relevant provisions of the statutory enactments and is also in accordance with the financial rule and regulation. This is called audit against rules and orders.

(ii) There is proper sanction either special or general accorded by the competent authority for all expenditure. This is known as audit of sanctions.

(iii) There are provisions or budget of funds out of which expenditure can be met. This is called audit against provisions of fund.

(iv) The expenditure is incurred with due regard to broad and general principle of propriety. This is called propriety audit.

(v) That the programmes, schemes and projects where large expenditure has been incurred are being run economically and yielding results. This is known as performance audit.

(b) Management Representations: AS-11 on 'Representation by Management' establishes standards on the use of management representations as audit evidence, the procedure to be applied in evaluating and documenting management representations and the action to be taken if management refers to provide appropriate representations.

Management Representation is of great use to the auditor when other sufficient appropriate audit evidence cannot reasonably be expected to exist. Representation by management sometimes may constitute only evidence with the auditor where matter is principally of intention.

It cannot be substitute for normal audit procedure. Auditor should seek the corroborative audit evidence supporting representation by the management. Auditor should evaluate the representation as to its reasonability.

Cases where management representation is normally obtained includes accounting policies, cost and physical existence of assets, investments, compliance of relevant laws, capital commitments etc.

OR

(b) Audit Techniques: For collection and accumulation of audit evidence, certain methods and means are available and these are known as audit techniques. Some of the techniques commonly adopted by the auditors are the following:

1. Posting checking
2. Casting checking
3. Physical examination and count
4. Confirmation
5. Inquiry
6. Year-end scrutiny
7. Re-computation
8. Tracing in subsequent period
9. bank reconciliation

The two terms, procedure and techniques often used interchangeably; in fact, however, a distinction does exist. Procedure may comprise a number techniques and represents the board frame of the manner of handling the audit work; techniques stand for the methods employed for carrying out the procedure. For example, procedure requires an examination of the documentary evidence. This job is performed by the procedure known as vouching which would involve technique of inspection and checking computation of documentary evidence. As per AAS-5 on Audit Evidence, basically audit procedures are broadly of two types viz, compliance procedures and substantive procedures. Substantive procedures are further comprised of tests of details and analytical review procedures. Vouching is a substantive audit procedure which involves audit techniques like casting, cross-casting, checking of posting, etc. On the other hand, verification of assets and liabilities is a substantive audit procedure which involves application of audit techniques like physical examination, confirmation from third parties etc.

(c) Supervision of Audit work : AAS-17 on quality control for audit work requires that personnel carrying out the supervisory responsibility should perform the following functions during the audit:

(i) Monitor the progress of the audit to consider whether the assistants have the necessary skills and competence, understanding of the audit directions and are discharging their work as per audit programme;

(ii) Collect and address significant audit questions raised during the audit and based on their significance modifying the overall audit plan and programme and

(iii) Resolve and difference of professional judgment with appropriate consultation.

LC

Total No. of Questions: 20 **Max Marks: 100**
No.of Pages : 3 **Time Allowed: 3 Hours**

PART 1

Question no 1 and 2 are compulsory. Attempt any 8 questions from the rest

1)

(a) A minor lent Rs. 1000 to B at the market rate of interest on the basis of promissory note. A year thereafter, when he had attained majority, he filed a suit against B for the recovery of the amount thereon. B contended that since a was minor at the time the loan was advanced, the contract was void. Would B succeed? (5 marks)

(b) Answer Yes or No to the following. Each sub-division carries one mark.

i) Is mere silecence "acceptance" of contract?
ii) A voidable contract is voidable at the option of the aggrieved party and remains valid until rescinded by him. Is it correct?
iii) Can the promisee accept the performance from a third party instead of the promisor?
iv) In performance of reciprocal promise where one order is expressly fixed and in other the order is understood by implication. Is this possible?
v) A agrees to pay Rs. One lakh if sum rises in the west next morning. Is the contract valid?

(5 marks)

2)

(a) What are rights of an agent? Agency coupled with interest is irrevocable. Is this statement true? (5 marks)

(b) Answer Yes or No to the following. Each sub-division carries one mark.

i) A private company which is a subsidiary of public company is treated as public limited company under Companies Act, 1956.
ii) When the public company is converted into private limited company, the number of directors should be reduced to 2 directors.
iii) A private limited company can commence business only after obtaining the certificate of commencement of business.
iv) A shelf prospectus is prospectus issued by public limited companies for raising capital.
v) A Memorandum of Association overrides the provisions of the Companies Act, 1956.

(5 marks)

3) What is the minimum bonus and maximum bonus payable under the Payment of Bonus Act, 1965? (5 marks)

4) A agrees to supply a quantity of paper to B his friend. B accepts a bill for Rs. 1000 drawn by A being the price of the paper. The paper is delivered to B but it turns out to be out of quality different from the stipulated one and worth rs.500 only. B retains the paper. A sues B on the bill. Is b bound to pay Rs.1000 to A? (5 marks)

5) What are the provisions regarding transfer of account under the employee's provident fund act, 1956? (5 marks)

6) A Hindu undivided family consisting of 11 persons carries on banking with a view to acquiring profit for itself or its members without itself being registered under the Banking Regulation Act, 1949.

   (a) Will it be a legal association?

   (b) Will your answer be the same, if two undivided families would have carried on the said business? (5 marks)

7) Distnguish between Memorandum of Association and Articles of Association. (5 marks)

8) Explain the provisions relating to forfeiture of gratuity under the Payment of Gratuity Act, 1972. (5 marks)

9) Explain the provisions of the Companies act, 1956 relating to interval between two annual general meetings. (5 marks)

10) Explain the meaning of Doctrine of Ultravires. (5 marks)

11) How the articles of association for a Company be altered? (5 marks)

12) What is the meaning of "Sweat Equity shares? (5 marks)

PART II

Question no 13 is compulsory. Answer any two of the rest.

13) (a) Explain the meaning of "Ethical Dilemma ". (5 marks)
(b) Who are stakeholders? Is it the responsibility of the organization to serve the stakeholders under corporate governance? (5 marks)

14) What is the need for social responsibility? Explain. (5 marks)

15) Answer Yes or No to the following. Each sub-division carries one mark.

i) Consumer includes a person who purchases goods or avails services for commercial purposes only.
ii) Right to information is one of the consumer rights.
iii) Ethics are necessary in marketing because to get recognition from the society.
iv) Consumer interest and public interest are synonymous.
v) A consumer was aggrieved by the goods that he purchased from an enterprise covered under the competition act 2002. He can seek remedy under the Competition Act, 2002.
(5 marks)

16) " A business that makes nothing but money is a poor kind of business"". Comment.
(5 marks)

PART III

Question No.17 is compulsory and answer any two questions from the rest. (5 marks)

17) (a) Compare oral communication with written communication. (5 marks)
(b) What are the benefits of effective communication? (5 marks)

18) What are the 'ethical dilemmas' in communication? (5 marks)

19) Draft a Partnership Dissolution Deed. (5 marks)

20) Write a letter to the Registrar of Companies enclosing relevant documents at the time of incorporation of a company. (5 marks)

PRIME ACADEMY

27 –Session PCC

LAW ETHICS AND COMMUNICATION

Suggested Answers
PART 1

1 (a) A minor on attaining major cannot validate any agreement which was entered into when he was minor, as the agreement was void. In this case B would not succeed.

(b)
i) No, Mere silence is not acceptance of contract.
ii) Yes it is correct.
iii) Yes the promise can accept the performance from a third party.
iv) It is possible.
v) No, the contract is not valid.

2 (a) Rights of an agent:
1. Right of lien on principal's property.
2. Right of indemnification for lawful acts.
3. Right of indemnification against acts done in good faith
4. Right of retention
5. Right of remuneration

Yes agency coupled with interest is irrevocable.

(b)
i) It is correct a private company which is a subsidiary of a public company is treated as public limited company under Companies act, 1956.
ii) Yes. The number of shares shares should be reduced to 2 members.
iii) Yes. It is correct.
iv) Not correct. A shelf prospectus is prospectus issued by banks / financial institutions for raising capital.
v) A Memorandum of Association overrides the provisions of the Companies Act, 1956. Not correct. . A Memorandum of Association cannot override the provisions of the Companies Act, 1956.

3. Minimum: 8.33 per cent of the salary or wages earned during the accounting year or Rs. 100 whichever is higher.
Maximum: 20 per cent of the salary or wages earned during the accounting year

4. Yes. B is bound to pay Rs. 1000 to A.

5. Transfer of accounts

Section 17-A of the Employees' provident Funds and Miscellaneous Provisions Act, 1952 provides for the transfer of accounts of an employee in case if his leaving the employment and taking up employment in another establishment and to deal with the case of an establishment to which this act applies and also to which does not apply. The option to get the amount transferred is that of the employee.

Where an employee of an establishment to which the Employees PF Act applies leaves his employment and obtains re-employment in another establishment to which this Act does not apply, the amount of accumulations to the credit of such employee in the fund or, as the case may be, in the provident fund in the establishment left by him shall be transferred to the credit of his account in the provident fund of the establishment in which he is re-employed, if the employee so desires and the rules in relation to that provident fund permit such transfer. This transfer has to be made within such time as may be specified by the central government in this behalf.

Conversely, when an employee of an establishment to which this act does not apply leaves his employment and obtains re-employment in another establishment to which this act applies, the amount of accumulations to the credit of such employee in the provident fund of the establishment left by him, if the employee so desires and the rules in relation to such provident fund permit, may be transferred to the credit of his account in the fund or as the case may be, in the provident fund of the establishment in which he is reemployed.

6.

(a) Yes it is a legal association.

(b) When two undivided families are joining together it will not be a legal association.

7.

S.no	Memorandum of Association	Articles of Association
1.	It is a primary document	It is a secondary document.
2.	It is subordinate to the Companies Act	It is subordinate to the memorandum and the Act.
3	It is the charter of the company and defines the fundamental conditions and objects.	It contains the rules and regulations
4.	For alteration, in certain cases CLB approval is required.	For alteration approval of the members is required.
5	It defines the relation between the company and the outsiders	It defines the relation between the company and the members (Internal management)
6	Acts which are ultravires the memorandum can not be ratified even by all the members	Acts ultravires the Articles can be ratified by the members.
7.	Every company must have its own memorandum	A public company limited by shares need not have articles of its own. In

		such case, table a applies.

8. <u>Forfeiture of gratuity (Section 4 (6)</u>

If the services of an employee have been terminated for any act, willful omission, or negligence causing any damage or loss to, or destruction of property belonging to the employer the gratuity shall be forfeited to the extent of damage or loss so caused.

And if the services of employee have been terminated for his disorderly conduct or any other act of violence on his part, or if the services of such employee have been terminated for any act which constitutes an offence involving moral turpitude, provided that such offence is committed by him in the course of his employment, the gratuity payable to the employee may be wholly or partially forfeited.

In the case of K C Mathew Vs Plantation Corporation of Kerala ltd it was clearly held that withholding of gratuity is not permissible under any circumstances other than those enumerated in section 4 (6) of the payment of gratuity act and the right of gratuity is a statutory right and none can deprived from such right.

9. According to Section 166 (1) there must not be more than 15 months between two consecutive annual general meetings. Section 210 requires the directors of a company to lay at every annual general meeting of the company a profit and loss and account, or in the case of a company not trading for profit, income and expenditure account. The first account must cover the period since its corporation and must be made up to a date not earlier than nine months. Subsequent accounts must cover the period since the preceding account, and must be made up to a date not earlier than the date of the meeting by more than six months.

The date on which the annual general meeting is to be held is apart from the first annual general meting, which is subject to different rules determined by three factors of time.

(1) The meeting must be held in each year;

(2) It must not held later than 15 months from the date of previous annual general meeting; and

(3) It must not held later than six months of date of balance sheet.

These three requirements are cumulative and separate; failure to comply with any of them constitutes an offence unless the Registrar of companies has granted an extension of time for holding the meeting. The period of extension is limited to three months. (Second proviso to Section 166(6).

10. The word ultra means beyond and the word vires means powers. Thus ultra vires means doing an act beyond the powers. Any activity done contrary to or in excess of the scope of activity of director's, Articles, memorandum or companies Act will be ultra vires. The ultra vires acts can be divided into the following categories;

(i) an act ultra vires the directors;
(ii) an act ultra vires the Articles of Association;
(iii) An act ultra vires the memorandum of Association; and
(iv) An act ultra vires the Companies Act.

Ultra-vires the Directors- if the act is ultra vires the directors, it is not altogether void, because this act can be ratified by the general body of shareholders and on such ratification the act becomes binding on the company.

Ultra vires the Memorandum of Association
The Memorandum of a company defines and confines the area within which the company is required to work. The company is formed to carry out or achieve the objects as laid down in the Memorandum. A company cannot do anything which is beyond the purview of the objects clause. If the company does any act which is contrary to the objects clause of Memorandum, it shall be termed as ultra vires the Memorandum and it shall be wholly void or inoperative. Such an act cannot be subsequently ratified or validated even by a unanimous resolution of all the shareholders.

11. Procedure for alteration of Articles of association:

- Convene a General meeting and Pass a Special Resolution.

- File a copy of special resolution in form 23 with ROC within 30 days of the date of resolution.

- File printed copy of altered articles of Company with the ROC within one month of the date of Central government approval wherever applicable.

12. Sweat equity shares means equity shares issued by the company to employees or directors at a discount or for consideration other than cash. Sweat equity shares may be issued for providing know-how or making available intellectual property rights (say, patents) or value additions, by whatever name called. Section 79A, allows companies to issue sweat shares subject to the following conditions:

(a) Sweat equity shares must be of a class of shares already issued by the company:

(b) The issue of sweat equity shares must be authorized by a special resolution passed by the company in the general meeting.

(c) The resolution must specify the number of shares, current market price, consideration if any and the class or classes of directors or employees to whom such equity shares are to be issued.

(d) Not less than one year must have, at the date of the issue, elapsed since the date of on which the company was entitled to commence business.

(e) The sweat equity shares of a company whose equity shares are listed on a recognized stock exchange shall be issued in accordance with the regulations made by the SEBI. However, in the case of a company whose equity shares are not listed, the same must be issued in accordance with the guidelines as may be prescribed.

(f) All the limitations, restrictions and provisions relating to equity shares shall be applicable to such sweat equity shares issued under sub-section (1) of Section 79A(2).

PART II

13. (a)

In business we are faced with the moral and ethical decisions daily. Not only are we faced with questions between right and wrong, but between right and right. According to Joseph Badaracco, we have all experienced situations in which our professional responsibilities unexpectedly come into conflict with our deepest values. We are caught in a conflict between right and right. And no matter which option we choose, we feel like we have come up in short.

Ethical dilemmas faced by the managers are often highly complex with no clear guidelines. Code of ethics is the most widespread means by which companies communicate their ethical standards to the employees. These are formalized rules and standards that describe what a company expects of its employees.

(b) Stakeholders for an organization means

Employees, Trade Unions, Customers, Shareholders and investors, suppliers, local communities, government and Competitors.

Yes it is the responsibility of the organization to serve the stakeholders under corporate governance.

14.

1. If a business intends to retain its existing social role and social power, it must respond to society's needs consecutively.
2. To fulfill long term self interest.
3. To establish better public image
4. To avoid Government Regulation or Control
4. To avoid Misuse of National Resources and economic power

5. To convert Resistance into Resources
6. To minimize Environmental Damage

15. i. No. Persons who purchases goods for commercial purpose is not consumer.

ii. Yes. Right to information is one of the consumer rights.

iii. Yes. Ethics are necessary in marketing because to get recognition from the society.

iv. No. Consumer interest and public interest are not synonymous.

v. Yes. A consumer can seek remedy under the Competition Act, 2002.

16.

Normally it is considered that a business is always done with profit motive. But in reality it is not so. Business has social responsibility also. Corporate social responsibility focuses on the idea that a business has social obligations above and beyond making a profit and follows from a decision by management to expand traditional management to expand traditional governance arrangements to include accountability to the full range of stakeholders. A business unit has economic responsibilities, ethical responsibilities and legal responsibilities. Thus a business that makes nothing but money is a poor kind of business and therefore it has to fulfill the social obligations.

PART III

17.(a)

Oral Communication	Written Communication
More personal and informal	Better for complex and difficult subjects, facts and opinions.
Makes immediate impact	Better for keeping records of messages exchanged
Provides opportunity for interaction and feedback	Provides opportunity to refer back
Helps us to correct ourselves (our messages according to the feedback and non-verbal cues received from the listener)	Can be read at receiver's convenience of pleasure
Better for conveying feelings and emotions	Can be revised before transmitting

(b)

Only through effective communication both inside and outside, an organization becomes an open system interacting with its environment. Effective internal communication works towards establishing and disseminating of the goals of an enterprise, evolving plans for their achievement, organizing human and other resources in an efficient way, selecting developing and appraising members of the organization, leading, motivating and encouraging people to put in their best and controlling performance.

External communication relates an organization to the environment outside. No enterprise can thrive in a vacuum. It has to be aware of the needs of the customers, the availability of the suppliers, the regulations of the government and the concerns of a community.

18. Ethical dilemmas in Communication
    Secrecy
    Needless Whistle-blowing
    Leaks
    Rumours and gossip
    Lying
    Euphemisms
    Ambiguity

19. The Deed of Dissolution executed on this day of 5th June 2008 between;

    1. Mr. R Jayaraman S/o Mr. V Raman aged 45 years, residing at 25, Luz Avenue , Chennai – 600004. (hereinafter called First Party)

    2. Mr. V Gopal S/o Mr S Venugopal aged 52 years residing at 78, New street, Mylapore, Chennai – 600004. (hereinafter called Second party)

    WITNESSETH AS FOLLOWS;

    WHEREAS the aforesaid parties constituted themselves into a partnership to run a business under the name and style of J and G Co the same having been constituted under an instrument of Partnership AND WHEREAS the parties have by mutual consent agreed to dissolve the partnership with effect from 1-9-2008 on the terms and conditions of the dissolution agreed to are hereby set down in writing.

    3. The partners agreed to sell all the assets of the firm and pay all the liabilities of the firm and share the remaining amount in their profit sharing ratio.

WITNESS

1. Signature of the First Party

2. Signature of the Second Party

20. The Registrar of Companies,
Haddows Road,
Chennai - 600006

Dear Sir,

Sub; Incorporation of M/s ABC Limited

We enclose the following documents for the incorporation of M/s ABC Limited

1. Memorandum and Articles of the Company duly stamped and signed by the subscribers,
2. Declaration of Compliance in Form No.1
3. Notice of the situation of the Registered Office of Company in Form No. 18
4. Particulars of Directors in Form No.32 in duplicate
5. Registrar's letter confirming availability of name.
6. Power of Attorney in favour of Mr. R Raman Practicing Chartered Accountant.

We request that the Certificate of Incorporation be issued.

Yours faithfully,

SIGNATURE OF THE PROMOTER