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PAPER – 1 : ACCOUNTING

QUESTIONS

- Mr. Ashok keeps his books in Single Entry system. From the following information, prepare Trading and Profit & Loss Account for the year ended 31st March, 2006 and the Balance Sheet as on that date:

Assets and Liabilities	31.3.2005 (Rs.)	31.3.2006 (Rs.)
Sundry Creditors	30,000	25,000
Outstanding expenses	1,000	500
Fixed Assets	23,000	22,000
Stock	16,000	22,500
Cash in Hand and at Bank	14,000	16,000
Sundry Debtors	?	36,000

Following further details are available for the Current year:

	Rs.		Rs.
Total receipts from debtors	1,30,000	Cash purchases	2,000
Returns inward	3,000	Fixed Assets purchased and paid by cheque	1,000
Bad Debts	1,000	Drawings by cheques	6,500
Total Sales	1,50,000	Deposited into the bank	10,000
Discount received	1,500	Withdrawn from bank	18,500
Return outwards	1,000	Cash in hand at the end	2,500
Capital introduced (paid into Bank)	15,000	Paid to creditors by cheques	1,20,000
Cheques received from Debtors	1,25,000	Expenses paid	20,000

- The balance sheet of A & B, a partnership firm, as at 31st March, 2006 is as follows.

Liabilities	Rs.	Assets	Rs.
Capital accounts:		Goodwill	14,000
A 26,400		Land and building	14,400
B <u>33,600</u>	60,000	Furniture	2,200
Contingency reserve	6,000	Stock	26,000
Sundry creditors	9,000	Sundry debtors	6,400
	<u>75,000</u>	Cash at bank	<u>12,000</u>
			<u>75,000</u>

A & B share profits and losses as 1:2. They agree to admit C (who is also in business on his own) as a third partner from 1.4.2006.

The assets are revalued as under:

Goodwill Rs. 18,000, land and building Rs. 30,000 and furniture Rs. 6,000. C brings the following assets into the partnership goodwill Rs. 6,000, furniture Rs. 2,800 and stock Rs. 13,600.

Profits in the new firm are to be shared equally by the three partners and the capital accounts are to be so adjusted as to be equal. For this purpose, additional cash should be brought in by the partner or partners concerned.

Prepare the necessary accounts and the opening balance sheet of new firm, showing the amounts of cash, if any, which each partner may have to provide.

3. Concept & Co., with its Head Office at Mumbai has a branch at Nagpur. Goods are invoiced to the Branch at cost plus 33 $\frac{1}{3}$ %. The following information is given in respect of the branch for the year ended 31st March, 2006:

	Rs.
Goods sent to Branch (Invoice price)	4,80,000
Stock at Branch on 1.4.2005 (Invoice price)	24,000
Cash sales	1,80,000
Return of goods by customers to the Branch	6,000
Branch expenses (paid in cash)	53,500
Branch debtors balance on 1.4.2005	30,000
Discount allowed	1,000
Bad debts	1,500
Collection from Debtors	2,70,000
Branch debtors cheques returned dishonoured	5,000
Stock at Branch on 31.3.2006 (Invoice price)	48,000
Branch debtors balance on 31.3.2006	36,500

Prepare, under the Stock and Debtors system, the following Ledger Accounts in the books of the Head Office:

Nagpur Branch Stock Account

Nagpur Branch Debtors Account

Nagpur Branch Adjustment Account.

Also compute shortage of Stock at Branch, if any.

4. On 1st March, 2006, XY Corporation Ltd purchased Rs.30,000, 5% Government stock at Rs.95 cum-interest. On 1st May, 2006 the company sold Rs.10,000 of stock at Rs.97 cum-interest. On 15th December, 2006, another Rs.10,000 stock was sold at Rs.93 ex-interest. On 31st December, 2006, the closing date of the financial year, the market price of the stock was Rs.92. Half-yearly interest is received every year as on 30th June and 31st December,.

Prepare a ledger account in the investment ledger assuming that the stock transfer book is closed 20 days before the date of payment of interest. Ignore income tax and brokerage.

5. On 1st April, 2005 Mr. B purchased from Mr. V a machine on hire-purchase basis. The hire-purchase price was Rs.80,000 payable as to Rs.20,000 as down-payment and three annual instalments of Rs.20,000 each; the first annual instalment being payable on 31st March, 2006. Mr. V disclosed that he was charging interest @ 5% per annum. Mr. B charged depreciation on the machine @ 15% per annum on diminishing balance of the machine. He closes his books of account every year on 31st March.

Calculate the cash price of the machine. Also prepare for the three accounting years in Mr. B's ledger the following accounts:

The account of Mr. V, the hire-vendor; Machinery Account; Interest Account and Depreciation Account.

6. B undertook a contract for Rs. 15,00,000 on an arrangement that 80% of the value of work done as certified by the architect of the contractee, should be paid immediately and that the remaining 20% be retained until the contract was completed.

In 2005, the amounts expended were Rs. 3,60,000; the work was certified for Rs. 3,00,000 and 80% of this was paid as agreed. It was estimated that future expenditure to complete the contract would be Rs. 10,00,000

In 2006, the amounts expended were Rs. 4,75,000. Three-fourths of the contract was certified as done by December 31st and 80% of this was received accordingly. It was estimated that future expenditure to complete the contract would be Rs. 4,00,000

In 2007, the amounts expended were Rs. 3,10,000 and on June 30th the whole contract was completed.

Show how the contract revenue would be recognised in the profit & loss account for each year.

7. A, B and C were equal partners. Their balance sheet on 31.12.2006 stood as under, when the firm was dissolved:

Balance Sheet as at 31.12.2006

Liabilities	Rs.	Assets	Rs.
Sundry creditors	32,000	Machinery	12,000
A's capital	4,000	Furniture	3,000
B's capital	3,000	Sundry debtors	5,000
		Stock	4,000
		Cash at bank	2,800
		C's capital	<u>12,200</u>
	<u>39,000</u>		<u>39,000</u>

The assets realised as under:

Machinery Rs.6,000; furniture Rs.1,000; sundry debtors Rs. 4,000 and stock Rs. 3,000.

The expenses of realisation came to Rs. 1,400.

A's personal properties are not sufficient to pay his personal liabilities, whereas in B's and C's private estate there is a surplus of Rs. 2,400 and Rs. 3,000 respectively.

Show necessary accounts closing the books of the firm.

8. Mr. A is insolvent. He supplies to you the following information as on 31.3.2006:

	Rs.
Cash in hand	10,000
Creditors for goods	10,00,000
Taxes due to Government	35,000
Bank loan secured by lien on stock	1,50,000
Furniture (expected to realize Rs.50,000)	75,000
Stock (expected to realize 50%)	6,00,000
Book debts (goods)	4,50,000
Book debts (doubtful) expected to realize 40%	5,50,000
Bills discounted (Rs.40,000 bad)	1,40,000
Loan from Nathan secured by second charge on stock	2,00,000
Bills receivable (Rs.40,000 bad)	1,00,000

Mr. A started business four years ago with a capital of Rs.4,50,000. He drew Rs.75,000 each year for private purposes, but did not maintain proper books of accounts. Mrs. A gave up her jewellery valued Rs.1,00,000 to the receiver.

Prepare Statement of Affairs of Mr. A as on 31.3.2006 and Deficiency Account as on that date.

9. The financial position of P Limited at 31st December, 2005 was as follows:

Liabilities	Rs.	Assets	Rs.
Authorised, Issued and Subscribed Capital		Assets	8,40,000
		Cash and Bank	3,00,000
40,000, 5 % Redeemable Preference shares of Rs. 10 each, fully paid	4,00,000		
20,000 Equity shares of Rs. 10 each, fully paid	2,00,000		
Securities Premium Account	50,000		
Profit and Loss Account	2,80,000		
Sundry Liabilities	2,10,000		
	<u>11,40,000</u>		<u>11,40,000</u>

As per the terms of issue of the Preference Shares these were redeemable at a premium of 5 % on 1st February, 2006 and it was decided to arrange this as far as possible out of the company's resources subject to leaving a balance of Rs. 50,000 in the credit of the Profit and Loss Account. It was also decided to raise the balance amount by issue of 17,000 Equity Shares of Rs. 10 each at a premium of Rs. 2.50 per share.

You are required to prepare the necessary Ledger Accounts giving effect to the above arrangements in the company's books. Journal Entries are not required.

10. The Balance Sheet of Munna Ltd. on 31st March, 2005 is as under:

Liabilities	Rs.	Assets	Rs.
Authorised, issued equity share capital		Goodwill	2,00,000
20,000 shares of Rs. 100 each	20,00,000	Plant and machinery	18,00,000
10,000 preference shares (7%) of Rs. 100 each	10,00,000	Stock	3,00,000
Sundry creditors	7,00,000	Debtors	7,50,000
Bank overdraft	3,00,000	Preliminary expenses	1,00,000
		Cash	1,50,000
		Profit and loss account	<u>7,00,000</u>
	<u>40,00,000</u>		<u>40,00,000</u>

Two years' preference dividends are in arrears. The company had bad time during the last two years and hopes for better business in future, earning profit and paying dividend provided the capital base is reduced.

An internal reconstruction scheme as follows was agreed to by all concerned:

- Creditors agreed to forego 50% of the claim.
- Preference shareholders withdrew arrear dividend claim. They also agreed to lower their capital claim by 20% by reducing nominal value in consideration of 9% dividend effective after reorganization in case equity shareholders' loss exceed 50% on the application of the scheme.
- Bank agreed to convert overdraft into term loan to the extent required for making current ratio equal to 2 : 1.
- Revalued figure for plant and machinery was accepted as Rs. 15,00,000.

- (v) Debtors to the extent of Rs. 4,00,000 were considered good.
- (vi) Equity shares shall be exchanged for the same number of equity shares at a revised denomination as required after the reorganisation.

Show:

- (a) Total loss to be borne by the equity and preference shareholders for the reorganization;
- (b) Share of loss to the individual classes of shareholders;
- (c) New structure of share capital after reorganization;
- (d) Working capital of the reorganized Company; and
- (e) A proforma balance sheet after reorganization.

11. The following balances are extracted from the books of Raj Ltd., a real estate company, on 31st March, 2006:

	Dr.	Cr.
		(Rs.'000)
Sales		2,760
Purchases of materials	1,218	
Share capital fully paid		100
Land purchased in the year as stock	73	
Leasehold premises	42	
Creditors		463
Debtors	735	
Directors' salaries	39	
Wages	111	
Work in progress on 01.04.2005	210	
Sub-contractors' cost	894	
Equipment, Fixtures and Fittings at cost on 01.04.2005	264	
Stock on 01.04.2005	59	
Profit and Loss Account, Credit Balance on 01.04.2005		128
Secured Loan		112
Bank Overdraft		105
Interest on Loan and Overdraft	22	
Depreciation on Equipment on 01.04.2005		164
Administration Expenses	147	
Office Salaries	<u>18</u>	
	<u>3,832</u>	<u>3,832</u>

You also obtain the following information:

- (a) On 31st March, 2006, stock on hand including the land acquired during the year, is valued at Rs. 1,42,000. Work in progress at that date is valued at Rs. 1,40,000.
- (b) On 1st October, 2005 the company moved to new premises. The premises are on a 12 years lease and the lease premium paid amounted to Rs. 42,000. The company used sub-contract labour of Rs. 40,000 and materials at cost of Rs. 38,000 in the refurbishment of the premises. These are to be considered as part of the cost of leasehold premises.
- (c) A review of the debtors reveals specific doubtful debts of Rs. 35,000 and the directors wish to provide for these together with a general provision based on 2% of the balance.

- (d) Depreciation on equipment, fixtures and fittings is provided at 15% on the written down value.
- (e) Raj Ltd. sued Bright Ltd. for supplying defective materials which has been written off as valueless. The Directors are confident that Bright Ltd. will agree for a settlement of Rs. 50,000.
- (f) The directors propose a dividend of 25%.
- (g) Rs. 20,000 is to be provided as audit fee.
- (h) The company will provide 10% of the pre tax profit as bonus to employees in the accounts before charging the bonus.
- (i) Income tax to be provided at 50% of the profits.

You are required:

- (i) to prepare the company's financial statements for the year ended 31st March, 2006 as near as possible to proper form of company final accounts; and
- (ii) to prepare a set of Notes to accounts including significant accounting policies.

Notes: Workings should form part of your answer.

Previous year figures can be ignored.

Figures are to be rounded off to nearest thousands.

12. A company went into liquidation on 31st March, 2006 when the following balance sheet was prepared:-

Liabilities	Rs.	Assets	Rs.
Share Capital:		Goodwill	50,000
Subscribed and paid up capital, 19,500 shares of Rs.10 each	1,95,000	Leasehold Property	48,000
Sundry Creditors:		Plant and Machinery	65,500
		Stock	56,800
Preferential	24,200	Sundry Debtors	64,820
Partly secured	55,310	Cash	2,500
Unsecured	<u>99,790</u>	Profit and Loss Account	98,680
Bank Overdraft (unsecured)	12,000		
	<u>3,86,300</u>		<u>3,86,300</u>

The liquidator realized the assets as follows:	Rs.
Leasehold property which was used in the first instance to pay the partly secured creditors pro rata	35,000
Plant and Machinery	51,000
Sundry Debtors	58,500
Stock	39,000
Cash	2,500

The expenses of liquidation amounted to Rs.1,000 and the liquidator's remuneration was agreed at 2.5% on the amount realized, including cash, and 2% on the amount paid to the unsecured creditors.

You are required to prepare the Liquidator's Final Accounts showing the distribution.

13. A company issues 1,000 14% Debentures of Rs.1,000 each at a premium of 20%. Sixty per cent of the issue was underwritten by M/s Bulls & Bears for a commission @ 1.5% of the issue price of debentures underwritten. Applications were received for 800 debentures which were accepted and payment of these was received in full. Give journal entries.
14. (a) Following are the statements of interest on advances in respect of performing and non-performing assets of Madura Bank Ltd. Find out the income to be recognised for the year ended 31st March, 2006.

	(Rs. in lakhs)	
	Interest earned	Interest received
Performing Assets		
Cash credit and overdrafts	1,800	1,060
Bills purchased and discounted	700	550
Non-performing Assets		
Cash credit and overdrafts	450	70
Bills purchased and discounted	350	36

- (b) Pass journal entries in year 1 in the case of the issue of debentures by ABC Co. Ltd.:
Issued Rs. 1,00,000, 11% debentures at 95% redeemable at the end of 10 years at 102%.
15. (a) Alpha Ltd. issued 2,000, 10% preference shares of Rs. 100 each at par, which are redeemable at a premium of 10%. For the purpose of redemption, the company issued 1,500 equity shares of Rs. 100 each at a premium of 20% per share. Calculate the amount to be transferred by the company to the capital redemption reserve at the time of redemption of preference shares.
- (b) A Ltd. take over B Ltd. on April 01, 2007 and discharges consideration for the business as follows:
- (a) Issued 42,000 fully paid equity shares of Rs. 10 each at par to the equity shareholders of B Ltd.
- (b) Issued fully paid up 15% preference shares of Rs. 100 each to discharge the preference shareholders (Rs. 1,70,000) of B Ltd. at a premium of 10%.
- (c) It is agreed that the debentures of B Ltd. (Rs. 50,000) will be converted into equal number and amount of 13% debentures of A Ltd.

Calculate the amount of purchase consideration.

16. (a) The following is an extract from the Trial Balance of Dream Bank Ltd. as at 31st March, 2006:

Rebate on bills discounted as on 1-4-2005	68,259 (Cr.)
Discount received	1,70,156 (Cr.)

Analysis of the bills discounted reveals as follows:

Amount (Rs.)	Due date
2,80,000	June 1, 2006
8,72,000	June 8, 2006
5,64,000	June 21, 2006
8,12,000	July 1, 2006
6,00,000	July 5, 2006

You are required to find out the amount of discount to be credited to Profit and Loss account for the year ending 31st March, 2006 and pass Journal Entries. The rate of discount may be taken at 10% per annum.

- (b) From the following figures appearing in the books of Fire Insurance division of a General Insurance Company, show the amount of claim as it would appear in the Revenue Account for the year ended 31st March, 2006 :

	Direct Business Rs.	Re- Insurance Rs.
Claim paid during the year	46,70,000	7,00,000
Claim Payable—1st April, 2005	7,63,000	87,000
31st March, 2006	8,12,000	53,000
Claims received	—	2,30,000
Claims Receivable—1st April, 2005	—	65,000
31st March, 2006	—	1,13,000
Expenses of Management (includes Rs. 35,000 Surveyor's fee and Rs. 45,000 Legal expenses for settlement of claims)	2,30,000	—

17. From the following information, calculate cash flow from operating activities:

Summary of Cash Account for the year ended March 31, 2008

Particulars	Rs.	Particulars	Rs.
To Balance b/d	1,00,000	By Cash Purchases	1,20,000
To Cash sales	1,40,000	By Creditors	1,57,000
To Debtors	1,75,000	By Office & Selling Expenses	75,000
To Trade Commission	50,000	By Income Tax	30,000
To Sale of Investment	30,000	By Investment	25,000
To Loan from Bank	1,00,000	By Repay of Loan	75,000
To Interest & Dividend	1,000	By Interest on loan	10,000
		By Balance c/d	1,04,000
	<u>5,96,000</u>		<u>5,96,000</u>

18. Power Electric Company decides to replace one of its old plant by an improved plant with larger capacity. The cost of the new plant is Rs. 16,00,000.

Materials and Labour earlier and now are in the ratio of 4 : 6.

Original cost of the old plant is Rs. 3,00,000. Materials cost has gone up by 2½ times and Labour cost by 3 times since then. Old materials worth Rs. 10,000 were used in the construction of the new plant and Rs. 20,000 were realised from the sale of old materials.

Give the necessary Journal Entries for recording the above transactions.

19. (a) Explain "Treasury system" and the functions entrusted to a Treasury.
 (b) Describe the procedure for compilation of accounting information in agricultural farm.
20. (a) Explain the necessity of creating unexpired risk reserve in the case of insurance companies.
 (b) Explain the implications of business entity concept for accounting purposes.
 (c) Describe the procedure for recognition of revenue under completed contract method.

- (d) Distinguish between realization and revaluation account in partnership accounts.
21. (a) Explain the concept of periodicity in brief.
 (b) What are the contents of 'Liquidator's statement of account'? Explain in brief.
 (c) What is meant by partial underwriting along with firm underwriting?
 (d) Write short note on classification of investments by a banking company.
22. Theory questions based on Accounting Standards
 (a) What is meant by an operating lease? Discuss in line with AS 19.
 (b) Explain the procedure for calculation of diluted earnings per share as per AS 20.
 (c) Write a short note on events occurring after balance sheet date and their disclosure requirements as per AS 4.
 (d) A company acquired a software for internal use. How will you account for such costs?
 (e) What are borrowing costs? Give five examples.
 (f) Describe the procedure for computation of cost of control while preparing consolidated financial statements.
 (g) Explain the provisions of AS 6 regarding change in method of charging depreciation.
 (h) Describe the procedure of translating the financial statements of a non-integral foreign operations for incorporation in financial statements of a reporting enterprise.
 (i) Explain disclosure requirements as regards changes in accounting estimates reported in prior interim periods or prior financial years assuming they have a material effect in current financial period.
23. Problems based on practical application of Accounting Standards
 (a) During the year 2005-2006, a medium size manufacturing company wrote down its inventories to net realisable value by Rs. 5,00,000. Is a separate disclosure necessary in final accounts?
 (b) The company deals in three products, A and B, which are neither similar nor interchangeable. At the time of closing of its account for the year 2005-06. The Historical Cost and Net Realisable Value of the items of closing stock are determined as follows:

Items	Historical Cost (Rs. in lakhs)	Net Realisable Value (Rs. in lakhs)
A	40	28
B	16	24

What will be the value of Closing Stock?

- (c) X Ltd. entered into an agreement to sell its immovable property included in the Balance Sheet at Rs.10 lacs to another company for Rs.15 lacs. The agreement to sell was concluded on 28th February, 2006 and the sale deed was registered on 1st May, 2006. Comment with reference to AS 4.
- (d) A Pharma Company spent Rs. 33 lakhs during the accounting year ended 31st March, 2006 on a research project to develop a drug to treat "AIDS". Experts are of the view that it may take four years to establish whether the drug will be effective or not and even if found effective it may take two to three more years to produce the medicine, which can be marketed. The company wants to treat the expenditure as deferred revenue expenditure. Comment.
- (e) In May, 2004 Speed Ltd. took a bank loan to be used specifically for the construction of a new factory building. The construction was completed in January, 2005 and the building was

put to its use immediately thereafter. Interest on the actual amount used for construction of the building till its completion was Rs. 18 lakhs, whereas the total interest payable to the bank on the loan for the period till 31st March, 2005 amounted to Rs. 25 lakhs.

Can Rs. 25 lakhs be treated as part of the cost of factory building and thus be capitalized on the plea that the loan was specifically taken for the construction of factory building?

- (f) At the end of the financial year ending on 31st December, 2006, a company finds that there are twenty law suits outstanding which have not been settled till the date of approval of accounts by the Board of Directors. The possible outcome as estimated by the Board is as follows:

	Probability	Loss (Rs.)
In respect of five cases (Win)	100%	—
Next ten cases (Win)	60%	—
Lose (Low damages)	30%	1,20,000
Lose (High damages)	10%	2,00,000
Remaining five cases		
Win	50%	—
Lose (Low damages)	30%	1,00,000
Lose (High damages)	20%	2,10,000

Outcome of each case is to be taken as a separate entity. Ascertain the amount of contingent loss and the accounting treatment in respect thereof.

- (g) Z Ltd. presents the following information for the year ending 31.03.2005 and 31.03.2006 from which you are required to calculate the Deferred Tax Asset/Liability assuming tax rate of 30% and state how the same should be dealt with as per relevant accounting standard.

	31.03.2005	31.03.2006
	Rs. (lakhs)	Rs. (lakhs)
Depreciation as per books	4,010.10	4,023.54
Unabsorbed carry forward business loss and depreciation allowance	2,016.60	4,110.00
Disallowance under Section 43B of Income tax Act, 1961	518.35	611.45
Deferred Revenue Expenses	4.88	—
Provision for Doubtful Debts	282.51	294.35

Z Ltd. had incurred a loss of Rs. 504 lakhs for the year ending 31.03.2006 before providing for Current Tax of Rs. 26.00 lakhs.

- (h) A company deals in petroleum products. The sale price of petrol is fixed by the government. After the Balance Sheet date, but before the finalisation of the company's accounts, the government unexpectedly increased the price retrospectively. Can the company account for additional revenue at the close of the year? Discuss.
- (i) Mohur Ltd. has equity capital of Rs.40,00,000 consisting of fully paid equity shares of Rs.10 each. The net profit for the year 2004-05 was Rs.60,00,000. It has also issued 36,000, 10% convertible debentures of Rs.50 each. Each debenture is convertible into five equity shares. The tax rate applicable is 30%. Compute the diluted earnings.

SUGGESTED ANSWERS/HINTS

1. Trading and Profit and Loss Account
for the year ended on 31st March, 2006

Particulars	Amount Rs.	Particulars	Amount Rs.
To Opening Stock	16,000	By Sales:	
To Purchases:		Cash	
Cash	2,000	(W.N.1)	6,500
Credit (W.N.3)	<u>1,17,500</u>	Credit	<u>1,43,500</u>
	1,19,500		1,50,000
Less: Returns	<u>1,000</u>	Less: Returns	<u>3,000</u>
	1,18,500		1,47,000
To Gross Profit c/d	<u>35,000</u>	By Stock	22,500
	<u>1,69,500</u>		<u>1,69,500</u>
To Expenses	20,000		
Add: O/s at the end	<u>500</u>	By Gross profit b/d	35,000
	20,500	By Discount received	1,500
Less: O/s at the beginning	<u>1,000</u>		
	19,500		
To Bad debts	1,000		
To Depreciation	2,000		
To Net Profit	<u>14,000</u>		
	<u>36,500</u>		<u>36,500</u>

Balance Sheet
as on 31st March, 2006

Liabilities	Amount Rs.	Assets	Amount Rs.
Capital (W.N.5)	48,500	Fixed Assets	23,000
Add: Additional Capital	15,000	Add: Purchased during the year	1,000
Add: Net Profit	14,000	Less: Depreciation	<u>2,000</u>
Less: Drawings	<u>6,500</u>		22,000
	71,000	Stock	22,500
Creditors	25,000	Cash	2,500
Outstanding Exp.	500	Bank	13,500
		Debtors	<u>36,000</u>
	<u>96,500</u>		<u>96,500</u>

Working Notes:

1. Cash Account

Particulars	Amount Rs.	Particulars	Amount Rs.
To Balance b/d	4,500	By Purchases	2,000
To Sales (Bal. Fig.)	6,500	By Bank (contra)	10,000
To Debtors	5,000	By Expenses	20,000
To Bank (contra)	<u>18,500</u>	By Balance c/d	<u>2,500</u>
	<u>34,500</u>		<u>34,500</u>

2. Bank Account

Particulars	Amount Rs.	Particulars	Amount Rs.
To Balance b/d (Bal. Fig.)	9,500	By Fixed Assets	1,000
To Capital	15,000	By Drawings	6,500
To Cash (contra)	10,000	By Cash (contra)	18,500
To Debtors	1,25,000	By Creditors	1,20,000
	<u> </u>	By Balance c/d	<u>13,500</u>
	<u>1,59,500</u>		<u>1,59,500</u>

3. Creditors Account

Particulars	Amount Rs.	Particulars	Amount Rs.
To Bank	1,20,000	By Balance b/d	30,000
To Returns	1,000	By Purchase (Bal. Fig.)	1,17,500
To Discount received	1,500		
To Balance c/d	<u>25,000</u>		<u> </u>
	<u>1,47,500</u>		<u>1,47,500</u>

4. Debtors Account

Particulars	Amount Rs.	Particulars	Amount Rs.
To Balance b/d (Bal. Fig.)	26,500	By Cash	5,000
To Sales	1,43,500	By Bank	1,25,000
		By Bad Debts	1,000
		By Returns	3,000
	<u> </u>	By Balance c/d	<u>36,000</u>
	<u>1,70,000</u>		<u>1,70,000</u>

5. Opening Balance Sheet as on 31.3.2005

Liabilities	Amount Rs.	Assets	Amount Rs.
Creditors	30,000	Fixed Assets	23,000
O/s Expenses	1,000	Stock	16,000
Capital (Bal. Fig.)	48,500	Cash	4,500
		Bank (W.N.2)	9,500
	<u> </u>	Debtors (W.N.4)	<u>26,500</u>
	<u>79,500</u>		<u>79,500</u>

2. Profit & Loss Adjustment Account

Dr.		Rs.	Cr.
			Rs.
To Partner's capital accounts (profit on revaluation)		By Goodwill	4,000
		By Land & building	15,600
		By Furniture	3,800
A	7,800		
B	<u>15,600</u>		<u> </u>
			<u>23,400</u>

Partners' Capital Accounts

Dr.							Cr.
	A	B	C		A	B	C
	Rs.	Rs.	Rs.		Rs.	Rs.	Rs.
To Balance c/d	53,200	53,200	53,200	By Balance b/d	26,400	33,600	
				By Contingency reserve	2,000	4,000	-
				By Profit & loss adjustment A/c	7,800	15,600	-
				By Sundry assets	-	-	22,400
				By Bank A/c	<u>17,000</u>		<u>30,800</u>
	<u>53,200</u>	<u>53,200</u>	<u>53,200</u>		<u>53,200</u>	<u>53,200</u>	<u>53,200</u>

Balance Sheet of New Firm as on 1st April, 2006

Liabilities		Rs.	Rs.	Assets	Rs.
Capital accounts:				Goodwill (18,000+6,000)	24,000
	A	53,200		Land & building	30,000
	B	53,200		Furniture (6,000+ 2,800)	8,800
	C	<u>53,200</u>	1,59,600	Stock (26,000+13,600)	39,600
Sundry creditors			9,000	Sundry debtors	6,400
				Cash at bank	<u>59,800</u>
			<u>1,68,600</u>		<u>1,68,600</u>

Note : Capital accounts of partners are to be so adjusted as to be equal and therefore, additional cash is to be brought in by the partner or partners concerned. For this purpose, highest capital of the partners is to be taken as base. In this case B's capital becomes highest, accordingly A is required to bring in Rs. 17,000 (53,200-36,200) and C has to bring in Rs. 30,800 (53,200-22,400).

3.

In the books of head office

Nagpur Branch Stock Account

	Rs.		Rs.
1.4.05 To Balance b/d	24,000	31.3.06 By Bank A/c	1,80,000
		(Cash Sales)	
31.3.06 To Goods sent to Branch A/c	4,80,000	By Branch Debtors (Credit Sales)	2,80,000
To Branch Debtors	6,000	By Stock shortage:	
		Branch P&L A/c	1,500*
		Branch Adjustment A/c (Loading)	<u>500</u>
		By Balance c/d	<u>48,000</u>
	<u>5,10,000</u>		<u>5,10,000</u>

Nagpur Branch Debtors Account

1.4.05 To Balance b/d	30,000	31.3.06 By Bank A/c	
		(Collection)	2,70,000
31.3.06 To Bank A/c (dishonour of cheques)	5,000	By Branch Stock A/c	6,000
To Branch Stock A/c	2,80,000*	By Bad debts	1,500

	By Discount allowed	1,000
	By Balance c/d	<u>36,500</u>
<u>3,15,000</u>		<u>3,15,000</u>

Nagpur Branch Adjustment Account

To Branch Stock A/c (loading of loss)	500*	By Stock Reserve A/c	6,000
To Stock Reserve	12,000	By Goods sent to Branch A/c	1,20,000
To Gross Profit c/d	<u>1,13,500</u>		
	<u>1,26,000</u>		<u>1,26,000</u>
To Branch Stock A/c (Cost of loss)	1,500	By Gross Profit b/d	1,13,500
To Branch Expenses	56,000		
To Net Profit (Transferred to General P & L A/c)	<u>56,000</u>		
	<u>1,13,500</u>		<u>1,13,500</u>

*Balancing figure.

Working Notes:

- Credit Sales have not been given in the problem. So, the balancing figure of Branch Debtors Account is taken as credit sales
- Loading is $33\frac{1}{3}\%$ or Cost; i.e. 25% of invoice value
Loading on opening stock = $24,000 \times 25\% = 6,000$
- Loading on goods sent = $4,80,000 \times 25\% = \text{Rs. } 1,20,000$
- Loading on Closing Stock = $\text{Rs. } 48,000 \times 25\% = \text{Rs. } 12,000$
- Total Branch Expenses = Cash expenses + Bad debt + Discount allowed
= $\text{Rs. } 53,500 + \text{Rs. } 1,500 + \text{Rs. } 1,000 = \text{Rs. } 56,000$
- Gross Profit

Total sales (at invoice price) - Goods returned by customers (at invoice price) $\times \frac{33.33}{100 + 33.33}$

$\{(\text{Rs. } 1,80,000 + \text{Rs. } 2,80,000) - \text{Rs. } 6,000\} \times \frac{33.33}{133.33} = \text{Rs. } 1,13,500$

4.

In the books of XY Corporation Ltd.

5% Government Stock Account

Dr.		[Interest Payable: 30 th June & 31 st December]						Cr.	
	Particulars	Nominal Value	Interest (Rs.)	Cost (Rs.)	Date	Particulars	Nominal Value	Interest (Rs.)	Cost (Rs.)
1.3.2006	To Bank A/c (Note 1)	30,000	250	28,250	1.5.2006	By Bank A/c (Note 2)	10,000	167	9,533
31.12.2006	To Profit & Loss A/c	-	896	-	30.6.2006	By Bank A/c (Interest)	-	500	-
					15.12.2006	By Bank A/c (Note 3)	10,000	229	9,300
					31.12.2006	By Bank A/c (Interest)	-	250	-

			31.12.2006	By Profit & Loss A/c	-	-	217
			31.12.2006	By Balance c/d (Note 4)	10,000	-	9,200
	<u>30,000</u>	<u>1,146</u>			<u>30,000</u>	<u>1,146</u>	<u>28,250</u>

Working Notes:

(1) Purchase of Stock (cum-Interest) on 1.3.2006	Rs.	(2) Sale of Stock (cum-Interest) on 1.5.2006	Rs.
Nominal Value	<u>30,000</u>	Nominal Value	<u>10,000</u>
Total amount paid (300 x Rs.95)	28,500	Sales Proceeds (100 x Rs.97)	9,700
Less: Accrued Interest for 2 months (30,000x5/100x2/12)	250	Less: Accrued Interest for 4 months (10,000x5/100x4/12)	<u>167</u>
Cost	<u>28,250</u>		<u>9,533</u>
(3) Sale of Stock (ex-Interest) on 15.12.2006		(4) Cost of Stock on 31.12.2006	Rs.
Nominal Value	<u>10,000</u>	(i) Cost Price (28,250/30,000x10,000)	9,416
Sale Proceeds (100 x Rs.93)	9,300	(ii) Market Price (100x Rs. 92)	9,200
Accrued Interest for 5½ months (10,000 x 5/100 x 11/24)	229	Value of Stock will be Rs.9,200 (being lower than cost price)	

5.

Dr.				Machinery Account			Cr.
1-4-2005	To	Vendor A/c	74,466	31-3-2006	By	Depreciation A/c	11,170
					By	Balance c/d	<u>63,296</u>
			<u>74,466</u>				<u>74,466</u>

1-4-2006	To	Balance b/d	63,296	31-3-2007	By	Depreciation A/c	9,494
					By	Balance c/d	<u>53,802</u>
			<u>63,296</u>				<u>63,296</u>
1-4-2007	To	Balance b/d	53,802	31-3-2008	By	Depreciation A/c	8,070
					By	Balance c/d	<u>45,732</u>
			<u>53,802</u>				<u>53,802</u>

1-4-2008	To	Balance b/d	45,732
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Dr.				Mr. V. Account			Cr.
1-4-2005	To	Bank A/c	20,000	1-4-2005	By	Machinery A/c	74,466
31.3.2006	To	Bank A/c	20,000	31-3-2006	By	Interest A/c	2,723
	To	Balance c/d	<u>37,189</u>				
			<u>77,189</u>				<u>77,189</u>
31-3-2007	To	Bank A/c	20,000	1-4-2006	By	Balance b/d	37,189
	To	Balance c/d	<u>19,048</u>	31-3-2007	By	Interest A/c	<u>1,859</u>
			<u>39,048</u>				<u>39,048</u>
31.3.2008	To	Bank A/c	20,000	1-4-2007	By	Balance b/d	19,048
				31-3-2008	By	Interest A/c	<u>952</u>
			<u>20,000</u>				<u>20,000</u>

Dr.				Interest Account			Cr.
31-3-2006	To	V A/c	<u>2,723</u>	31-3-2006	By	Profit & Loss A/c	<u>2,723</u>
			<u>2,723</u>				<u>2,723</u>

31-3-2007	To	V A/c	<u>1,859</u>	31-3-2007	By	Profit & Loss A/c	<u>1,859</u>
			<u>1,859</u>				<u>1,859</u>
31-3-2008	To	V A/c	<u>952</u>	31-3-2008	By	Profit & Loss A/c	<u>952</u>
			<u>952</u>				<u>952</u>

Dr.				Depreciation Account			Cr.
31-3-2006	To	Machinery A/c	<u>11,170</u>	31-3-2006	By	Profit & Loss A/c	<u>11,170</u>
			<u>11,170</u>				<u>11,170</u>
31-3-2007	To	Machinery A/c	<u>9,494</u>	31-3-2007	By	Profit & Loss A/c	<u>9,494</u>
			<u>9,494</u>				<u>9,494</u>
31-3-2008	To	Machinery A/c	<u>8,070</u>	31-3-2008	By	Profit & Loss A/c	<u>8,070</u>
			<u>8,070</u>				<u>8,070</u>

Working Note:

Year	Instalment	Interest	CPI	Amount outstanding (opening)
3	20,000	$5/105 \times 20,000 = 952$	$20,000 - 952 = 19,048$	19,048
2	20,000	$5/105 (20,000 + 19,048) = 1,859$	$20,000 - 1,859 = 18,141$	37,189
1	20,000	$5/105 (20,000 + 37,189) = 2,723$	$20,000 - 2,723 = 17,277$	54,466
Down Payment	20,000	Nil	20,000	74,466

Cash price for machinery is Rs.74,446

6.

Particulars	2005	2006	2007
Contract Price	1,500,000	1,500,000	1,500,000
Less: Expenditure till date	360,000	835,000	1,145,000
	<u>1,140,000</u>	<u>665,000</u>	<u>355,000</u>
Less: Expected Future Profits	1,000,000	400,000	-
Profits	<u>140,000</u>	<u>265,000</u>	<u>355,000</u>

Stage of Completion	20%	75%	100%
Profit to be recognised	NIL	133,163	355,000

7.

In the books of A,B and C
Realisation Account

Dr.						Cr .
2006		Rs.	Rs.	2006		Rs.
Dec. 31	To Sundry assets:			Dec. 31	By Bank A/c:	
	Machinery	12,000			Machinery	6,000
	Furniture	3,000			Furniture	1,000

Debtors	5,000	
Stock	<u>4,000</u>	24,000
To Bank A/c: expenses		1,400
		<u>25,400</u>

Debtors	4,000	
Stock	<u>3,000</u>	14,000
By Partner's capital A/c: (loss on realisation)		
A	3,800	
B	3,800	
C	<u>3,800</u>	<u>11,400</u>
		<u>25,400</u>

Bank Account

Dr.		Rs.	2006	Cr.		Rs.	2006
2006							
Dec. 31	To Balance b/d	2,800	Dec. 31	By Realisation A/c	1,400		
	To Realisation A/c	14,000		By Creditors A/c (balancing figure)	20,800		
	To B's capital A/c	2,400					
	To C's capital A/c	<u>3,000</u>					
		<u>22,200</u>					

Creditors Account

Dr.		Rs.	2006	Cr.		Rs.	2006
2006							
Dec. 31	To Bank A/c	20,800	Dec. 31	By Balance b/d	32,000		
	To Deficiency A/c	<u>11,200</u>					
		<u>32,000</u>					

Partners' Capital Accounts

Dr.		A	B	C	2006		A	B	C	Cr.
		Rs.	Rs.	Rs.			Rs.	Rs.	Rs.	
2006					2006					
Dec. 31	To Balance b/d			12,200	Dec. 31	By Balance b/d	4,000	3,000	-	
	To Realisation A/c	3,800	3,800	3,800		By Bank A/c	-	2,400	3,000	
	To Deficiency A/c	200	1,600			By Deficiency A/c			13,000	
		<u>4,000</u>	<u>5,400</u>	<u>16,000</u>			<u>4,000</u>	<u>5,400</u>	<u>16,000</u>	

Deficiency Account

Dr.		Rs.	2006	Cr.		Rs.	2006
2006							
Dec.31	To C's capital A/c	13,000	Dec.31	By Creditors A/c	11200		
				By A's capital A/c	200		
				By B's capital A/c	<u>1,600</u>		
		<u>13,000</u>			<u>13,000</u>		

8. Statement of Affairs of Mr. 'A' as on 31.3.2006

Gross Liabilities	Liabilities	Expected to Rank	Property & Assets	Book Value	Expected to produce
Rs.	Rs.			Rs.	Rs.
11,40,000	Unsecured creditors as per list A	10,40,000	Property as per list E		
1,50,000	Fully secured Creditors		Cash in Hand	10,000	10,000
	As per List B (Bank Loan)	1,50,000	Furniture	75,000	50,000
	Estimated value of stock	<u>3,00,000</u>	Jewellery from wife	-	1,00,000
	Surplus transferred to List C	1,50,000	Book debts as per List F		
		<u>1,50,000</u>	-		
2,00,000	Partly secured creditors as per List C (Loan from Nathan)	2,00,000	Good	4,50,000	4,50,000
	Surplus transferred from List B		Doubtful	5,50,000	2,20,000
		<u>1,50,000</u>			
35,000	Preferential creditors as per list D	35,000	Bills Receivable as per list G	<u>1,00,000</u>	<u>60,000</u>
	Deducted as per contra	<u>35,000</u>		11,85,000	8,90,000
			Less: Preferential creditors as per contra		<u>35,000</u>
					8,55,000
			Deficiency as per List H		<u>2,35,000</u>
<u>15,25,000</u>		<u>10,90,000</u>			<u>10,90,000</u>

Deficiency Account (List H)

	Rs.		Rs.	Rs.
Excess of Assets over Liabilities	4,50,000	Bad debts as per List F		3,30,000
Profit (Note 2)	2,50,000	Drawings (75,000x4)		3,00,000
Income or Profit from other sources Jewellery from wife	1,00,000	<u>Other Losses</u>		
Deficiency as per List H	2,35,000	Loss on realization of		
		Furniture	25,000	
		Stock	3,00,000	
		Bills receivable	<u>40,000</u>	3,65,000
		Loss on Bills Discounted		<u>40,000</u>
	<u>10,35,000</u>			<u>10,35,000</u>

Note 1: Calculation of unsecured creditors

	Gross	Expected to Rank
	Rs.	Rs.
Creditors for Goods	10,00,000	10,00,000
Liabilities for Bills Discounted	<u>1,40,000</u>	<u>40,000</u>
	<u>11,40,000</u>	<u>10,40,000</u>

Note 2: Calculation of Accumulated Profit/Loss

Trial Balance			
Debit	Rs.	Credit	Rs.
Cash	10,000	Creditors	10,00,000
Furniture	75,000	Taxes due to Government	35,000
Stock	6,00,000	Bank Loan	1,50,000
Debtors (4,50,000 + 5,50,000)	10,00,000	Loan from Nathan	2,00,000
Bills Receivable	1,00,000	Capital	4,50,000
Drawings (75,000 x 4)	<u>3,00,000</u>	Accumulated Profit (b/f)	<u>2,50,000</u>
	<u>20,85,000</u>		<u>20,85,000</u>

9. 5% Redeemable Preference Share Capital Account

2006	Rs.	2006	Rs.
Feb. 1 To Preference Share holders A/c	4,00,000	Jan. 1 By Balance b/d	4,00,000
	<u>4,00,000</u>		<u>4,00,000</u>

Preference Shareholders Account

2006	Rs.	2006	Rs.
Feb. 1 To Bank A/c	4,20,000	Feb. 1 By 5% Redeemable Preference Share Capital A/c	4,00,000
		By Premium on Redemption A/c	20,000
	<u>4,20,000</u>		<u>4,20,000</u>

Premium on Redemption Account

2006	Rs.	2006	Rs.
Feb. 1 To Preference Share-holders A/c	<u>20,000</u>	Feb. 1 By Securities Premium A/c	<u>20,000</u>

Equity Shares Application and Allotment Account

2006	Rs.	2006	Rs.
Feb. 1 To Equity Share Capital A/c	1,70,000	Feb. 1 By Bank A/c	2,12,500
To Securities Premium A/c	<u>42,500</u>		
	<u>2,12,500</u>		<u>2,12,500</u>

Capital Redemption Reserve Account

2006	Rs.	2006	Rs.
Feb. 1 To Balance c/d	<u>2,30,000</u>	Feb. 1 By Profit and Loss A/c	<u>2,30,000</u>
	<u>2,30,000</u>		<u>2,30,000</u>

Equity Share Capital Account

2006	Rs.	2006	Rs.
Feb. 1 To Balance	3,70,000	Jan. 1 By Balance b/d	2,00,000
		Feb. 1 By Equity shares application and allotment A/c	<u>1,70,000</u>
	<u>3,70,000</u>		<u>3,70,000</u>

Securities Premium Account

2006		Rs.	2006		Rs.
Feb. 1	To Premium on Redemption A/c	20,000	Jan. 1	By Balance b/d	50,000
	To Balance c/d	<u>72,500</u>	Feb. 1	By Equity Shares Application and Allotment A/c	<u>42,500</u>
		<u>92,500</u>			<u>92,500</u>

Profit and Loss Account

2006		Rs.	2006		Rs.
Feb. 1	To Capital Redemption Reserve A/c	2,30,000	Jan. 1	By Balance b/d	2,80,000
	To Balance c/d	<u>50,000</u>			
		<u>2,80,000</u>			<u>2,80,000</u>

Cash and Bank Account

2006		Rs.	2006		Rs.
Jan. 1	To Balance b/d	3,00,000	Feb. 1	By Preference Share Holders A/c	4,20,000
Feb. 1	To Equity Share Application and Allotment A/c	<u>2,12,500</u>		By Balance c/d	<u>92,500</u>
		<u>5,12,500</u>			<u>5,12,500</u>

Note: No dividend has been paid on preference shares in the above solution. Alternatively, dividend may be paid at the rate of 5% for one month because the redemption takes place on 1st February, 2006 assuming that the articles of the company and terms of contract of company with the preference shareholders provide for such dividend.

10. (a) Loss to be borne by Equity and Preference Shareholders

	Rs.
Profit and loss account (debit balance)	7,00,000
Preliminary expenses	1,00,000
Goodwill	2,00,000
Plant and machinery (Rs. 18,00,000 – Rs. 15,00,000)	3,00,000
Debtors (Rs. 7,50,000 – Rs. 4,00,000)	<u>3,50,000</u>
Amount to be written off	16,50,000
Less: 50% of sundry creditors	<u>3,50,000</u>
Total loss to be borne by the equity and preference shareholders*	<u>13,00,000</u>

(b) Share of loss to preference shareholders and equity shareholders

Total loss of Rs. 13,00,000 being more than 50% of equity share capital i.e. Rs.10,00,000.

Preference shareholders' share of loss = 20% of Rs. 10,00,000 = Rs. 2,00,000

Equity shareholders' share of loss (Rs. 13,00,000 – Rs. 2,00,000) = Rs. 11,00,000

Total loss Rs. 13,00,000

* Two years' preference dividend (arrears) have been ignored in the computation of loss to be borne by equity and preference shareholders.

(c) New structure of share capital after reorganisation

Equity shares:	Rs.
20,000 equity shares of Rs. 45 each, fully paid up (Rs. 20,00,000 – Rs. 11,00,000)	9,00,000
Preference shares:	
10,000, 9% preference shares of Rs. 80 each, fully paid up (Rs. 10,00,000 – Rs. 2,00,000)	<u>8,00,000</u>
	<u>17,00,000</u>

(d) Working capital of the reorganized company

Current Assets:	Rs.	Rs.
Stock		3,00,000
Debtors		4,00,000
Cash		<u>1,50,000</u>
		8,50,000
Less: Current liabilities:		
Creditors	3,50,000	
Bank overdraft **	<u>75,000</u>	<u>4,25,000</u>
Working capital		<u>4,25,000</u>

(e) Balance Sheet of Munna Ltd. (and reduced)
as on 31st March, 2005

Liabilities	Rs.	Assets	Rs.
Share Capital Authorised (issued and paid up)		Fixed Assets	
20,000 equity shares of Rs. 45 each	9,00,000	Plant and Machinery	15,00,000
10,000, 9% preference shares of Rs. 80 each	8,00,000	Current Assets	
Unsecured loan		Stock	3,00,000
Term loan with Bank	2,25,000	Debtors	4,00,000
Current liabilities		Cash	1,50,000
Bank overdraft	75,000		
Creditors	<u>3,50,000</u>		
	<u>23,50,000</u>		<u>23,50,000</u>

11.

Raj Ltd.

BALANCE SHEET AS AT 31ST MARCH, 2006

(Rs. in thousands)

I SOURCES OF FUNDS

(1) Shareholders' funds:

(a) Capital	100	
(b) Reserves and surplus	<u>189</u>	289

**

Current ratio shall be 2 : 1, i.e. total current liabilities shall be 50% of Rs. 8,50,000 (i.e. Rs. 3,00,000 + 4,00,000 + 1,50,000) = Rs. 4,25,000. Therefore, Bank overdraft = Rs. 75,000 (Rs. 4,25,000 less creditors Rs. 3,50,000).

(2)	Loan funds:		
(a)	Secured loans	112	
(b)	Unsecured loans	<u>—</u>	<u>112</u>
	TOTAL		<u>401</u>
II	APPLICATION OF FUNDS		
(1)	Fixed assets:		
(a)	Gross block	384	
(b)	Less: Depreciation	<u>184</u>	
(c)	Net block	200	
(d)	Capital work in progress	<u>—</u>	200
(2)	Investments		—
(3)	Current assets, loans and advances:		
(a)	Inventories	282	
(b)	Sundry debtors	686	
(c)	Cash and bank balances	—	
(d)	Other current assets	—	
(e)	Loans and advances	<u>—</u>	
		968	
	Less: Current Liabilities and Provisions:		
(a)	Liabilities	588	
(b)	Provisions	<u>179</u>	
		<u>767</u>	
	Net current assets		201
(4)	Miscellaneous expenditure		—
	(to the extent not written off or adjusted)		<u>—</u>
	TOTAL		<u>401</u>
	Contingent Liabilities	Nil	

Profit and Loss Account
for the year ended 31st March, 2006

(Rs. in thousands)

INCOME

Sales 2,760

EXPENDITURE

Manufacturing Expenses 2,205

Other Expenses 297

Interest	22	
Depreciation on Fixed Assets	<u>20</u>	
		<u>2,544</u>
Profit before Taxation		216
Provision for Tax		<u>130</u>
Net Profit		86
Balance brought forward from previous year		<u>128</u>
Profit Available for Appropriation		214
Appropriations		
Proposed Equity Dividend	25	
Amount transferred to General Reserve*	<u>9</u>	<u>34</u>
Balance Carried Forward		<u>180</u>

NOTES ON ACCOUNTS FOR THE YEAR ENDED 31ST MARCH, 2006

1. Accounting Policies: The Accounts have been prepared primarily on the historical cost convention. The significant accounting policies followed by the Company are stated below:
 - (a) Fixed Assets: Fixed assets are shown at cost less depreciation. Cost comprises the purchase price and other attributable expenses.
 - (b) Depreciation on Fixed Assets: Depreciation on equipment, fixtures and fittings has been provided on written down value method at 15% per annum. Lease-hold premises/improvements are being amortised over the lease period.
 - (c) Inventories: Inventories are valued at the lower of historical cost or the net realizable value.
2. Other Matters:
 - (a) The cost of leasehold premises includes the cost of refurbishment to the extent of Rs. 78,000 (Materials Rs. 38,000 + Labour Rs. 40,000).
 - (b) Bright Ltd. has been sued for supplying defective materials. Settlement of Rs. 50,000 is hopeful however it has not been recognized in the accounts as it represents contingent gain.

Working Notes:

(Rs. in thousands)

(1) Manufacturing Expenses	
Stocks at Commencement:	
Opening Stock	59
Opening Work-in-progress	<u>210</u>
	269
Purchases of Materials (1,218 – 38)	1,180
Purchase of Land	73
Wages	111
Sub-contractors' cost (894 – 40)	<u>854</u>

* As per Companies (Transfer of Profits to Reserves) Rules, the amount to be transferred to the reserves shall not be less than 10% of the current profits since proposed dividend exceeds 20% of the paid up capital. In this answer, it has been assumed that Rs. 9,000 have been transferred to General Reserve. The students may transfer any amount based on a suitable percentage not less than 10%.

		2,487
Less: Stocks at close:		
Closing Stock	142	
Closing Work-in-progress	<u>140</u>	
		<u>282</u>
		<u>2,205</u>
(2) Other Expenses		
Administration Expenses		147
Office Salaries		18
Directors' Salaries		39
Provision for Doubtful Debts [35 + 2% of (735 – 35)]		49
Audit Fees		20
Bonus (See Working Note 3)		<u>24</u>
		<u>297</u>
(3) Bonus		
Sales		2,760
Less: Manufacturing Expenses	2,205	
Other Expenses (excluding bonus)	273	
Depreciation	20	
Interest	<u>22</u>	
		<u>2,520</u>
Pre-tax Profit		<u>240</u>
Bonus (10%)		<u>24</u>
(4) Fixed Assets		
(a) Gross block		
Equipment, Fixtures and Fittings		264
Leasehold Premises (42 + 40 + 38) **		<u>120</u>
		<u>384</u>
(b) Depreciation		
Equipment, Fixtures and Fittings		
as on 1.4.2005	164	
For the year [15% on (264 – 164)]	<u>15</u>	
		179
Cost of Leasehold Premises written off**		5
[(42 + 40 + 38) × 1/12 × 1/2]		<u>184</u>
(5) Provision for Taxation		
Profit as per Profit and Loss Account		216
Add back: Provision for doubtful debts	49	
Cost of Leasehold premises written off	5	
Depreciation on equipment, fixtures and fittings	<u>15</u>	
		<u>69</u>
		<u>285</u>
Less: Depreciation under Income-tax Act		<u>25</u>
		<u>260</u>

** According to AS 19 'Leases' (issued in 2001), the leases are classified as finance lease and operating lease. A lease is classified as a finance lease if it transfers substantially all the risks and rewards incident to ownership. An operating lease is a lease other than finance lease. At the inception of lease, assets under finance lease are capitalized in the books of the lessee with the corresponding liability of lease obligations as against the operating lease wherein lease payments are recognized as an expense in the profit and loss account on a systematic basis (i.e. straight line) over the lease term without capitalizing the asset. The person (lessor/lessee) presenting the leased asset in his balance sheet should also consider the additional requirements of AS 6 and AS 10.

Provision for Tax (@ 50%)	130
(It has been assumed that depreciation calculated under Income-tax Act amounts to Rs. 25,000)	
(6) Current Liabilities	
(a) Sundry creditors	463
(b) Bank overdraft	105
(c) Audit fees	<u>20</u>
	<u>588</u>
(7) Provisions	
(a) Provision for taxation	130
(b) Proposed dividend	25
(c) Provision for bonus	<u>24</u>
	<u>179</u>

12. Liquidator's Final Statement of Account

Receipts	Estimated value*	Value realized Rs.	Payments	Rs.
Assets Realised:			Liquidator/s Remuneration**:	Rs.
Cash	2,500	2,500	2.5% on Rs.1,86,000	4,650
Debtors	64,820	58,500	2% on Rs.24,200	484
Stock	56,800	39,000	2% on Rs.1,18,300	<u>2,366</u>
Plant & Machinery	65,500	51,000	Liquidation Expenses	1,000
			Preferential Creditors	24,200
			Unsecured Creditors (89.55%)	<u>1,18,300</u>
		<u>1,51,000</u>		<u>1,51,000</u>

- Note. (i) Goodwill valued at Rs.50,000 in books in valueless.
- (ii) The total amount due to the unsecured creditors is Rs.1,32,100 calculated as follows:-

	Rs.
Unsatisfied balance of partly secured creditors	20,310
Unsecured creditors	99,790
Bank Overdraft	<u>12,000</u>
	<u>1,32,100</u>

* In absence of estimated value, book figures have been given.

** Commission due to the liquidator will be on the total realization on the supposition that the securities in the hands of creditors are realized by the liquidator on behalf of the partly secured creditors.

13. Since M/s. Bulls & Bears underwrite 60% of the issue, the company must itself be treated as an underwriter of the remaining 40%. In the absence of any information, the applications for 800 debentures must be deemed to have been marked 60% in favour of the underwriters, viz., 480 debentures. The underwriters are, therefore, liable to take up 120 debentures (600-480). The journal entries are as follows:-

	Dr.	Cr.
	Rs.	Rs.
Bank	Dr. 9,60,000	
To 14% Debentures Account		8,00,000
To Premium on Issue of Debentures/Securities Premium		1,60,000
(Allotment of 800 debentures applied for, payment being @ Rs.1,200 per debenture, as per Directors' resolution of.....)		
M/s Bulls & Bears	Dr. 1,44,000	
To 14% Debentures Account		1,20,000
To Premium on Issue of Debentures/Securities Premium		24,000
(Allotment of 120 debentures to the underwriters in pursuance of their agreement, dated....)		
Underwriting Commission on Issue of Debentures Account	Dr. 10,800	
To M/s Bulls & Bears		10,800
(The commission @ 1 ½% on 600 debentures calculated at the issue price of Rs.1,200 per debenture.)		
Bank	Dr. 1,33,200	
To M/s. Bulls & Bears		1,33,200
(The amount received from the underwriters in settlement.)		

14. (a) Interest on Performing Assets should be recognised on accrual basis, but interest on Non-performing Assets should be recognised on cash/realisation basis.

			Rs. in lakhs
Interest on cash credit and overdrafts	(1,800 + 70)	=	1,870
Interest on bills purchased and discounted	(700 + 36)	=	736
Total income to be recognised			<u>2,606</u>

- (b) ABC Co. Ltd.
Journal Entries

	Dr.	Cr.
	Rs.	Rs.
Bank A/c	Dr. 95,000	
Discount on issue of debentures A/c	Dr. 5,000	
Loss on issue of debentures A/c	Dr. 2,000	
To 11% Debentures A/c		1,00,000
To Premium on Redemption of debentures A/c		2,000
(Issue of Rs. 1,00,000 11% debentures at a discount of 5% but redeemable at a premium of 2%)		

15. (a) Nominal value of preference shares redeemed Rs. 2,00,000
Less: Face value of shares issued Rs. 1,50,000
Amount transferred to capital redemption reserve Rs. 50,000

(b) Particulars	Rs.	Rs.
Equity Shares (42,000 x 10)		4,20,000
Preference Share Capital	1,70,000	
Add: Premium on Redemption	<u>17,000</u>	<u>1,87,000</u>
Purchase Consideration		<u>6,07,000</u>

16. (a) The amount of rebate on bills discounted as on 31st March, 2006 for the period which has not been expired upto that day will be calculated as follows:

Discount on Rs.2,80,000 for 62 days @ 10%	4,756
Discount on Rs.8,72,000 for 69 days @ 10%	16,484
Discount on Rs.5,64,000 for 82 days @ 10%	12,671
Discount on Rs.8,12,000 for 92 days @ 10%	20,467
Discount on Rs.6,00,000 for 96 days @ 10%	<u>15,781</u>
Total	<u>70,159</u>

The amount of discount to be credited to the profit and loss account will be:

	Rs.
Transfer from rebate on bills discounted as on 31.03.2005	68,259
Add: Discount received during the year	<u>1,70,156</u>
	2,38,415
Less: Rebate on bills discounted as on 31.03.2006 (as above)	<u>70,159</u>
	<u>1,68,256</u>

Journal Entries

		Rs.	Rs.
Rebate on bills discounted A/c	Dr.	68,259	
To Discount on bills A/c			68,259
<u>(Transfer of unexpired discount on 31.03.2005)</u>			
Discount on bills A/c	Dr.	70,159	
To Rebate on bills discounted			70,159
<u>(Unexpired discount on 31.03.2006 taken into account)</u>			
Discount on Bills A/c	Dr.	1,68,256	
To P & L A/c			1,68,526
<u>(Discount earned in the year, transferred to P&L A/c)</u>			

- (b) General Insurance Company
(Abstract showing the amount of claims)

	Rs. '000	Rs. '000
Claims less Re-insurance :		
Paid during the year	52,20	
Add : Outstanding claims at the end of the year	<u>7,52</u>	
	59,72	
Less : Outstanding claims at the beginning of the year	<u>7,85</u>	51,87

Working Notes :

	Rs. '000	Rs. '000
1. Claims paid during the year		
Direct business	46,70	
Reinsurance	<u>7,00</u>	53,70
Add : Surveyor's fee	35	
Legal expenses	<u>45</u>	80
		<u>54,50</u>
Less : Claims received from re-insurers		<u>2,30</u>
		<u>52,20</u>

2.	Claims outstanding on 31st March, 2006		
	Direct business	8,12	
	Reinsurance	<u>53</u>	8,65
	Less : Claims receivable from re-insurers		<u>1,13</u>
			<u>7,52</u>
3.	Claims outstanding on 1st April, 2005		
	Direct business	763	
	Reinsurance	<u>87</u>	8,50
	Less : Claims receivable from re-insurers		<u>65</u>
			<u>7,85.</u>

17. Cash Flow Statement of for the year ended March 31, 2008 (Direct Method)

Particulars	Rs.	Rs.
Operating Activities:		
Cash received from sale of goods	1,40,000	
Cash received from Debtors	1,75,000	
Trade Commission received	<u>50,000</u>	3,65,000
Less: Payment for Cash Purchases	1,20,000	
Payment to Creditors	1,57,000	
Office and Selling Expenses	75,000	
Payment for Income Tax	<u>30,000</u>	3,82,000
Net Cash Flow from Operating Activities		<u>(17,000)</u>

18. Journal Entries

Particulars	Dr. Amount Rs.	Cr. Amount Rs.
Plant account	Dr. 7,70,000	
To Bank account		7,60,000
To Replacement account		10,000
(Being the additional cost incurred and old materials utilized in new plant)		
Replacement account	Dr. 8,40,000	
To Bank account		8,40,000
(Being the current cost of replacement)		
Bank account	Dr. 20,000	
To Replacement account		20,000
(Being the old materials sold)		
Revenue account	Dr. 8,10,000	
To Replacement account		8,10,000
(Being the balance of replacement account transferred to revenue account)		

Working Note:

Old cost of the plant Rs. 3,00,000:

$$\text{Material} = 3,00,000 \times \frac{4}{10} = 1,20,000$$

$$\text{Labour} = 3,00,000 \times \frac{6}{10} = 1,80,000$$

		Rs.
Cost of materials increased by 250% = $1,20,000 \times 250\%$		3,00,000
Cost of labour increased by 300% = $1,80,000 \times 300\%$		<u>5,40,000</u>
Current cost of replacing old plant		8,40,000
Less: Sale of old materials	20,000	
Old materials utilized in new plant	<u>10,000</u>	<u>30,000</u>
Amount to be transferred to Revenue account		<u>8,10,000</u>
Cash cost of the new plant		16,00,000*
Add: Old materials utilized		<u>10,000</u>
		16,10,000
Less: Current cost of replacing old plant		<u>8,40,000</u>
Amount to be capitalized		<u>7,70,000</u>

* The cost of new plant has been given as Rs. 16,00,000 in the question. It has been assumed in the above solution that this cost does not include the cost of old materials used in the construction of new plant worth Rs. 10,000.

19. (a) Under the treasury system, district treasury is the basic unit and the focal point for the primary record of financial transactions of government in the district with sub-treasuries under it at the Taluks and Tehsils level.

The Treasuries are of two kinds - (i) Banking (ii) Non-banking. A bank treasury means a treasury, the cash business of which is conducted by the Reserve Bank of India or its branches or agencies authorised to conduct Government business and non-banking treasury means a treasury, the cash business of which is conducted by itself.

The functions entrusted to the treasury are as follows:

- (i) Receipt of money from the public and departmental officers for credit to government.
- (ii) Payment of claims against Government on bills or cheques or other instruments presented by departmental drawing and disbursing officers or pensioners or others authorised to do so.
- (iii) Keeping initial and subsidiary accounts of the receipts and payments occurring at them and rendering statements of such transactions to the Accountant General for detailed compilation and consolidation.
- (iv) Acting as a banker in respect of funds of local bodies, Zilla Parishads, Panchayat Institutions etc. who keep their funds with the treasuries.
- (v) Custody of opium and other valuables because of the strong room facility provided at the treasury.
- (vi) Custody of cash balances of the State Government and conducting cash business of Government at non-banking treasuries.

- (b) Agricultural activities are carried on mostly in an unorganized manner. The farmer has no office and also does not find time for day by day record keeping. The transactions and events are also not supported by vouchers or other documents in most of the cases. So it is desirable to maintain a Diary to record happenings of the day. This Diary becomes the source document for record keeping.

Seven registers are required for running the accounting system.

1. Cash Book: to record cash transactions.
 2. Fixed Assets Register: to record details of fixed assets – description of assets, cost of purchases/construction/generation, disposal, depreciation and balance.
 3. Loan Register: to record borrowings from bank, cooperatives and other agencies trade creditors along with interest paid or payable.
 4. Stock Register: to record details of input, output and by product – receipts, utilization, wastage and balance.
 5. Debtors and Creditors Register: to record credit transactions classified by parties involved.
 6. Register for National Transactions: to record transactions between farm and farm household.
 7. Cost Analysis Register: to record crop wise input and output inclusive of apportionment of common costs and finding out crop profit.
20. (a) In most cases policies are renewed annually except in some cases where policies are issued for a shorter period. Since insurers close their accounts on a particular date, not all risks under policies expire on that date. Many policies extend into the following year during which the risk continues. Therefore on the closing date, there is unexpired liability under various policies which may occur during the remaining term of the policy beyond the year and therefore, a provision for unexpired risks is made at normally 50% in case of Fire Insurance and 100% of in case of Marine Insurance. This reserve is based on the net premium income earned by the insurance company during the year
- (b) The business entity concept has three major implications for accounting:
1. It limits the area to be covered by accounting records and reports. For example, personal transactions of the sole proprietor is not to be recorded in his business accounts as business expenses, they are simply treated as drawings.
 2. All transactions are recorded from the point of the entity itself and not from the point of other parties such as owners, managers or customers. For example, when a firm sells goods to customers, this is recorded as sales by the firm and not as purchases by the customers.
 3. The entity concept underlines the accounting concept of profits in which a sharp distinction is made between the expenses of operating the business and payment to the owners. All payments to the owners take the form of repayment of capital or loan, or a distribution of profits. They are not treated as business expenses.
- (c) Under the completed contract method, revenue is recognized only when the contract is completed or substantially completed; that is, when only minor work is expected other than warranty obligation. Costs and progress payments received are accumulated during the course of the contract but revenue is not recognized until the contract activity is substantially completed.
- (d) Realization account is opened to close all other accounts standing in the balance sheet on the date of dissolution as the firm is to be closed. All assets (except cash and bank balances and debit balance of profit and loss account and partners' capital and current account) and all liabilities (except partners' capital, reserves) are closed by transfer to realization account.

All subsequent entries regarding the realization of assets and settlement of liabilities are made through this account only.

Revaluation account records the changes in the value of assets and liabilities; whatever profit or loss arises on such revaluation should be credited or debited to old partner's capital accounts in their old profit and loss sharing ratio at the time of admission, retirement or death of the partner.

21. (a) This is also called the concept of definite accounting period. As per 'going concern' concept, an indefinite life of the entity is assumed. For a business entity it causes inconvenience to measure performances achieved by the entity in the ordinary course of business. If a textile mill lasts for 100 years, it is not correct to measure its performance as well as financial position only at the end of its life.

So a small but workable fraction of time is chosen out of infinite life cycle of the business entity for measuring performance and looking at the financial position. Generally one year period is taken up for performance measurement and appraisal of financial position. However, it may also be 6 months or 9 months or 15 months.

Thus, for performance appraisal it is not necessary to look into the revenues and expenses of an unduly long time frame. This concept makes the accounting system workable and the term 'accrual' meaningful. If one thinks of indefinite time-frame, nothing will accrue. There cannot be unpaid expenses and non-receipt of revenue. Accrued expenses or accrued revenue is only with reference to a finite time-frame which is called accounting period.

- (b) The statement prepared by the liquidator showing receipts and payments of cash in case of voluntary winding up is called "Liquidators' statement of account" (Form No. 156 Rule 329 of the Companies Act, 1956). There is no double entry involved in the preparation of liquidator's statement of account. It is only a statement though presented in the form of an account.

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

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

Payments made to redeem securities and cost of execution and payments per Trading Account are deducted from total receipts.

Payments are made and shown in the following order :

- (a) Legal charges;
- (b) Liquidator's expenses;
- (c) Debentureholders (including interest up to the date of winding up if the company is insolvent and to the date of payment if it is solvent);
- (d) Creditors :
 - (i) Preferential (in actual practice, preferential creditors are paid before debenture holders having a floating charge);
 - (ii) Unsecured creditors;

- (e) Preferential shareholders (Arrears of dividends on cumulative preference shares should be paid up to the date of commencement of winding up); and
 - (f) Equity shareholders.
- (c) In firm underwriting the underwriter agrees to subscribe upto a certain number of shares/debentures irrespective of the nature of public response to issue of securities. He gets these securities even if the issue is fully subscribed or over-subscribed. These securities are taken by the underwriter in addition to his liability for securities not subscribed by the public. Under partial underwriting along with firm underwriting, unless otherwise agreed, individual underwriter does not get the benefit of firm underwriting in determination of number of shares/debentures to be taken up by him.
- (d) The investment portfolio of a bank would normally consist of both approved securities (predominantly government securities) and other securities (shares, debentures, bonds etc.). Banks are required to classify their entire investment portfolio into three categories : held-to-maturity, available-for-sale and held-for-maturity. Securities acquired by banks with the intention to hold them upto maturity should be classified as 'held-to-maturity'. Securities acquired by banks with the intention to trade by taking advantage of short-term price interest rate movements should be classified as held-for trading/maturity. Securities which do not fall within the above two categories should be classified as available-for-sale'.
22. (a) Operating Lease : A lease is classified as an operating lease if it does not transfer substantially all the risks and rewards incident to ownership. Lease payments under an operating lease should be recognised as an expense in the statement of profit and loss on a straight line basis over the lease term unless another systematic basis is more representative of the time pattern of the user's benefit.
- (b) For the purpose of calculating diluted earnings per share, the net profit or loss for the period attributable to equity shareholders and the weighted average number of shares outstanding during the period should be adjusted for the effects of all dilutive potential equity shares.
- The amount of net profit or loss for the period attributable to equity shareholders should be adjusted, after taking into account any attributable change in tax expense for the period.
- The number of equity shares should be the aggregate of the weighted average number of equity shares (as per paragraphs 15 and 22 of AS 20) and the weighted average number of equity shares which would be issued on the conversion of all the dilutive potential equity shares into equity shares. Dilutive potential equity shares should be deemed to have been converted into equity shares at the beginning of the period or, if issued later, the date of the issue of the potential equity shares.
- An enterprise should assume the exercise of dilutive options and other dilutive potential equity shares of the enterprise. The assumed proceeds from these issues should be considered to have been received from the issue of shares at fair value. The difference between the number of shares issuable and the number of shares that would have been issued at fair value should be treated as an issue of equity shares for no consideration.
- (c) Events occurring after the balance sheet date are those significant events, both favourable and unfavourable, that occur between the balance sheet date and the date on which the financial statements are approved by the Board of Directors in the case of a company and in the case of any other entity by the corresponding approving authority.
- Assets and liabilities should be adjusted for events occurring after the balance sheet date that provide additional evidence to assist the estimation of amounts relating to conditions existing at the balance sheet date or that indicate that the fundamental accounting assumption of going concern (i.e., the continuance of existence or substratum of the enterprise) is not appropriate. However, assets and liabilities should not be adjusted for but disclosure should be made in the report of the approving authority of events occurring after the balance sheet date that represent material changes and commitments affecting the financial position of the enterprise.

Disclosure regarding events occurring after the balance sheet date :

- (a) The nature of the event;
- (b) An estimate of the financial effect, or a statement that such an estimate cannot be made.
- (d) Paragraphs 10 and 11 of Appendix A to the Accounting Standard 26 on Intangible Assets, lays down the following procedure for accounting of software acquired for internal use:-
 - The cost of a software acquired for internal use should be recognised as an asset if it meets the recognition criteria prescribed in paragraphs 20 and 21 of this statement.
 - The cost of a software purchased for internal use comprises its purchase price, including any import duties and other taxes (other than those subsequently recoverable by the enterprise from the taxing authorities) and any directly attributable expenditure on making the software ready for its use.

Any trade discounts and rebates are deducted in arriving at the cost. In the determination of cost, matters stated in paragraphs 24 to 34 of the Statement which deal with the method of accounting for 'Separate Acquisitions', 'Acquisitions as a part of Amalgamations', 'Acquisitions by way of Government Grant', and 'Exchanges of Assets', need to be considered, as appropriate.

Recognition criteria as per paragraphs 20 and 21 of the standard are stated below:-

- An intangible asset should be recognised if, and only if:
 - (a) it is probable that the future economic benefits that are attributable to the asset will flow to the enterprise; and
 - (b) the cost of the asset can be measured reliably.

An enterprise should assess the probability of future economic benefits using reasonable and supportable assumptions that represent best estimate of the set of economic conditions that will exist over the useful life of the asset.

- (e) Borrowing costs are interest and other costs incurred by an enterprise in connection with the borrowing of funds.

As per para 4 of AS 16 on Borrowing Costs, borrowing costs may include :

- (a) interest and commitment charges on bank borrowings and other short-term and long-term borrowings;
- (b) amortisation of discounts or premiums relating to borrowings ;
- (c) amortisation of ancillary costs incurred in connection with the arrangement of borrowings;
- (d) finance charges in respect of assets acquired under finance leases or under other similar arrangements; and
- (e) exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest cost
- (f) The cost of investment of the parent in each of its subsidiaries and the parent's share in equity of each subsidiary should be eliminated. For the purpose equity and investment as on the date of each investment is taken.
 - On the date of investment if the cost of investment to the parent is more than share of equity in that particular subsidiary, the difference is taken as Goodwill in the consolidated statement.
 - On the date of investment if the cost of investment to the parent is less than share of equity in that particular subsidiary, the difference is taken as Capital Reserve in the consolidated statement.

- (g) The depreciation method selected should be applied consistently from period to period. A change from one method of providing depreciation to another should be made only if the adoption of the new method is required by statute or for compliance with an accounting standard or if it is considered that the change would result in a more appropriate preparation or presentation of the financial statements of the enterprise. When such a change in the method of depreciation is made, depreciation should be recalculated in accordance with the new method from the date of the asset coming into use.

The deficiency or surplus arising from retrospective recomputation of depreciation in accordance with the new method should be adjusted in the accounts in the year in which the method of depreciation is changed. In case the change in the method results in deficiency in depreciation in respect of past years, the deficiency should be charged in the statement of profit and loss. In case the change in the method results in surplus, the surplus should be credited to the statement of profit and loss. Such a change should be treated as a change in accounting policy and its effect should be quantified and disclosed.

- (h) In translating the financial statements of a non-integral foreign operation for incorporation in its financial statements, the reporting enterprise should use the following procedures:
- a The assets and liabilities, both monetary and non-monetary, of the non-integral foreign operation should be translated at the closing rate;
 - b Income and expense items of the non-integral foreign operation should be translated at exchange rates at the dates of the transactions; and
 - c All resulting exchange differences should be accumulated in a foreign currency translation reserve until the disposal of the net investment.
 - d For practical reasons, a rate that approximates the actual exchange rates, for example an average rate for the period, is often used to translate income and expense items of a foreign operation.
 - e Any goodwill or capital reserve arising on the acquisition of a non-integral foreign operation is translated at the closing rate.
 - f A contingent liability disclosed in the financial statements of a non-integral foreign operation is translated at the closing rate for its disclosure in the financial statements of the reporting enterprise.
 - g The incorporation of the financial statements of a non-integral foreign operation in those of the reporting enterprise follows normal consolidation procedures, such as the elimination of intra-group balances and intra-group transactions of a subsidiary. However, an exchange difference arising on an intra-group monetary item, whether short-term or long-term, cannot be eliminated against a corresponding amount arising on other intra-group balances because the monetary item represents a commitment to convert one currency into another and exposes the reporting enterprise to a gain or loss through currency fluctuations.
 - h When the financial statements of a non-integral foreign operation are drawn up to a different reporting date from that of the reporting enterprise, the non-integral foreign operation often prepares, for purposes of incorporation in the financial statements of the reporting enterprise, statements as at the same date as the reporting enterprise.
 - i The exchange differences are not recognised as income or expenses for the period because the changes in the exchange rates have little or no direct effect on the present and future cash flows from operations of either the non-integral foreign operation or the reporting enterprise. When a non-integral foreign operation is consolidated but is not wholly owned, accumulated exchange differences arising from translation and attributable to minority interests are allocated to, and reported as part of, the minority interest in the consolidated balance sheet.
 - j An enterprise may dispose of its interest in a non-integral foreign operation through

sale, liquidation, repayment of share capital, or abandonment of all, or part of, that operation. The payment of a dividend forms part of a disposal only when it constitutes a return of the investment. In the case of a partial disposal, only the proportionate share of the related accumulated exchange differences is included in the gain or loss. A write-down of the carrying amount of a non-integral foreign operation does not constitute a partial disposal. Accordingly, no part of the deferred foreign exchange gain or loss is recognised at the time of a write-down.

- (i) The disclosure requirements with regard to change in accounting estimates as laid down in paragraph 16(d) of AS 25 on Interim Financial Reporting are as under:
- Nature and amount of changes in estimates of amounts reported in prior periods of current financial year; or
 - Changes in estimates of amounts reported in prior financial years, if those changes have a material effect in the current interim period.

Example: A sum of Rs.32 lacs was provided for doubtful debts on an estimated basis, in the last interim report for quarter ended 31st December. A major portion of the debts earlier considered doubtful has actually been realized since then. Accordingly, provision stands reduced to Rs.8 lacs.

23. (a) Although the case under consideration does not relate to extraordinary item, but the nature and amount of such item may be relevant to users of financial statements in understanding the financial position and performance of an enterprise and in making projections about financial position and performance. Para 12 of AS 5 (Revised in 1997) on Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies states that :

“When items of income and expense within profit or loss from ordinary activities are of such size, nature or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately.”

Circumstances which may give to separate disclosure of items of income and expense in accordance with para 12 of AS 5 include the write-down of inventories to net realisable value as well as the reversal of such write-downs.

- (b) As per para 5 of AS 2 on Valuation of Inventories, inventories should be valued at the lower of cost and net realizable value. Inventories should be written down to net realizable value on an item-by-item basis in the given case.

Items	Historical Cost (Rs. in lakhs)	Net Realisable Value (Rs. in lakhs)	Valuation of closing stock (Rs. in lakhs)
A	40	28	28
B	<u>16</u>	<u>24</u>	<u>16</u>
	<u>56</u>	<u>52</u>	<u>44</u>

Hence, closing stock will be valued at Rs. 44 lakhs.

- (c) According to para 13 of AS 4 “Contingences and Events occurring after the Balance Sheet Date”, assets and liabilities should be adjusted for events occurring after the balance sheet date that provide additional evidence to assist the estimation of amounts relating to conditions existing at the balance sheet date.

In this case the sale of immovable property was carried out before the closure of the books of Accounts. This is clearly an event occurring after the balance sheet date. Agreement to sell was effected before the balance sheet date and the registration was done after the balance sheet date. So the adjustment for the sale of immovable property is necessary in the books of account for the year ended 31st March, 2006.

- (d) As per para 41 of AS 26 'Intangible Assets', no intangible asset arising from research (or from the research phase of an internal project) should be recognized. Expenditure on research (or on the research phase of an internal project) should be recognized as an expense when it is incurred. Thus the company cannot treat the expenditure as deferred revenue expenditure. The entire amount of Rs. 33 lakhs spent on research project should be charged as an expense in the year ended 31st March, 2006.
- (e) AS 16 clearly states that capitalization of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use are completed. Therefore, interest on the amount that has been used for the construction of the building upto the date of completion (January, 2005) i.e. Rs. 18 lakhs alone can be capitalized. It cannot be extended to Rs. 25 lakhs.
- (f) According to AS 29 'Provisions, Contingent Liabilities and Contingent Assets', contingent liability should be disclosed in the financial statements if following conditions are satisfied:
- There is a present obligation arising out of past events but not recognized as provision.
 - It is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation.
 - The possibility of an outflow of resources embodying economic benefits is also remote.
 - The amount of the obligation cannot be measured with sufficient reliability to be recognized as provision.

In this case, the probability of winning of first five cases is 100% and hence, question of providing for contingent loss does not arise. The probability of winning of next ten cases is 60% and for remaining five cases is 50%. As per AS 29, we make a provision if the loss is probable. As the loss does not appear to be probable and the possibility of an outflow of resources embodying economic benefits is not remote rather there is reasonable possibility of loss, therefore disclosure by way of note should be made. For the purpose of the disclosure of contingent liability by way of note, amount may be calculated as under:

$$\begin{aligned}\text{Expected loss in next ten cases} &= 30\% \text{ of Rs. } 1,20,000 + 10\% \text{ of Rs. } 2,00,000 \\ &= \text{Rs. } 36,000 + \text{Rs. } 20,000 \\ &= \text{Rs. } 56,000\end{aligned}$$

$$\begin{aligned}\text{Expected loss in remaining five cases} &= 30\% \text{ of Rs. } 1,00,000 + 20\% \text{ of Rs. } 2,10,000 \\ &= \text{Rs. } 30,000 + \text{Rs. } 42,000 \\ &= \text{Rs. } 72,000\end{aligned}$$

To disclose contingent liability on the basis of maximum loss will be highly unrealistic. Therefore, the better approach will be to disclose the overall expected loss of Rs. 9,20,000 (Rs. 56,000 × 10 + Rs. 72,000 × 5) as contingent liability.

(g)	Rs. in lakhs	Rs. in lakhs
	31.3.2005	31.3.2006
Carried Forward Business Loss and Depreciation Allowance	2,016.60	4,110.00
Add: Disallowance under Section 43 B of Income Tax Act, 1961	518.35	611.45
Provision for Doubtful Debts	<u>282.51</u>	<u>294.35</u>
	2,817.46	5,015.80
Less: Depreciation	<u>4,010.10</u>	<u>4,023.54</u>
	(-) 1,192.64	992.26
Less: Deferred Revenue Expenditure*	<u>4.88</u>	<u>—</u>

Timing Differences	(-) <u>1,197.52</u>	<u>992.26</u>
Deferred Tax Liability	359.26	
Deferred Tax Asset		297.68

Where an enterprise has unabsorbed depreciation or carry forward of losses under tax laws, deferred tax assets should be recognized only to the extent that there is virtual certainty supported by convincing evidence that future taxable income will be available against which such deferred tax assets can be realized. The existence of unabsorbed depreciation or carry forward of losses is strong evidence that future taxable income may not be available. Deferred Tax Asset of Rs. 297.68 lakhs should not be recognized as an asset as per para 17 of AS 22 on 'Accounting for Taxes on Income'. Deferred Tax Liability of Rs. 359.26 lakhs should be disclosed under a separate heading in the balance sheet of Z Ltd., separately from current assets and current liabilities.

- (h) According to para 8 of AS 4 (Revised 1995), the unexpected increase in sale price of petrol by the government after the balance sheet date cannot be regarded as an event occurring after the Balance Sheet date, which requires an adjustment at the Balance Sheet date, since it does not represent a condition present at the balance sheet date. The revenue should be recognized only in the subsequent year with proper disclosures. The retrospective increase in the petrol price should not be considered as a prior period item, as per AS 5, because there was no error in the preparation of previous period's financial statements.

(i)

Interest on Debentures @ 10% for the year	$36,000 \times 50 \times \frac{10}{100}$
	= Rs.1,80,000
Tax on interest @ 30%	= Rs.54,000
Diluted Earnings (Adjusted net profit)	= (60,00,000 + 1,80,000-54,000)
	= Rs. 61,26,000

APPENDIX

ACCOUNTING STANDARDS

Accounting Standard (AS) 15 (revised 2005) on 'Employee Benefits' comes into effect in respect of accounting periods commencing on or after April 1, 2006. AS 15 (revised 2005) was originally published in March, 2005 issue of the ICAI's Journal 'The Chartered Accountant'. Subsequently, the ICAI, in January 2006, made limited revision to AS 15 (revised 2005) primarily with a view to bring the disclosure requirements of the standard relating to the defined benefit plans in line with the corresponding International Accounting Standard (IAS) 19, Employee Benefits; to clarify the application of the transitional provisions; and to provide relaxation/exemption to the small and medium-sized enterprises (SMEs). The limited revision has been duly incorporated by the ICAI in AS 15 (revised 2005), which has been published in the 'The Chartered Accountant', March 2006 (page nos. 1354 to 1385).

Note: AS 1 to AS 29 [including AS 15 (Revised 2005)] are applicable for November, 2007 Examination

ACCOUNTING STANDARDS INTERPRETATIONS

The authority of the Accounting Standards Interpretations (ASI) is the same as that of the Accounting Standard to which it relates. The contents of the ASI are intended for the limited purpose of the Accounting Standard to which it relates. ASI is intended to apply only to material items. The Institute of Chartered Accountants of India has, so far, issued 30 ASIs and has also revised some of the existing ASIs. These interpretations are available at the institute's website www.icaai.org. The same can also be seen from the Compendium of the Accounting Standards (as on July 1, 2006).

PAPER – 2 : AUDITING

QUESTIONS

1. What do you mean by "Audit Sampling"? How the size of a statistical sample is determined and what are the methods of selecting such a sample?
2. (a) What do you mean by Internal Control System?
(b) Discuss scope and objectives of the internal audit function?
(c) What is the relationship between internal and external auditor?
3. (a) Describe fraud and error and their characteristics. Who is primarily responsible for the prevention and detection of fraud and error?
(b) Give some examples of circumstances that indicate the possibility of fraud or error?
4. What do you mean by representation by management? What are the basic elements of a management representation letter?
5. (a) What is non-compliance? Who is responsible for compliance with laws and regulations?
(b) What are the reporting requirements of non-compliance?
6. Write short note on the following:
 - (a) General Purpose Financial Statements
 - (b) Going Concern Concept
 - (c) Disclosure of accounting policies
 - (d) Audit working papers
 - (e) Basic elements of the Auditor's Report
 - (f) Audit risk
 - (g) Surprise check
 - (h) Cut-off arrangement.
 - (i) Outstanding assets
7. How will you vouch and/or verify the following:
 - (a) Borrowing from Banks
 - (b) Provision for income tax
 - (c) Deferred Revenue Expenditure
 - (d) Trade Marks and Copyrights
8. State briefly the duty of an auditor with regard to each of the following:
 - (a) No depreciation has been charged for the year ended 31st March 2001, in respect of a spare Bus purchased during the year and kept ready by the company for use as a stand-by on the ground that it was not used during the year.
 - (b) A sum of Rs.10,00,000 is received from an Insurance company in respect of a claim for loss of goods in transit costing Rs.8,00,000. The amount is credited to the Purchases Account.
 - (c) Cost of structural alterations amounting to Rs.60,000 to self-owned factory premises has been charged to Building Repairs.
 - (d) A loss of Rs.2,00,000 on account of embezzlement of cash was suffered by the company and it was debited to Salary Account.
9. State the rules relating to exemption to branch audit?
10. What are sweat equity shares? On which conditions these shares are issued?

11. Write short notes on:
 - (a) Issue of shares at discount
 - (b) Payment of interest out of capital during construction
 - (c) Duty of auditor in regard to reduction of share capital
 - (d) Verification of Forfeiture of shares
12. (a) What do you mean by NGO's? Give some examples of NGO's? What are their sources and uses of funds?
 (b) Explain the audit procedure for conducting the audit of a Non-Governmental Organisation (NGO)?
13. Distinguish between :
 - (a) Reserves and Provision
 - (b) Reports and Certificates
 - (c) Preliminary expenses and pre-production expenses
14. (a) Audit is not legally obligatory for all types of business organisations or institutions. On this basis audits may be of two broad categories i.e., audit required under law and voluntary audits. State the organizations which require audit under law and which come into the category of voluntary audit.
 (b) What are the advantages of an independent audit where audit is not compulsory.
15. (a) What do you mean by internal check? What are the essential elements of a good system of internal check ?
 (b) What are the general considerations in framing a system of internal check?

SUGGESTED ANSWERS / HINTS

1. According to AAS-15 on "Audit Sampling", it means the application of audit procedures to less than 100% of the items within an account balance or class of transactions to enable the auditor to obtain and evaluate audit evidence about some characteristic of the items selected in order to form or assist in forming a conclusion concerning the population.

It is important to recognise that certain testing procedures do not come within the definition of sampling. Tests performed on 100% of the items within a population do not involve sampling. Likewise, applying audit procedures to all items within a population which have a particular characteristic (for example, all items over a certain amount) does not qualify as audit sampling with respect to the portion of the population examined, nor with regard to the population as a whole, since the items were not selected from the total population on a basis that was expected to be representative. Such items might imply some characteristic of the remaining portion of the population but would not necessarily be the basis for a valid conclusion about the remaining portion of the population.

Determination of sample size: While determining the sample size, the auditor should consider sampling risk, the tolerable error, and the expected error.

Sampling Risk: Sampling risk arises from the possibility that the auditor's conclusion, based on a sample, may be different from the conclusion that would be reached if the entire population were subjected to the same audit procedure.

The auditor is faced with sampling risk in both tests of control and substantive procedures as follows:

- (a) Tests of Control:
 - (i) Risk of Under Reliance: The risk that, although the sample result does not support the

auditor's assessment of control risk, the actual compliance rate would support such an assessment.

- (ii) Risk of Over Reliance: The risk that, although the sample result supports the auditor's assessment of control risk, the actual compliance rate would not support such an assessment.
- (b) Substantive Procedures:
 - (i) Risk of Incorrect Rejection: The risk that, although the sample result supports the conclusion that a recorded account balance or class of transactions is materially mis-stated, in fact it is not materially mis-stated.
 - (ii) Risk of Incorrect Acceptance: The risk that, although the sample result supports the conclusion that a recorded account balance or class of transactions is not materially mis-stated, in fact it is materially misstated.

The risk of under reliance and the risk of incorrect rejection affect audit efficiency as they would ordinarily lead to additional work being performed by the auditor, or the entity, which would establish that the initial conclusions were incorrect. The risk of over reliance and the risk of incorrect acceptance affect audit effectiveness and are more likely to lead to an erroneous opinion on the financial statements than either the risk of under reliance or the risk of incorrect rejection. Sample size is affected by the level of sampling risk the auditor is willing to accept from the results of the sample. The lower the risk the auditor is willing to accept, the greater the sample size will need to be.

Tolerable Error: Tolerable error is the maximum error in the population that the auditor would be willing to accept and still conclude that the result from the sample has achieved the audit objective. Tolerable error is considered during the planning stage and, for substantive procedures, is related to the auditor's judgement about materiality. The smaller the tolerable error, the greater the sample size will need to be.

In tests of control, the tolerable error is the maximum rate of deviation from a prescribed control procedure that the auditor would be willing to accept, based on the preliminary assessment of control risk.

In substantive procedures, the tolerable error is the maximum monetary error in an account balance or class of transactions that the auditor would be willing to accept so that when the results of all audit procedures are considered, the auditor is able to conclude, with reasonable assurance, that the financial statements are not materially misstated.

Expected Error: If the auditor expects error to be present in the population, a larger sample than when no error is expected ordinarily needs to be examined to conclude that the actual error in the population is expected to be error free. In determining the expected error in a population, the auditor would consider such matters as error levels identified in previous audits, changes in the entity's procedures, and evidence available from other procedures.

Selection of the Sample: The auditor should select sample items in such a way that the sample can be expected to be representative of the population. This requires that all items in the population have an opportunity of being selected.

While there are a number of selection methods, three methods commonly used are:

- (i) Random selection, which ensures that all items in the population have an equal chance of selection, for example, by use of random number tables.
- (ii) Systematic selection, which involves selecting items using a constant interval between selections, the first interval having a random start. The interval might be based on a certain number of items (every 20th voucher number) or on monetary totals (every Rs 1,000 increase in the cumulative value of the population). When using systematic selection, the auditor would need to determine that the population is not structured in such a manner that the sampling interval corresponds with a particular pattern in the population. For example, if in a population of branch sales, a particular branch's sales occur only as every 100th item

and the sampling interval selected is 50, the result would be that the auditor would have selected all, or none, of the sales of that particular branch.

- (iii) Haphazard selection, which may be an acceptable alternative to random selection, provided the auditor attempts to draw a representative sample from the entire population with no intention to either include or exclude specific units. When the auditor uses this method, care needs to be taken to guard against making a selection that is biased, for example, towards items which are easily located, as they may not be representative.
- 2 (a) "Internal Control System means all the policies and procedures (internal controls) adopted by the management of an entity to assist in achieving management's objective of ensuring, as far as practicable, the orderly and efficient conduct of its business, including adherence to management policies, the safeguarding of assets, the prevention and detection of fraud and error, the accuracy and completeness of the accounting records, and the timely preparation of reliable financial information. The internal audit function constitutes a separate component of internal control with the objective of determining whether other internal controls are well designed and properly operated."
- (b) Scope and Objectives of the Internal Audit Function : The scope and objectives of internal audit vary widely and are dependent upon the size and structure of the entity and the requirements of its management.

Normally, however, internal audit operates in one or more of the following areas:

- (a) Review of accounting system and related internal controls: The establishment of an adequate accounting system and the related controls is the responsibility of management which demands proper attention on a continuous basis. The internal audit function is often assigned specific responsibility by management for reviewing the accounting system and related internal controls, monitoring their operation and recommending improvements thereto.
 - (b) Examination for management of financial and operating information: This may include review of the means used to identify, measure, classify and report such information and specific inquiry into individual items including detailed testing of transactions, balances and procedures.
 - (c) Examination of the economy, efficiency and effectiveness of operations including non-financial controls of an organisation: Generally, the external auditor is interested in the results of such audit work only when it has an important bearing on the reliability of the financial records.
 - (d) Physical examination and verification: This would generally include examination and verification of physical existence and condition of the tangible assets of the entity.
- (c) Relationship between Internal and External Auditors:
- 1. The role of the internal audit function within an entity is determined by management and its prime objective differs from that of the external auditor who is appointed to report independently on financial information. Nevertheless, some of the means of achieving their respective objectives are often similar and, thus, much of the work of the internal auditor may be useful to the external auditor in determining the nature, timing and extent of his procedures.
 - 2. The external auditor should, as part of his audit, evaluate the internal audit function to the extent he considers that it will be relevant in determining the nature, timing and extent of his compliance and substantive procedures. Depending upon such evaluation, the external auditor may be able to adopt less extensive procedures than would otherwise be required.
 - 3. By its very nature, the internal audit function cannot be expected to have the same degree of independence as is essential when the external auditor expresses his opinion on the financial information. The report of the external auditor is his sole responsibility,

and that responsibility is not by any means reduced because of the reliance he places on the internal auditor's work.

3. (a) Fraud and Error and their characteristics: As per AAS 4 "The Auditor's Responsibility to Consider Fraud and Error in an Audit of Financial Statements" misstatements in the financial statements can arise from fraud or error. The term "error" refers to an unintentional misstatement in the financial statements, including the omission of an amount or a disclosure, such as:

- A mistake in gathering or processing data from which financial statements are prepared.
- An incorrect accounting estimate arising from oversight or misinterpretation of facts.
- A mistake in the application of accounting principles relating to measurement, recognition, classification, presentation, or disclosure.

The term "fraud" refers to an intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception to obtain an unjust or illegal advantage. Although fraud is a broad legal concept, the auditor is concerned with fraudulent acts that cause a material misstatement in the financial statements. Misstatement of the financial statements may not be the objective of some frauds. Auditors do not make legal determinations of whether fraud has actually occurred. Fraud involving one or more members of management or those charged with governance is referred to as "management fraud"; fraud involving only employees of the entity is referred to as "employee fraud". In either case, there may be collusion with third parties outside the entity.

Two types of intentional misstatements are relevant to the auditor's consideration of fraud-misstatements resulting from fraudulent financial reporting and misstatements resulting from misappropriation of assets.

Fraudulent financial reporting involves intentional misstatements or omissions of amounts or disclosures in financial statements to deceive financial statement users. Fraudulent financial reporting may involve:

- Deception such as manipulation, falsification, or alteration of accounting records or supporting documents from which the financial statements are prepared.
- Misrepresentation in, or intentional omission from, the financial statements of events, transactions or other significant information.
- Intentional misapplication of accounting principles relating to measurement, recognition, classification, presentation, or disclosure.

Misappropriation of assets involves the theft of an entity's assets. Misappropriation of assets can be accomplished in a variety of ways (including embezzling receipts, stealing physical or intangible assets, or causing an entity to pay for goods and services not received); it is often accompanied by false or misleading records or documents in order to conceal the fact that the assets are missing.

Fraud involves motivation to commit fraud and a perceived opportunity to do so. Individuals might be motivated to misappropriate assets, for example, because the individuals are living beyond their means. Fraudulent financial reporting may be committed because management is under pressure, from sources outside or inside the entity, to achieve an expected (and perhaps unrealistic) earnings target particularly when the consequences to management of failing to meet financial goals can be significant. A perceived opportunity for fraudulent financial reporting or misappropriation of assets may exist when an individual believes internal control could be circumvented, for example, because the individual is in a position of trust or has knowledge of specific weaknesses in the internal control system.

The distinguishing factor between fraud and error is whether the underlying action that results in the misstatement in the financial statements is intentional or unintentional. Unlike

error, fraud is intentional and usually involves deliberate concealment of the facts. While the auditor may be able to identify potential opportunities for fraud to be perpetrated, it is difficult, if not impossible, for the auditor to determine intent, particularly in matters involving management judgment, such as accounting estimates and the appropriate application of accounting principles.

Responsibility of Those Charged With Governance and of Management: The primary responsibility for the prevention and detection of fraud and error rests with both those charged with the governance and the management of an entity. The respective responsibilities of those charged with governance and management may vary from entity to entity. Management, with the oversight of those charged with governance, needs to set the proper tone, create and maintain a culture of honesty and high ethics, and establish appropriate controls to prevent and detect fraud and error within the entity.

It is the responsibility of those charged with governance of an entity to ensure, through oversight of management, the integrity of an entity's accounting and financial reporting systems and that appropriate controls are in place, including those for monitoring risk, financial control and compliance with the laws and regulations.

It is the responsibility of the management of an entity to establish a control environment and maintain policies and procedures to assist in achieving the objective of ensuring, as far as possible, the orderly and efficient conduct of the entity's business. This responsibility includes implementing and ensuring the continued operation of accounting and internal control systems, which are designed to prevent and detect fraud and error. Such systems reduce but do not eliminate the risk of misstatements, whether caused by fraud or error. Accordingly, management assumes responsibility for any remaining risk.

(b) **Examples of Circumstances that Indicate the Possibility of Fraud or Error:** The auditor may encounter circumstances that, individually or in combination, indicate the possibility that the financial statements may contain a material misstatement resulting from fraud or error. The circumstances listed below are few examples

- Unrealistic time deadlines for audit completion imposed by management.
- Reluctance by management to engage in frank communication with appropriate third parties, such as regulators and bankers.
- Limitation in audit scope imposed by management.
- Identification of important matters not previously disclosed by management.
- Significant difficult-to-audit figures in the accounts.
- Aggressive application of accounting principles.
- Conflicting or unsatisfactory evidence provided by management or employees.
- Unusual documentary evidence such as handwritten alterations to documentation, or handwritten documentation which is ordinarily electronically printed.
- Information provided unwillingly or after unreasonable delay.
- Seriously incomplete or inadequate accounting records.
- Unsupported transactions.
- Unusual transactions, by virtue of their nature, volume or complexity, particularly if such transactions occurred close to the year-end.
- Transactions not recorded in accordance with management's general or specific authorization.
- Significant unreconciled differences between control accounts and subsidiary records or between physical count and the related account balance which were not appropriately investigated and corrected on a timely basis.

- Inadequate control over computer processing (for example, too many processing errors; delays in processing results and reports).
 - Significant differences from expectations disclosed by analytical procedures.
 - Fewer confirmation responses than expected or significant differences revealed by confirmation responses.
 - Evidence of an unduly lavish lifestyle by officers or employees.
 - Unreconciled suspense accounts.
 - Long outstanding account receivable balances.
4. Representation by management refers to written or oral confirmation by them regarding the items presented in financial statements. For example if management confirms through a letter to the auditor that they have recorded all known liabilities in the financial statements, such confirmation is called management representation.

Basic Elements of a Management Representation Letter :

- (i) A management representation letter should be addressed to the auditor, containing the relevant information and be appropriately dated and signed.
 - (ii) A management representation letter would normally be dated the same date as the auditor's report on the financial information or a date prior thereto. However, in certain circumstances, in respect to specific transactions or events, separate representation letters may also be obtained during the course of audit.
 - (iii) A management representation letter should ordinarily be signed by the members of management who have primary responsibility for the entity and its financial aspects, e.g., managing director, finance director.
 - (iv) If management refuses to provide representations on any matter that the auditor considers necessary, this will constitute a limitation on the scope of his examination. In such circumstances, the auditor should evaluate any reliance he has placed on other representations made by management during the course of his examination and consider if the refusal may have any additional effect on his report.
 - (v) In case management is not willing to give in writing the representations made by it during the course of audit, the auditor should himself prepare a letter in writing setting out his understanding of management's representations that have been made to him during the course of audit and send it to management with a request to acknowledge and confirm that his understanding of the representations is correct. If the management refuses to acknowledge or confirm the letter sent by the auditor, this will constitute a limitation on the scope of his examination. In such circumstances, the auditor should evaluate any reliance on those representations and consider if the refusal may have any additional effect on his report.
- 5 (a) The term "non-compliance" as used in this AAS 21 refers to acts of omission or commission by the entity being audited, either intentional or unintentional, which are contrary to the prevailing laws or regulations. Such acts include transactions entered into by, or in the name of, the entity or on its behalf by its management or employees. For the purpose of this AAS, non-compliance does not include personal misconduct (unrelated to the business activities of the entity) by the entity's management or employees.
- It is management's responsibility to ensure that the entity's operations are conducted in accordance with laws and regulations. The responsibility for the prevention and detection of non-compliance rests with management.
- (b) Communication/Reporting of Non-compliance:
- (1) To Management :
 - (i) The auditor should, as soon as practicable, either communicate with the audit

committee, the board of directors and senior management, or obtain evidence that they are appropriately informed, regarding non-compliance that comes to the auditor's attention. However, the auditor need not do so for matters that are clearly inconsequential or trivial and may reach agreement in advance on the nature of such matters to be communicated.

- (ii) If in the auditor's judgement, the non-compliance is believed to be intentional and/or material, the auditor should communicate the finding without delay.
 - (iii) If the auditor suspects that members of senior management, including members of the board of directors, are involved in non-compliance, the auditor should communicate the matter to the next higher level of authority at the entity, such as an audit committee or board of directors. Where no higher authority exists, or if the auditor believes that the communication may not be acted upon or is unsure as to the person to whom to report, the auditor may consider seeking legal advice.
- (2) To the Users of the Auditor's Report on the Financial Statements :
- (i) If the auditor concludes that the non-compliance has a material effect on the financial statements, and has not been properly reflected in the financial statements, the auditor should express a qualified or an adverse opinion.
 - (ii) If the auditor is precluded by the entity from obtaining sufficient appropriate audit evidence to evaluate whether non-compliance that may be material to the financial statements has, or is likely to have, occurred, the auditor should express a qualified opinion or a disclaimer of opinion on the financial statements on the basis of a limitation on the scope of the audit.
 - (iii) If the auditor is unable to determine whether non-compliance has occurred because of limitations imposed by the circumstances rather than by the entity, the auditor should consider the effect on the auditor's report.
- (3) To Regulatory and Enforcement Authorities : The auditor's duty of confidentiality would ordinarily preclude reporting non-compliance to a third party. However, in certain circumstances, that duty of confidentiality is overridden by statute, law or by courts of law (for example, the auditor is required to report certain matters of non-compliance to the Reserve Bank of India as per the requirements of Non Banking Financial Companies Auditor's Report (Reserve Bank) Directions, 1988, issued by the Reserve Bank of India).
6. (a) General Purpose Financial Statements: The term "General Purpose Financial Statements" normally includes a balance sheet, a statement of profit and loss (also known as 'income statement'), a cash flow statement and those notes and other statements and explanatory material that are an integral part of the financial statements. They may also include supplementary schedules and information based on or derived from, and expected to be read with, such statements. Such schedules and supplementary information may deal, for example, with financial information about business and geographical segments, and disclosures about the effects of changing prices. Financial statements do not, however, include such items as reports by directors, statements by the chairman, discussion and analysis by management and similar items that may be included in a financial or annual report. Such financial statements are prepared and presented at least annually and are directed toward the common information needs of a wide range of users. Some of these users may require, and have the power to obtain, information in addition to that contained in the financial statements. Many users, however, have to rely on the financial statements as their major source of financial information and such financial statements should, therefore, be prepared and presented with their needs in view. Accounting Standards are applicable to all General Purpose Financial Statements.
- (b) Going Concern Concept: AS 1, "Disclosure of Accounting Policies", lays down that the "Going Concern", is one of the fundamental accounting assumption underlying financial statements. This Going Concern concept envisages that the entity will continue for the

foreseeable future. Accounts are prepared on this concept unless there are indication that going concern concept is not holding good for a particular entity. On account of this basic concept of going concern, assets and liabilities are recorded on the basis that the entity will be able to realise its assets and discharge its liabilities in the normal course of business. If this assumption is unjustified, the entity may not be able to realise its assets at the recorded amounts and there may be changes in the amounts and maturity dates of liabilities. AS 1, "Disclosure of Accounting Policies", also requires that no specific disclosure is required in case the same has been followed in the preparation of financial statements. In case this assumption is not followed, the fact should be disclosed.

AAS 16, "Going Concern", establishes standards on the auditor's responsibilities in the audit of financial statements regarding the appropriateness of the going concern assumption as a basis for the preparation of the financial statements.

- (c) **Disclosure of Accounting Policies:** The view presented in the financial statements of an enterprise of its state of affairs and of the profit or loss can be significantly affected by the accounting policies followed in the preparation and presentation of the financial statements.

The accounting policies followed vary from enterprise to enterprise. Disclosure of significant accounting policies followed is necessary if the view presented is to be properly appreciated. The disclosure of some of the accounting policies followed in the preparation and presentation of the financial statements is required by some cases.

The purpose of AS-1 is to promote better understanding of financial statements by establishing through an accounting standard and the disclosure of significant accounting policies and the manner in which such accounting policies are disclosed in the financial statements.

Such disclosure would also facilitate a more meaningful comparison between financial statements of different enterprises.

To ensure proper understanding of financial statements, it is necessary that all significant accounting policies adopted in the preparation and presentation of financial statements should be disclosed. Such disclosure should form part of the financial statements.

It would be helpful to the reader of financial statements if they are all disclosed at one place instead of being scattered over several statements, schedules and notes which form part of financial statements.

Any change in accounting policy, which has a material effect, should be disclosed. The amount by which any item is in the financial statement is affected by such change should also be disclosed to the extent ascertainable. Where such amount is not ascertainable, wholly or in part, the fact should be indicated. If a change is made in the accounting policies, which has not material effect on the financial statements for the current period, which is reasonably expected to have material effect in latter periods, the fact of such change should be appropriately disclosed in the period in which the change is adopted.

- (d) **Audit Working Papers:** AAS 3 "Documentation", states that the audit working papers are written records kept by the auditor, of the evidence gathered during the course of an audit, the methods and procedures followed and the conclusions arrived at. These papers generally include all the information that the auditor considers necessary to adequately conduct his examination and provide support for his audit report. It also includes a summary of all significant matters identified which may require the exercise of judgement together with the auditor's conclusions thereon.

Thus the auditor is required to document matters which are important in providing evidence, that the audit was carried out in accordance with the basic principles.

- (e) **Basic Elements of the Auditor's Report :** The auditor's report includes the following basic elements, ordinarily, in the following layout:

- (a) Title;

- (b) Addressee;
- (c) Opening or introductory paragraph
 - (i) identification of the financial statements audited;
 - (ii) a statement of the responsibility of the entity's management and the responsibility of the auditor;
- (d) Scope paragraph (describing the nature of an audit)
 - (i) a reference to the auditing standards generally accepted in India;
 - (ii) a description of the work performed by the auditor;
- (e) Opinion paragraph containing
 - (i) a reference to the financial reporting framework used to prepare the financial statements; and
 - (ii) an expression of opinion on the financial statements;
- (f) Date of the report;
- (g) Place of signature; and
- (h) Auditor's signature.

A measure of uniformity in the form and content of the auditor's report is desirable because it helps to promote the reader's understanding of the auditor's report and to identify unusual circumstances when they occur.

A statute governing the entity or a regulator may require the auditor to include certain matters in the audit report or prescribe the form in which the auditor should issue his report. In such a case, the auditor should incorporate in his audit report, the matters specified by the statute or regulator and/or report in the form prescribed by them in addition to the requirements of this AAS.

- (f) **Audit Risk :** Audit risk is the risk that an auditor may give an inappropriate opinion on financial information which is materially misstated. An auditor may give an unqualified opinion on financial statements without knowing that they are materially misstated. Such risk may exist at overall level, while verifying various transactions and balance sheet items. There are three components of audit risk:
 - (i) **Inherent risk:** is a risk that material errors will occur. Inherent risk is the susceptibility of an account balance or class of transactions to misstatement that could be material, individually or when aggregated with misstatements in other balances or classes, assuming that there were no related internal controls.
 - (ii) **Control Risk:** is the risk that the client's system internal control will not prevent or correct such errors. To assess control risk, the auditor should consider the adequacy of control design as well as test adherence to control procedure.
 - (iii) **Detection Risk:** is the risk that an auditor's procedures will not detect a misstatement that exists in an account balance or class of transactions that could be material, individually or when aggregated with misstatements in other balances or classes. The level of detection risk relates directly to the auditor's procedures, Some detection risk would always be present.

The inherent and control risks are functions of the entity's business and its environment and the nature of the account balances or classes of transactions, regardless of whether an audit is conducted. Even though inherent and control risks cannot be controlled by the auditor, the auditor can assess them and design his substantive procedures to produce on acceptable level of detection risk, thereby reducing audit risk to an acceptable low level.

- (g) **Surprise Check:** Surprise checks are a part of normal audit, and the results of such checks are therefore important to the auditor in deciding the scope of his audit and submission of his report. An element of surprise can significantly improve the audit effectiveness.

Wherever practical, an element of surprise should be incorporated in the audit programme. The element of surprise in an audit may be both in regard to the time of audit, that is selection of date, when the auditor will visit the client's office for audit, and selection of the areas of audit. Surprise checks are mainly intended to ascertain whether the internal control system is working effectively, and whether all accounting and other records are kept up to date and as per the statutory regulations. Such checks and surprise visit can exercise good moral checks on the client's staff.

Surprise checks also determines whether errors, or frauds exist, and if they exist, bring the matter promptly to the attention of the management so that corrective action can be taken at the earliest. Surprise checks are very effective in case of organizations having weak internal control system, very large, diversified and well spread out organizations, etc.

Frequency and extent of surprise checks would depend on the extent to which the auditor feels necessary, depending upon system of internal control complications of transactions, importance of items like cash, investments, stock, etc. The results of surprise checks should be communicated to the management if internal control weakness, fraud, or error is found.

The auditor should satisfy himself that adequate action is taken by the management on the matters communicated by him.

- (h) **Cut-off arrangement:** Accounting is a continuous process because the business never comes to halt. It is, therefore, necessary that transactions of one period would be separated from those in the ensuing period so that the results of the working of each period can be correctly ascertained. The arrangement that is made for this purpose is technically known as "cut-off arrangement". It essentially forms part of the internal control system of the organisation. Accounts, other than sales, purchase and stock are not usually affected by the continuity of the business and therefore, this arrangement is generally applied only to sales, purchase and stock. The auditor satisfies by examination and test-checks that the cut-off procedure are adequately followed and ensure that:

- (i) Goods purchased, property in which passed on to the client, have in fact been included in the inventories and that the liability has been provided for in case credit purchase.
- (ii) Goods sold have been excluded from the inventories and credit has been taken for the sales. If the value of sales is to be received, the concerned party has been debited.

The auditor may examine a sample of documents, evidencing the movement of stock into and out of stores, including documents pertaining to period shortly before and after the cut-off date and check whether stocks represented by those documents were included or excluded as appropriate during stock taking for perfect and correct presentation in the financial statements.

- (i) **Outstanding Assets:** It is a well accepted accounting principle that all expenditure pertaining to the year alone should be charged against year's revenue and all income whether received or not should be accrued for the year. Following this principle one has to make certain year end adjustments in the books of account and outstanding assets are brought to book in that process. If expenditure has been made on certain revenue heads, the benefit of which is to be derived even after the year is over and adjustment is made to the original figure of expenditure so as to carry forward the sum that does not pertain to the year an outstanding assets is created. Similarly, if certain income has accrued for the year but has not been received, the amount that has so accrued is usually brought into books as year end adjustment and thereby creating an outstanding assets account.

Generally, outstanding assets are those items for which amounts are yet to be received though services, etc. have been rendered, or items for which benefit of service will be received later. For example, in case insurance amount has been paid in advance then the

proportion thereof applicable to the period subsequent to the date of the balance sheet should be calculated and shown as an outstanding assets. Other examples of outstanding assets may include rent receivable, commission receivable, advertising amount paid in advance, interest receivable on loans, etc.

- 7 (a) **Borrowing from Banks:** Borrowing from banks may be either in the form of overdraft limits or term loans. In each case, the borrowings should be verified as follows:
- (i) Reconcile the balances in the overdraft or loan account with that shown in the pass book(s) and confirm the last mentioned balance by obtaining a certificate from the bank showing the balance in the accounts as at the end of the year.
 - (ii) Obtain a certificate from the bank showing particulars of securities deposited with the bank as security for the loans or of the charge created on an asset or assets of the concern and confirm that the same has been correctly disclosed and duly registered with Registrar of Companies and recorded in the Register of charges.
 - (iii) Verify the authority under which the loan or draft has been raised. In the case of a company, only the Board of Directors is authorised to raise a loan or borrow from a bank.
 - (iv) Confirm, in the case of a company, that the restraint contained in Section 293 of the Companies Act, 1956 as regards the maximum amount of loan that the company can raise has not been contravened.

Ascertain the purpose for which loan has been raised and the manner in which it has been utilised and that this has not prejudicially affected the entity.

- (b) **Provision for Income Tax :**
- (i) Obtain the computation of income prepared by the auditee and verify whether it is as per the Income-tax Act, 1961 and Rules made thereunder.
 - (ii) Review adjustments, expenses, disallowed special rebates, etc. with particular reference to the last available completed assessment.
 - (iii) Examine relevant records and documents pertaining to advance tax, self assessment tax and other demands.
 - (iv) Compute tax payable as per the latest applicable rates in the Finance Act.
 - (v) Ensure that overall provisions on the date of the balance sheet is adequate having regard to current year provision, advance tax paid, assessment orders, etc
- (c) **Deferred Revenue Expenditure:** This is a type of revenue expenditure, whose benefit extends to more than one accounting year during which it is actually incurred. Accountancy principles require that only that part of the expenditure which is pertaining to the accounting period should be debited to the profit and loss account of the year. Remaining amount should be carried forward in the balance sheet and it should be written off against the future income, depending upon the number of years during which the benefit of expenditures is likely to be enjoyed. This type of expenditure is known as deferred revenue expenditure. Part of such revenue expenditure is to be treated as assets for the purpose of disclosure in the balance sheet for the time till the benefit of such expenditure is fully exhausted.

Some examples of deferred revenue expenditure are expenditure on an advertisement campaign to launch a product in the market, discount allowed on subscription to debentures, development expenses in the case of mines and plantations, etc. While verifying deferred revenue expenditure, this may satisfy himself that:

- (a) it is proper to defer the expenditure;
- (b) the period of amortisation of the expenditure is reasonable;
- (c) the expenditure shown to have been incurred during the year actually occurred during the year and there is proper authority for the expenditure and for its deferral;

- (d) the criteria which previously justified the deferral of the expenditure continue to be met and the expected future revenue / other benefits related to the expenditure continue to exceed the amount of unamortized expenditure.
- (d) Trade Marks and Copyrights :
- (a) Obtain schedule of Trade Marks and Copyrights duly signed by the responsible officer and scrutinise the same and confirm that all of them are shown in the Balance Sheet.
 - (b) Examine the written agreement in case of assignment of Copyrights and Assignment Deed in case of transfer of trade marks. Also ensure that trade marks and copyrights have been duly registered.
 - (c) Verify existence of copyright by reference to contract between the another and noting down the terms of payment of royalty.
 - (d) See that the value has been determined properly and the costs incurred for the purpose of obtaining the trade marks and copyrights have been capitalised.
 - (e) Verify existence of copyright by reference to contact between the author and the entity and to check the payments of royalty made to author.
 - (f) Ascertain that the legal life of the trade marks and copyrights have not expired.
 - (g) Ensure that amount paid for both the intangible assets is properly amortised having regard to appropriate legal and commercial considerations.
8. (a) Depreciation on Stand-by Asset: As per AS-6 on "Depreciation Accounting", depreciation is a measure of the wearing out, consumption or other loss of value of a depreciable asset arising from use, effluxion of time or obsolescence through technology and market changes. Thus, depreciation has to be charged even in case of these assets which are not used at all during the year but by mere effluxion of time provided such assets qualify as depreciable assets. When the spare bus was kept ready for use as stand-by, it means it was intended to be used for the purpose of business. Depreciation in respect of this bus ought to have been provided in the accounts for the year ended 31st March, 2001. If there is an intention to use an asset, though it may not have actually been used, it is a 'constructive' or 'passive' use and eligible for claim of depreciation.
- (b) Amount Received from an Insurance Company: AS-5 on "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies" requires that all items of income and expense which are recognised in a period should be included in the determination of net profit or loss for the period. The claim for loss of goods in transit is arising out of ordinary activities of the enterprise as a part of its normal course of business. However, the cost of goods lost in transit is only Rs.8,00,000 while the insurance money received is Rs.10,00,000. Purchases Account need not be credited since it would distort the purchases done during the year and as also the gross profit. Therefore, entire amount of Rs.10 lacs needs to be taken to profit and loss account under an appropriate head. This is an income arising from an ordinary activities of the enterprise but having regard to amount involved and exceptional nature, a separate disclosure be made in the profit and loss account. Such disclosure would enable the users to understand the performance of an enterprise for the period.
- (c) Cost of Structural Alterations: Any subsequent expenditure on fixed assets which increases the future benefits arising from them beyond their previously assessed standards of performance amounts to capital expenditure and, thus, must form part of the cost of the asset. The words "structural alteration" would generally signify that some significant changes have taken place in the design of building to provide more strength to the building or expansion in the capacity of the building. Therefore, cost of Rs.60,000 represents the cost of expansion or extension or may increase the life span of premises, it is a capital expenditure, and an adjustment entry debiting Buildings Account and crediting Building Repairs Account should be made and depreciation should also be provided accordingly.

- (d) Embezzlement of Cash: AS-5 on "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies", requires that "all items of income and expense which are recognised in a period should be included in the determination of net profit or loss for the period". It further states that "when items of income and expense within profit or loss from ordinary activities are of such size, nature or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately". Embezzlement of cash during the course of business is a 'business loss'. It is a business hazard which can occur once in a while. It cannot be merged with any other head much less the salary. Being material item, it is required to be disclosed under a distinct head in the profit and loss account.

9. Exemptions to Branches: Central Government has been empowered to make Rules so as to exempt branch offices from audit to extent as is specified in the Rules [section 228(4)]. In exercise of the powers conferred by section 228(4) the Central Government has framed certain rules, "The Companies (Branch Audit Exemption) Rules, 1961".

These rules are summarised below :

- (1) Exemption based on quantum of activity: If a company, carrying on any manufacturing, processing or trading activity, has a branch office whose average of the 'quantum of activity' i.e. (i) the aggregate value of the goods and articles produced, manufactured or processed, or (ii) the aggregate value of the goods or articles sold and of service rendered, or (iii) the amount of the expenditure, whether of a revenue or capital nature, incurred by a branch office of a company during a financial year, (i.e., the financial year of the company in respect of which exemption from branch audit is to be determined) does not exceed Rs. 2 lakhs or 2% of the average of the total turnover of the company including all its branches and other offices and the earnings from services rendered and from any source during the same period, whichever is higher, the branch office shall be exempted from the provisions of section 228. It may be noted that in any such case, the auditors of the company shall have the rights referred to in section 229(2) relating to the audit of accounts of the branch office (Rules 2 and 3). For this exemption there is no necessity to make any application.
- (2) Grant of exemption in certain other cases: When an application for exemption is made to the Central Government, it may, after making the necessary inquiry, exempt the branch office from the provisions of audit in section 228 on any one of the following grounds, viz.
 - (i) that the company carrying on activities other than those of manufacturing or processing, or trading, has made satisfactory arrangements for the security and check, at regular intervals, of the accounts of the branch office by a responsible person competent to scrutinise and check the accounts;
 - (ii) that the company has made arrangements for the audit of the accounts of the branch office by a person otherwise qualified for appointment as branch auditors, even though such a person is an employee of the company;
 - (iii) that having regard to the nature and the quantum of activity carried on at the branch office or for any other reason a branch auditor is not likely to be available at a reasonable cost; and
 - (iv) that, for any other reason, the Central Government is satisfied that exemption may be granted.

A copy of the Central Government's order of exemption is required to be forwarded to the company which shall forthwith send a copy thereof to the auditor of the company and shall also cause it to be read before the next general meeting (Rule 4).

- (3) Condition of exemption in certain cases : In every case in which an exemption is granted on the ground referred to in clause (ii) of the foregoing paragraph, the company shall afford such a person access, at all the times, to the books, accounts and vouchers maintained at the branch office and also shall furnish him with such information and explanation as he may require. Such a person, during the period of exemption, is required to prepare in respect of

each financial year, a report on the accounts of the branch office examined by him, as well as, to forward the same to the company's auditor. A certificate to the effect that no material change had taken place in the arrangements made for the audit of the accounts of the branch office shall have to be attached to the balance sheet for each financial year. Such a certificate shall be signed by the manager or secretary of the company and by two directors, one of whom shall be managing director where there is one (Rule 6).

10. As per explanation to section 79A, the expression "sweat equity shares" means equity shares issued by the company to employees or directors at a discount or for consideration other than cash for providing know-how or making available right in the nature of intellectual property rights or value additions, by whatever name called. The auditor may see that the sweat equity shares issued by the company are of a class of shares already issued and following conditions are fulfilled :

- (a) The issue of sweat equity shares is authorised by a special resolution passed by the company in the general meeting;
- (b) The resolution specifies 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;
- (c) Not less than one year has, at the date of the issue elapsed since the date on which the company was entitled to commence business;
- (d) The sweat equity shares of a company whose equity shares are listed on a recognised stock exchange are issued in accordance with the regulations made by the Securities Exchange Board of India in this behalf:

Provided that in the case of a company whose equity shares are not listed on any recognised stock exchange, the sweat equity shares are issued in accordance with the guidelines as may be prescribed.

For the purposes of this sub-section, the expression "a company" means the company incorporated, formed and registered under this Act and includes its subsidiary company incorporated in a country outside India.

11. (a) **Shares Issued at a Discount :** A company can issue shares at a discount on the following conditions (Section 79) :

- (i) The issue should be authorised by an ordinary resolution of the company and sanctioned by the Central Government.
- (ii) No such resolution shall be sanctioned by the Central Government in case the maximum rate of discount should exceed 10 per cent unless the Central Government is of opinion that a higher rate for discount is justified by the special circumstances of the case.
- (iii) The issue should be made within two months of the sanction by the Central Government but not earlier than one year after the date of commencement of business.
- (iv) The shares should be of a class already issued by the company.

It is the duty of the auditor to confirm that all the conditions aforementioned have been complied with by the company at the time the allotment was made. Though there appears to be no obligation on the part of the company to write off discount on the issue of shares, it is nonetheless advisable that it should be so done within a few years of the shares being issued. The amount of discount, until written off, should be shown separately in the Balance Sheet under the head "Miscellaneous Expenditure".

- (b) **Payment of Interest out of capital during construction:** Under the provisions of section 208, a company which has raised money by issue of shares to meet the cost of construction of any work or building or provision of any plant which cannot be made profitable for a long time, can pay interest on paid-up capital for a period and subject to conditions specified in

sub-sections (2) to (7) of section 208. Accordingly, the payment of interest should be verified as follows :

- (a) Ascertain that the payment is authorised by the Articles or by a special resolution.
- (b) Verify that the previous sanction of the Central Government for making such payment has been obtained.
- (c) Confirm that the interest has been paid only for such period as has been authorised by the Central Government and does not extend beyond the half-year next following during which the construction was completed or the plant was provided.
- (d) Verify that the rate of interest shall, in no case exceed such rate as the Central Government may, by notification in official Gazette direct.
- (e) Check that the amount of interest paid has been added to the cost of assets created out of the capital.

The interest paid being a part of the capital expenditure incurred in bringing into existence assets, it should be added thereto. Until so added, it must be shown as a separate item in the Balance Sheet under the head 'Miscellaneous Expenditure'.

- (c) Reduction of Capital (Section 100) : The duties of the auditor in this regard are following :
 - (i) Verifying that the meeting of the shareholder held to pass the special resolution was properly convened; also that the proposal was circularised in advance among the members.
 - (ii) Confirming that the Articles of Association authorise reduction of capital.
 - (iii) Examining the order of the Tribunal confirming the reduction and seeing that a copy of the order and the minutes have been registered and filed with the Registrar of Companies.
 - (iv) Inspecting the Registrar's Certificate as regards reduction of capital.
 - (v) Vouching the journal entries recorded to reduce the capital and to write down the assets by reference to the resolution of shareholders and other documentary evidence; also seeing that the requirements of Schedule VI, Part I, have been complied with.
 - (vi) Confirming that the revaluation of assets have been properly disclosed in the Balance Sheet.
 - (vii) Verifying the adjustment made in the members' accounts in the Register of Members and confirming that either the paid up amount shown on the old share certificates have been altered or new certificates have been issued in lieu of the old, and the old ones have been cancelled.
 - (viii) Confirming that the words "and reduced", if required by the order of the Tribunal, have been added to the name of the company in the Balance Sheet.
 - (ix) Verifying that the Memorandum of Association of the company has been suitably altered.
- (d) Verification of Forfeiture of Shares: The auditor should
 - (i) ascertain that the Articles authorise the Board of Directors to forfeit shares and that the power has been exercised by the Board in the best interest of the company;
 - (ii) verify the amount of call or instalment of calls which was outstanding in respect of each of the share forfeited;
 - (iii) ascertain that the procedure in the Articles has been followed, viz., the notice given (14 days, according to Table A) to the defaulting shareholders, warning them that in the event of non-payment, by a specified date, of the amount of call already made on the shares standing in their names, together with interest, if any, the shares shall be forfeited; see that the proper resolutions of Directors, first as regards issuance of notice

and afterwards in respect of forfeiture of shares; and

- (iv) verify the entries recorded in the books of account consequent upon forfeiture of shares to confirm that the premium, if any, received on the issue of shares has not been transferred to the Forfeited Shares Account.

12. (a) NGOs can be defined as non-profit making organisations which raise funds from members, donors or contributors apart from receiving donation of time, energy and skills for achieving their social objectives like imparting education, providing medical facilities, economic assistance to poor, managing disasters and emergent situations. Therefore, this definition of NGO would include religious organisations, voluntary health and welfare agencies, charitable organisations, hospitals, old age homes, research foundations etc. The scope of services rendered by NGOs is extremely wide and as such can not be covered in a small definition. Some examples of NGOs operating in India include Child Relief and You (CRY), NORAD, UNICEF, Godhuli, Vidya, Concern India Foundation., etc.

Sources and applications of funds of NGO's : The main sources of funds include grants and donations, fund raising programmes, advertisements, fees from the members, technical assistance fees / fee for services rendered, subscriptions, gifts, sale of produce or publications, etc.

Donations and grants received in the nature of promoter's contribution are in the nature of capital receipts and shown as liabilities in the Balance Sheet of NGO. These may either be in the form of corpus contribution or a contribution towards revolving fund. A contribution made towards the capital or the corpus of an NGO is known as corpus contribution. The donors are generally required to specify whether the donation/grant given by him shall form part of the corpus of the NGO. Such contributions are generally given with reference to the total funds required by an NGO. Section 11(1)(d) of the Income Tax Act 1961 also states that income in the form of voluntary contributions made with a specific direction that they shall form part of the corpus of the trust or institution shall not be included in the computation to total income. The objective of a contribution or grant towards a Revolving Fund is to rotate the amount by giving temporary loans from the fund to other NGO or beneficiaries for their projects and then recover the loan so as to give temporary loans again and so on. However, any interest earned from the beneficiary on such temporary loans from the revolving fund could be either added back to the fund or credited to the Income and Expenditure Account depending on restrictions laid down by the authority providing the contribution (for the revolving fund) or by the rules and regulations laid down by the concerned NGO in this regard.

Donations and grants received for acquisition of specific fixed assets are those grants whose primary condition is that an NGO accepting them should purchase, construct or otherwise acquire the assets for which the grant is given.

Many a times NGOs receive contributions in kind. These contributions include assets such as land, buildings, vehicles, office equipment, etc. and articles related to programmes / projects such as food, books, building materials, clothes, beds, and raw material for training purposes, e.g., Wool, reeds, cloth, etc.

The areas of application of funds for an NGO include Establishment Costs, Office and Administrative Expenses, Maintenance Expenses, Programme / Project Expenses, Charity, Donations and Contributions given, etc.

- (b) While planning the audit, the auditor may concentrate on the following:
 - (i) Knowledge of the NGO's work, its mission and vision, areas of operations and environment in which it operate.
 - (ii) Updating knowledge of relevant statutes especially with regard to recent amendments, circulars, judicial decisions viz. Foreign Contribution (Regulation) Act 1976, Societies Registration Act, 1860, Income Tax Act 1961 etc. and the Rules related to the statutes.
 - (iii) Reviewing the legal form of the Organisation and its Memorandum of Association,

Articles of Association, Rules and Regulations.

- (iv) Reviewing the NGO's Organisation chart, then Financial and Administrative Manuals, Project and Programme Guidelines, Funding Agencies Requirements and formats, budgetary policies if any.
- (v) Examination of minutes of the Board/Managing Committee/Governing Body/Management and Committees thereof to ascertain the impact of any decisions on the financial records.
- (vi) Study the accounting system, procedures, internal controls and internal checks existing for the NGO and verify their applicability.
- (vii) Setting of materiality levels for audit purposes.
- (viii) The nature and timing of reports or other communications.
- (ix) The involvement of experts and their reports.
- (x) Review the previous year's Audit Report.

The audit programme should include in a sequential order all assets, liabilities, income and expenditure ensuring that no material is omitted:

- (i) Corpus fund :The contributions/grants received towards corpus be vouched with reference to the letters from the donor(s). The interest income be checked with investment Register and physical investments in hand.
- (ii) Reserves : Vouch transfers from projects/programmes with donors letters and board resolutions of NGO. Also check transfers and adjustments made during the year.
- (iii) Ear-marked Funds : Check requirements of donors' institutions, board resolution of NGO, rules and regulations of the schemes of the ear-marked funds.
- (iv) Project/Agency Balances: Vouch disbursements and expenditures as per agreements with donors for each of the balances.
- (v) Loans : Vouch loans with loan agreements receipt counter –foil issued.
- (vi) Fixed Assets : Vouch all acquisitions/sale or disposal of assets including depreciation and the authorisations for the same. Also check donor's letters/agreements for the grants. For immovable property, check title, etc.
- (vii) Investments : Check Investment Register and the investments physically ensuring that investments are in the name of the NGO. Verify further investments and dis-investments for approval by the appropriate authority and reference in the bank accounts for the principal amount and interest.
- (viii) Cash in Hand : Physically verify the cash in hand and imprest balance, at the close of the year and whether it tallies with the books of accounts.
- (ix) Bank Balance : Check the bank reconciliation statements and ascertain details for old outstanding and unadjusted amounts.
- (x) Stock in Hand : Verify stock in hand and obtain certificate from the management for the quantities and valuation of the same.
- (xi) Programme and Project Expenses : Verify agreement with donor/contributor (s) supporting the particular programme or project to ascertain the conditions with respect to undertaking the programme/project and accordingly, in the case of programmes/projects involving contracts, ensure that income tax is deducted, deposited and returns filed and verify the terms of the contract.
- (xii) Establishment Expenses : Verify that provident fund, life insurance and their administrative charges are deducted, contributed and deposited within the prescribed time. Also check other office and administrative expenses such as postage, stationery, travelling, etc.

The receipt of income of NGO may be checked on the following lines:

- (i) Contribution and Grants for projects and programme;; Check agreements with donors and grants letters to ensure that funds received have been accounted for. Check that all foreign contribution receipts are deposited in the foreign contribution bank account as notified under the Foreign Contribution (Regulation) Act, 1976.
- (ii) Receipts from Fund arising programmes: verify in detail the internal control system and ascertain who are the persons responsible for collection of funds and mode of receipt. Ensure that collections are counted and deposited in the bank daily.
- (iii) Membership Fees: Check fees received with membership register, ensure proper classification is made between entrance and annual fees and life membership fees. Reconcile fees received with fees to be received during the year.
- (iv) Subscription: Check with subscription register and receipts issued. Reconcile subscription received with printing and dispatch of corresponding magazine/circulars/periodicals. Check the receipts with subscription rate schedule.
- (v) Interest and Dividends: Check the interest and dividends received and receivable with investments held during the year.

13. (a) Reserves and Provisions:

Reserves : Reserve denotes retained profits. In other words, certain sum or sums are set apart out of the profits earned for specific or general purposes, and this constitutes reserve (or reserves).

These reserves are s not available for dividend purposes in the year concerned. However, subject to decision of the Board of Directors, there can be appropriation out of reserves created in the past for dividend purposes, provided such reserves are not capital reserves.

If there is no profit, no reserve can be created and, basically, reserves are at the disposal of the undertaking; they are not required to be maintained for meeting possible losses or expenses. The term "reserve" has been negatively defined in Part III of Schedule VI to the Companies Act, 1956 as not including any amount written off or retained by way of providing for diminution, renewals or diminution in value of assets or retained by way of providing for any known liability.

Provision: Provision, on the other hand, represents a charge for an estimated expense or loss or for a shrinkage in the cost of an asset or the accrual of a liability.

Except for provision for dividend which is appropriation of profits, provisions are meant to meet expected losses and expenses for which the amount is uncertain.

Profit cannot be ascertained unless the necessary provisions are first made. Part III of Schedule VI to the Companies Act, 1956 has defined "provision" to mean any amount written off or retained by way of providing for depreciation, renewals or diminution in value of assets, or retained by way of providing for any known liability of which the amount cannot be determined with substantial accuracy. Amounts provided for depreciation, renewals or diminution in value of assets are expenses and losses.

Hence, the character of provision is of an expense or loss which must be charged against the revenue so as to arrive at the true and fair profit or loss. Since reserve is retained profit, it is necessarily an appropriation of profit obtained after charging all the expenses and losses including provisions. It, therefore, cannot include anything which is properly chargeable as expense or loss, i.e., provision.

However, if amounts are provided in excess of the needs, the excess should be treated as reserve. For example, the company may provide for depreciation at the rate of 25% as against the statutory rate of 15%. The excess of depreciation to the extent of 10% would be treated as reserve even though the entire 25% has been a charge to the profit and loss account. For creation of reserve, existence of profit is a must while provision is necessary even where there is a loss so as to correctly reflect the operating results of the enterprise.

- (b) **Audit Reports and Certificates:** The term 'certificate', is a written confirmation of the accuracy of the facts stated therein and does not involve any estimate or opinion. When an auditor certifies a financial statement, it implies that the contents of that statement can be measured and that the auditor has vouchsafed the exactness of the data. The term certificate is, therefore, used where the auditor verifies certain exact facts. An auditor may, thus, certify the circulation figures of a newspaper or the value of imports or exports of a company. An auditor's certificate represents that he has verified certain precise figures and is in a position to vouchsafe their accuracy as per an examination of documents and books of account.

An auditor's report, on the other hand, is an expression of opinion. When we say that an auditor is reporting, we imply that he is expressing an opinion on the financial statements.

The term report implies that the auditor has examined relevant records in accordance with generally accepted auditing standards and that he is expressing an opinion whether or not the financial statements represent a true and fair view of the state of affairs and of the working results of an enterprise. Since an auditor cannot guarantee that the figures in the balance sheet and profit and loss account are absolutely precise, he cannot certify them. This is primarily because the accounts themselves are product of observance of several accounting policies, the selection of which may vary from one professional to another and, thus, he can only have an overall view of the accounts through normal audit procedures. Therefore, the term certificate cannot be used in connection with these statements.

Thus, when a reporting auditor issues a certificate, he is responsible for the factual accuracy of what is stated therein. On the other hand, when a reporting auditor gives a report, he is responsible for ensuring that the report is based on factual data, that his opinion is in due accordance with facts, and that it is arrived at by the application of due care and skill.

- (c) **Preliminary expenses and pre-production expenses:** Preliminary expenses are incurred by promoters of a company to bring the company into existence. They normally include:
- (i) Legal costs in drafting the Memorandum and Articles of Association.
 - (ii) Stamp duty and other fees on registration of the company.
 - (iii) Cost of printing the Memorandum and Articles of Association.
 - (iv) Cost of statutory books to be maintained by the company.
 - (v) Any other expenses incurred to bring into existence the corporate structure of the company.

These expenses, when approved by the Board of the company after its incorporation, become the expenses of the company and instead of being charged off in the year itself as revenue expenses, these are generally carried forward in the asset side of the balance sheet under the heading "Miscellaneous Expenditure". This accounting treatment is meted out because of the nature of these expenses. These are expenses necessarily to be incurred to bring the company into existence and consequently these assume a capital expenditure character. Since, these are not backed by any specific item of asset; it is also a recognised accounting practice to write them off from profits of subsequent three to five years. Under the provisions of the Income-tax Act, these expenses can be amortised over a period of ten years.

Pre-production expenses are incurred by an industrial company after its incorporation. Often such a company needs considerable time to set up the plant and other production facilities. In the meantime, it has to incur certain revenue expenses which cannot be capitalised. Pre-production expenses refer to such expenses. They include expenses in the accounts as they have been incurred in the pre-production period. They are carried forward in the asset side of the balance sheet under the general heading of "Miscellaneous Expenditure". These expenses are generally written off at the earliest opportunity after commercial production starts, within three to five years.

14. (a) Audit is not legally obligatory for all types of business organisations or institutions. On this basis audits may be of two broad categories i.e., audit required under law and voluntary audits.
- (i) Audit required under law: The organisations which require audit under law are the following:
 - (a) companies governed by the Companies Act, 1956;
 - (b) banking companies governed by the Banking Regulation Act, 1949;
 - (c) electricity supply companies governed by the Electricity Supply Act, 1948;
 - (d) co-operative societies registered under the Co-operative Societies Act, 1912;
 - (e) public and charitable trusts registered under various Religious and Endowment Acts;
 - (g) corporations set up under an Act of Parliament or State Legislature such as the Life Insurance Corporation of India.
 - (h) Specified entities under various sections of the Income-tax Act, 1961.
 - (ii) In the voluntary category are the audits of the accounts of proprietary entities, partnership firms, Hindu undivided families, etc. In respect of such accounts, there is no basic legal requirement of audit. Many of such enterprises as a matter of internal rules require audit. Some may be required to get their accounts audited on the directives of Government for various purposes like sanction of grants, loans, etc. But the important motive for getting accounts audited lies in the advantages that follow from an independent professional audit. This is perhaps the reason why large numbers of proprietary and partnership business get their accounts audited.
- (b) Advantages of an Independent Audit: The fact that audit is compulsory by law, in certain cases by itself should show that there must be some positive utility in it. The chief utility of audit lies in reliable financial statements on the basis of which the state of affairs may be easy to understand. Apart from this obvious utility, there are other advantages of audit. Some or all of these are of considerable value even to those enterprises and organisations where audit is not compulsory, these advantages are given below :
- (a) It safeguards the financial interest of persons who are not associated with the management of the entity, whether they are partners or shareholders.
 - (b) It acts as a moral check on the employees from committing defalcations or embezzlement.
 - (c) Audited statements of account are helpful in settling liability for taxes, negotiating loans and for determining the purchase consideration for a business.
 - (d) These are also useful for settling trade disputes for higher wages or bonus as well as claims in respect of damage suffered by property, by fire or some other calamity.
 - (e) An audit can also help in the detection of wastages and losses to show the different ways by which these might be checked, especially those that occur due to the absence or inadequacy of internal checks or internal control measures.
 - (g) Audit ascertains whether the necessary books of account and allied records have been properly kept and helps the client in making good deficiencies or inadequacies in this respect.
 - (h) As an appraisal function, audit reviews the existence and operations of various controls in the organisations and reports weaknesses, inadequacies, etc., in them.
 - (i) Audited accounts are of great help in the settlement of accounts at the time of admission or death of partner.

- (j) Government may require audited and certified statement before it gives assistance or issues a licence for a particular trade.
15. (a) Internal check has been defined by the Institute of Chartered Accountants of England and Wales as the "checks on day-to-day transactions which operate continuously as part of the routine system whereby the work of one person is proved independently or is complementary to the work of another, the object being the prevention or early detection of errors or fraud". Internal check is a part of the overall internal control system and operates as a built-in device as far as the staff organisation and job allocation aspects of the control system are concerned. A system of internal check in accounting implies organisation of system of book keeping and arrangement of staff duties in such a manner that no one person can completely carry through a transaction and record every aspect thereof. The essential elements of a goods system of internal check are :
- (i) Existence of checks on the day-to-day transaction.
 - (ii) Which operate continuously as a part of the routine system.
 - (iii) Whereby the work of each person is either proved independently or is made complementary to the work of another.

Its objective is to prevent and to bring about a speedy detection of frauds, wastes and errors. The system is based on the principle that when the performance of each individual in an organisation, normally and automatically, is checked by another, the chances of occurrence of errors, or their remaining undetected, are greatly reduced; also that, when two or more persons essentially must combine either to receive or to make a payment, there will be lesser possibility of a fraud being perpetrated by them.

(b) General Considerations in Framing a System of Internal Check :

- (1) No single person should have an independent control over any important aspect of the business. All dealings and acts of every employee should, in the ordinary course, come under the review of another.
- (2) The duties of members of the staff should be changed from time to time without any previous notice so that the same officer or subordinate does not, without a break, perform the same function for a considerable length of time.
- (3) Every member of the staff should be encouraged to go on leave at least once in a year. Experience has shown that frauds successfully concealed by employees are often unearthed when they are on leave.
- (4) Persons having physical custody of assets must not be permitted to have access to the books of account.
- (5) There should exist an accounting control in respect of each important class of assets; in addition, these should be periodically inspected so as to establish their physical condition.
- (6) To prevent loss or misappropriation of cash, mechanical devices, such as the automatic cash register, should be employed.
- (7) A majority of business concerns now-a-days work according to some kind of budgetary control. It enables them to review from time to time the progress of their trading activities. Such business houses should have a separate staff for the collection of statistical figures which later on should be checked with the corresponding figures from the financial books. If wide discrepancies are observed, these should be reconciled.
- (8) For stock-taking, at the close of the year, trading activities should, if possible, be suspended. The task of stock-taking, and evaluation should be done by staff belonging to several sections of the organisation. It may prove dangerous to depend exclusively on the stock section staff for these tasks, since they may be tempted to under or over-state the stock.

- (9) The financial and administrative powers should be distributed very judiciously among different officers and the manner in which these are actually exercised should be reviewed periodically.
- (10) Procedures should be laid down for periodical verification and testing of different sections of accounting records to ensure that they are accurate.
- (11) Accounting procedures should be reviewed periodically, for, even well designed and carefully installed procedures, in course of time, cease to be effective.

PAPER – 3 : BUSINESS AND CORPORATE LAW

QUESTIONS

1. Explain the concept of 'misrepresentation' in matters of contract. Sohan induced Suraj to buy his motorcycle saying that it was in a very good condition. After taking the motorcycle, Suraj complained that there were many defects in the motorcycle. Sohan proposed to get it repaired and promised to pay 40% cost of repairs. After a few days, the motorcycle did not work at all. Now Suraj wants to rescind the contract. Decide giving reasons.
2. Father promised to pay his son a sum of Rs. One lakh if the son passed C.A. examination in the first attempt. The son passed the examination in the first attempt, but father failed to pay the amount as promised. Son files a suit for recovery of the amount. State along with reasons whether son can recover the amount under the Indian Contract Act, 1872.
3. What are the principles of law of guarantee with regard to contribution of the same debt between the co-sureties?
4. State the rules under the Indian Contract Act, 1872 regarding time and place for the performance of the promise.
5. Miss.Chitra, a singer, enters in to a contract with the manager of Bangalore Gate Club, to sing in the Club for two concerts every week during the next two months and the club agrees to pay her at the rate of Rs.2000 for each concert. On the seventh concert Miss.Chitra willfully absents herself. With the assent of the manager of the club, Miss.Chitra sings for the eighth concert. But on the following day, the club, puts an end to the contract. Can Miss.Chitra claim damages for breach of contract? Advise.
6. M advances to N Rs.5,000 on the guarantee of P. The loan carries interest at ten percent per annum. Subsequently, N becomes financially embarrassed. On N's request, M reduces the interest to six per cent per annum and does not sue N for one year after the loan becomes due. N becomes insolvent. Can M sue P?
7. Mr.Jayanth sells and consigns certain goods to Mr.Srikanth for cash and sends the Railway Receipt to him. Mr.Srikanth becomes insolvent and while the goods are in transit, he assigns the Railway Receipt to Mr.Naveen, who does not know that Mr.Srikanth is insolvent. Mr.Jayanth being an unpaid seller wants to exercise his rights. Advise:
 - (a) whether Mr.Jayanth can exercise the right of stoppage of goods in transit.
 - (b) would your answer be different if Mr.Naveen was aware of Mr.Jayanth's insolvency before the assignment of the Railway Receipt in favour of Mr.Naveen ?
8. M Ltd., contracts with Shanti Traders to make and deliver certain machinery to them by 30.6.2004 for Rs. 11.50 lakhs. Due to labour strike, M Ltd. could not manufacture and deliver the machinery to Shanti Traders. Later, Shanti Traders procured the machinery from another manufacturer for Rs.12.75 lakhs. Shanti Traders was also prevented from performing a contract which it had made with Zenith Traders at the time of their contract with M Ltd. and were compelled to pay compensation for breach of contract. Advise Shanti Traders the amount of compensation which it can claim from M Ltd., referring to the legal provisions of the Indian Contract Act.
9. What do you understand by "Agency by Ratification"? What is the effect of ratification? Point out any four elements of a valid ratification.
10. Briefly discuss the position of a minor under the Indian Contract Act, 1872 with regard to the contracts entered into by him.
11. Define 'Condition' and 'Warranty' under the Sale of Goods Act, 1930. When can a breach of warranty be treated as a breach of condition and vice-versa?
12. On a Bill of Exchange for Rs.1 lakh, X's acceptance to the Bill is forged. 'A' takes the Bill from his customer for value and in good faith before the Bill becomes payable. State with reasons whether

'A' can be considered as a 'Holder in due course' and whether he (A) can receive the amount of the Bill from 'X'.

13. M., a legal successor of N (a deceased person) signs a Bill of Exchange in his own name admitted a liability of Rs.50,000 i.e. the extent to which he inherits the assets from the deceased payable to P after 3 months from 1st January, 2002. On maturity, when P presents the bill to M, he (M) refuses to pay for the bill on the ground that since the original liability was that of N, the deceased, therefore he is not liable to pay for the bill. Referring to the provisions of the Negotiable Instruments Act, 1881 decide whether P can succeed in recovering Rs.50,000 from M. Would your answer be still the same in case M does not state the limit in the bill and the liability is more than the assets he inherits from N (the deceased)?
14. A indorses and delivers a cheque to B, and B keeps it for an unreasonable length of time and then indorses and delivers it to C. C presents the cheque for payment with in a reasonable time after its receipt by him and it is dishonoured. Advise C.
15. A Bill is drawn payable at No. A-17 CA apartments, Soniya Vihar, New Delhi, but does not contain drawee's name. Mr. Vinod who resides at the above address accepts the bill. Is it a valid Bill?
16. A banker made payment of a cheque in which the drawers signature was forged. Can the banker claim protection in respect of such payment? What would be the protection if it was a case of forgery of indorsee's signature.?
17. State by and to whom, a notice of dishonour of a negotiable instrument should be given and also state the mode to be followed for giving such notice under the provisions of the Negotiable Instruments Act, 1881.
18. Explain the rights and obligations of following persons under the Negotiable Instruments Act, 1881:
 - (i) Finder of a lost instrument;
 - (ii) Obtained an instrument by unlawful means or by unlawful consideration.
19. 'A' draws a cheque for Rs.50,000. When the cheque ought to be presented to the drawee bank, the drawer has sufficient funds to make payment of the cheque. The bank fails before the cheque is presented. The payee demands payment from the drawer. What is the liability of the drawer.
20. A, a major, and B, a minor, executed a Promissory Note in favour of C. Examine with reference to the provisions of the negotiable Instruments Act, 1881 the validity of the Promissory Note and state whether it is binding on A and B.
21. J. a shareholder of a Company purchased for his personal use certain goods from a Mall (Departmental Store) on credit. He sent a cheque drawn on the Company's account to the Mall (Departmental Store) towards the full payment of the bills. The cheque was dishonoured by the Company's Bank. J, the shareholder of the company was neither a Director nor a person in-charge of the company. Examining the provisions of the Negotiable Instruments Act, 1881 state whether J has committed an offence under Section 138 of the Act and decide whether he (J) can be held liable for the payment, for the goods purchase from the Mall (Departmental Store).
22. An employee working in an establishment covered by the E.P.F. and M.P. Act, 1952, leaves his employment and takes up employment in another establishment. State in this connection:
 - (i) How shall the amount accumulated to his P.F. account be transferred?
 - (ii) What steps shall be taken if the establishment in which he has joined is not covered by the Act?
 - (iii) What would be your answer if the establishment in which he was previously working is not covered by the Act?
23. A company which is covered by the EPF and MP Act, 1952 was adjudged insolvent and an order of winding up was made. State in this connection, whether the provident fund is attachable and

whether the payment of PF contribution be considered as a priority over other debts of the company.

24. State the powers of the Central Government to authorize certain employers to maintain provident fund accounts under the Employees Provident Funds and Miscellaneous Provisions Act, 1952.
25. Who are entitled to bonus under the Payment of Bonus Act, 1965? Illustrate with example of employees not entitled to bonus?
26. Can the funds of a co-operative society be distributed by way of dividend? To what extent a co-operative society under the Co-operative Societies Act, 1912 can contribute towards charitable purpose?
27. Explain the provisions of Cooperative Societies Act 1912 with regards to inquiry by the Registrar into the affairs of a society and inspection of books of an indebted society.
28. A Co-operative Society with unlimited liability wants to expel its member, who prejudices the society by his misconduct. For this purpose, the society wants to amend its bye-laws. State the grounds which should be included in the bye-laws of the society so as to expel such member from the membership of the society.
29. Mohan, a member of a cooperative society, registered with unlimited liability, desires to withdraw from the membership of the society. Advise in the light of provisions of the Cooperative Societies Act, 1912, whether Mohan can do so. What will be the consequences of such withdrawal from the society?
30. Explain the manner in which 'Net Profits' of a Multi-State Cooperative Society can be appropriated. Examine also the validity of the following acts of the society during a particular year:
31. Describe the procedure of registration of a Multi-State Cooperative Society laid down in the Multi State Co-operative Societies Act, 1984*. Which are the documents required to be filed at the time of registration of such a society?
32. Who is an 'Expert'? Explain his liability, relating to publication of prospectus, for any mis-statement in the report given by him? When he is not liable?
33. Ashok Ltd issued a notice for holding of its AGM on 7th November, 2006. The notice was posted to the members on 16th October, 2006. Some of the members alleged that the company had not complied with the provisions of the Act with regard to the period of notice and as such the meeting was not validly called. Decide.
 - (i) Whether the meeting has been validly called?
 - (ii) If there is a shortfall in the number of days by which the notice falls short of the statutory requirement. State and explain by how many days the notice fall short of the statutory requirement?
 - (iii) Can the shortfall, if any, be condoned?
34. 40 out of 100 members of a company submitted a requisition for holding of an extra-ordinary general meeting in order to remove Managing Director from office. On the failure of the company to call the meeting, the requisitionists themselves called the meeting at the registered office of the company. On the appointed day, they could not hold the meeting at the registered office as it was kept under lock and key by the Managing Director himself. The members held the meeting elsewhere and adopted a resolution removing the Managing Director from office. Is the resolution valid?
35. Explain the meaning of 'Shelf Prospectus'. What are the provisions in the Companies Act, 1956, as amended in 2000, relating to the issue of 'Shelf Prospectus'?
36. Explain clearly the meaning of 'Small Depositor' as introduced by the Companies (Amendment) Act, 2000. In what way does the Act regulate the acceptance of deposits from small depositors? Explain.

37. A Public Limited Company has only 7 shareholders, all the shares being paid up in full. All the shares of one such shareholder are sold by the court in an auction and purchased by another shareholder. The company continues to carry on its business, thereafter. Discuss the liability of remaining six members of the company.
38. A Ltd. as a part of revival and profitable strategy is considering a proposal to start a new additional business which has no relation to the existing business. State whether the proposal can be legally carried out?
39. State the procedure relating to passing of resolutions by postal ballot, under Companies Act, 1956.
40. (a) State the purposes and procedure by which the objects clause of a memorandum be altered?
(b) Mr. X, a subscriber to a Memorandum of Association of ABC Ltd, wants to withdraw his name from the document. Can he do so?
41. (a) What is the purpose of having 'Capital clause' and 'Liability clause' in the Memorandum of Association? Are there any exceptions to the 'limited liability principle'? Can a company impose upon its members any additional liability?
(b) Briefly explain the mode of registration and incorporation of a company. What is the effect of registration of company?
42. What do you mean by certification of transfer? How nomination facility shall operate in case of transmission of shares?
43. Can the right of the share holders be varied? If so, what procedure has to be followed?
44. A Public Limited Company wants to increase its subscribed share capital by offering the new shares to the persons who are not the members of the company. Referring to the provisions of the Companies Act, 1956, advice the company about the procedure the company has to adopt to give effect to the above proposal.
45. Explain the meaning and significance of the 'Pari Passu' clause in a debenture. State the particulars to be filed with the Registrar of Companies in case of such debentures secured by a charge on certain assets of the company.
46. ABC Limited realised on 2nd May, 2006 that particulars of charge created on 12th March, 2006 in favour of a Bank were not filed with the Register of Companies for Registration, What procedure should the Company follow to get the charge registered with the Registrar of Companies? Would the procedure be different if the charge was created on 12th February, 2006 instead of 12th March, 2006? Explain with reference to the relevant provisions of the Companies Act, 1956.
47. XYZ Co. Ltd. was in the process of incorporation. Promoters of the company signed an agreement for the purchase of certain furniture for the company and payment was to be made to the suppliers of furniture by the company after incorporation. The company was incorporated and the furniture was used by it. Shortly after incorporation, the company went into liquidation and the debt could not be paid by the company for the purchase of above furniture. As a result suppliers sued the promoters of the company for the recovery of money.

Examine whether promoters can be held liable for payment under the following situations:

- (i) When the company has already adopted the contract after incorporation?
 - (ii) When the company makes a fresh contract with the suppliers in terms of preincorporation contract?
48. Describe the ways to become a member of a company.

A company issued 20 partly paid equity shares and registered them in the name of the minor describing him as minor. The father of the minor signed the application on the minor's behalf. After some time company went into liquidation. The company filed a suit against father of the

minor to recover the remaining amount on the shares. Whether the company will succeed ? Advise.

49. The Articles of Association of Mars Company Ltd. provides that documents may be served upon the company only through Fax. Ramesh despatches a document to the company by post, under certificate of posting. The company does not accept it on the ground that it is in violation of the Articles of Association. As a result Ramesh suffers loss. Explain with reference to the provisions of the Companies Act, 1956:
 - (i) What refusal of document by the company is valid?
 - (ii) Whether Ramesh can claim damages on this basis?
50. Dinesh, a director in a company, gave in writing to the company that notice for any General Meeting and the Board of Directors' Meeting be sent to him at his address in India only by Registered Mail and for which he paid sufficient money. The company sent two notices to him, of such meetings, by ordinary mail, under certificate of posting. Dinesh did not receive the said notices and could not attend the meetings and the proceedings thereof on the ground of improper notice. Decide in the light of the provisions of the Companies Act, 1956:
 - (i) Whether the contention of Dinesh is valid?
 - (ii) Would you answer be still the same in case Dinesh remained outside India for two months (when such notices were given and meetings held).

SUGGESTED ANSWERS

1. According to Section 18 of the Indian Contract Act, 1872, misrepresentation is there:
 1. When a person positively asserts that a fact is true when his information does not warrant it to be so, though he believes it to be true.
 2. When there is any breach of duty by a person, which brings an advantage to the person committing it by misleading another to his prejudice.
 3. When a party causes, however, innocently, the other party to the agreement to make a mistake as to the substance of the thing which is the subject of the agreement.

Problem:

The aggrieved party, in case of misrepresentation by the other party, can avoid or rescind the contract [Section 19, Indian Contract Act, 1872]. The aggrieved party loses the right to rescind the contract if he, after becoming aware of the misrepresentation, takes a benefit under the contract or in some way affirms it. Accordingly in the given case Suraj could not rescind the contract, as his acceptance to the offer of Sohan to bear 40% of the cost of repairs impliedly amount to final acceptance of the sale [Long v. Lloyd, (1958)].

2. Problem asked in the question is based on the provisions of the Indian Contract Act, 1872 as contained in Section 10. According to the provisions there should be an intention to create legal relationship between the parties. Agreements of a social nature or domestic nature do not contemplate legal relationship and as such are not contracts, which can be enforced. This principle has been laid down in the case of Balfour vs. Balfour (1912 2 KB. 571). Accordingly, applying the above provisions and the case decision, in this case son cannot recover the amount of Rs.1 lakh from father for the reasons explained above.
3. Contribution as between co-sureties: The principle in this regard is laid down in Section 146 of the Indian Contract Act, 1872 which is as follows:

"When two or more persons are co-sureties for the same debt, or duty either jointly, or severally and whether under the same or different contracts and whether with or without the knowledge of each other, the co-sureties in the absence of any contract to the company, are liable, as between themselves, to pay each an equal share of the whole debt, or of that part of it which remains unpaid by the principal debtor".

A co-surety is entitled to recover from other sureties the amount that he has paid but the right arises only if the surety has paid an amount beyond his share of the debt to the creditor, for only then does it become certain that there is ultimately a case for contribution at all. A judgement against the surety at the suit of the creditor for the full amount of the guarantee will have the same effect as payment made for these parties and would entitle the surety or his representative to a declaration of the right to contribution on the very same principle by which the rights of company trustees in respect of amount which they are made liable to pay are settled.

Liabilities of two sureties are not affected by mutual agreements between them. This principle has been laid down in Section 132 which runs thus, where two persons, contract with a third party to undertake a certain liability, and also contract with each other that one of them shall be liable only on the default of the other the third person not being a party to such contract, the liability of each of such two persons to the third person under the first contract is not affected by the existence of the second contract, although such third person may have been aware of its existence.

This position is applicable when the liability is undertaken jointly by two parties in respect of the same debt but not in different debts [Pogose v. Bank of Bengal (1877)].

4. Section 46 to 50 of the Indian Contract Act, 1872 are relevant regarding time and place for the performance of the promise which are as follows:
 - (i) If no time is specified, the promise must be performed within a reasonable time. The expression 'reasonable' time is to be interpreted having regard to the facts and circumstances of a particular case (Section 46).
 - (ii) If a promise is to be performed on a specified date but the hour is not mentioned the promisor may perform it at any time during the usual hours of business, on such day. Moreover, the delivery must be made at the usual place of business (Section 47).
 - (iii) Where no place is fixed, it is the duty of the promisor to ask the promisee to fix a reasonable place for the performance of the promise. In all cases the promisor must apply to the promisee; here no distinction is made between an obligation to pay money and obligation to deliver goods or discharge any other obligation [Section 49].
 - (iv) Where the promisor has not undertaken to perform the promise without an application by the promisee, and the promise is to be performed on a certain day it is the duty of the promisee to apply for performance at a proper place and within the usual hours of business (Section 48).

Generally, the performance of any promise may be made in any manner, or at any time which the promisee prescribes or sanctions.

- 5 On the seventh Concert when Miss.Chitra willfully absents herself, the club is at liberty to put an end to the contract. If Miss.Chitra sings on the eighth Concert with the consent of the club. The club has signified its acquiescence in the continuance of the contract and cannot now put an end to it. The club is entitled to compensation for the damage sustained because of Miss.Chitra's failure to sing on the seventh concert. If the club puts an end to the contract, Miss.Chitra can claim damages for breach of contract [Section 39 of The Indian Contract Act, 1872)].
- 6 M cannot sue P, because a surety is discharged from liability when, without his consent, the creditor makes any change in the terms of his contract with the principal debtor, no matter whether the variation is beneficial to the surety or does not materially affect the position of the surety (Sec.133, Indian Contract Act, 1872).
- 7
 - (a) Mr.Jayanth cannot exercise the right of stoppage of goods in transit, because the goods are being taken by Mr.Naveen in good faith and for consideration.
 - (b) Yes, Mr. Jayanth in this case can exercise his right of stoppage of goods in Transit, as Mr.Naveen has not acted in good faith. (Refer to section 27 of The Sale of Goods Act,1930)
- 8 Section 73 of the Indian Contract Act, 1872 provides for consequences of breach of contract. According to it, when a contract has been broken, the party who suffers by such breach is entitled

to receive from the party who has broken the contract, compensation for any loss or damage caused to him thereby which naturally arose in the usual course of things from such breach or which the parties knew when they made the contract, to be likely to result from the breach of it. Such compensation is not given for any remote and indirect loss or damage sustained by reason of the breach. It is further provided in the explanation to the section that in estimating the loss or damage from a breach of contract, the means which existed of remedying the inconvenience caused by the non-performance of the contract must be taken into account.

Applying the above principle of law to the given case, M Ltd is obliged to compensate for the loss of Rs.1.25 lakhs (i.e. Rs.12.75 minus Rs.11.50 = Rs. 1.25 lakhs) which had naturally arisen due to default in performing the contract by the specified date.

Regarding the amount of compensation which Shanti Traders were compelled to make to Zenith Traders, it depends upon the fact whether M Ltd knew about the contract of Shanti Traders for supply of the contracted machinery to Zenith Traders on the specified date. If so, M Ltd is also obliged to reimburse the compensation which Shanti Traders had to pay to Zenith Traders for breach of contract. Otherwise M Ltd is not liable.

9 Agency by Ratification; its effect & essentials of valid ratification:

Meaning: A person may act on behalf of another without his knowledge or consent. Later on such another person may accept the act of the former or reject it. If he accepts the act of the former done without his consent, he is said to have ratified that act and it places the parties in exactly the same position in which they would have been if the former had later's authority at the time he made the contract. Likewise, when an agent exceeds the authority bestowed upon him by the principal, the principal may ratify the unauthorised act.

Effect of Ratification: The effect of ratification is to tender the acts done by one person (agent) on behalf of another (principal), without his (principal's) knowledge or authority, as binding on the other person (principal) as if they had been performed by his authority (Section 196: Indian Contract Act, 1872).

Further, ratification relates back to the date when the act was done by the agent. This means the agency comes into existence from the moment the agent first acted and not from the time when the principal ratified the act.

Essentials of a valid Ratification

1. The agent must purport to act as agent for a principal who is in contemplation and is identifiable at the time of contract.
 2. The principal must be in existence at the time of contract.
 3. The principal must have contractual capacity both at the time of the contract and at the time of ratification.
 4. The principal must have the full knowledge of all the material facts.
 5. Ratification must be done within a reasonable time of the act purported to be ratified.
 6. The act to be ratified must be lawful and not void or illegal or ultra vires in case of a company.
 7. The whole transaction can be ratified.
 8. Ratification must be communicated to the party who is sought to be bound by the act done by the agent.
 9. Ratification can be of the acts which the principal had the power to do.
 10. Ratification should not put a third party to damages.
 11. Ratification relates back to the date of the act of the agent.
10. **Position of a minor:** A minor is a person who has not completed eighteen years of age. The Indian Contract Act, 1872 places a minor in a different position as compared to others which may be discussed as under:

- (i) A contract by a minor is altogether void. (*Mohini Bibi v. Dhamodas Ghose*) A minor is incapable of giving a promise imposing a legal obligation.
- (ii) A minor can be a promisee or a beneficiary. He can hold other parties liable for the performance of their promise.
- (iii) A minor cannot be a partner in a firm. However, he may be admitted to the benefits of partnership with the consent of all the partners.
- (iv) There is no estoppel against a minor. He can always plead minority in a suit attempting to hold him liable, no matter he might have earlier misrepresented himself to be major in age.
- (v) A minor cannot ratify contracts which he might have made during minority, after becoming major.
- (vi) A minor's agreement being void cannot be specifically enforced. However, the estate of a minor can be held liable for the necessities supplied to him or to his dependents suited to his status in life.
- (vii) Though the agreement of a minor is void, his guardian can, under certain circumstances and for the benefit of minor, enter into contracts.
- (viii) A minor can be an agent, but not a principal.
- (ix) A minor can hold property, fully paid shares and can seek contracts of employment or apprenticeship.
- (x) The principle of restitution does not apply against a minor.
- (xi) A person giving guarantee for a minor debtor can be held liable as a surety on the default of the minor.
- (xii) A minor can never be adjudicated insolvent.

11. "Condition" and "Warranty"

Section 12(2) of the Sale of Goods Act, 1930 defines a condition as a stipulation essential to the main purpose of the contract, the breach of which gives rise to a right to treat the contract as having repudiated.

Section 12(3) of the Sale of Goods Act, 1930 defines a warranty as a stipulation collateral to the main purpose of the contract, the breach of which gives rise to a claim for damages but not a right to repudiate the contract.

X buys a car from Y for touring purposes. The car is unfit for touring purpose. Here X can repudiate the contract since "touring purpose" is a condition for buying the car.

On the other hand, the horn of the car is defective. X cannot repudiate the contract, since defective horn is only a warranty and horn can be repaired or replaced.

Whether a stipulation is a condition or a warranty depends in each case, on the construction of contract. 'Condition's and 'Warranties' may be either express or implied.

A warranty cannot be treated as a condition because it is a lesser importance to the concerned parties. But a condition may be treated as a warranty under the following circumstances:

- (1) The buyer altogether waives the performance of the condition.
- (2) The buyer elects to treat the breach of the condition as breach of warranty and claims damages only.
- (3) Where the contract is non-severable and the buyer has accepted either the whole goods or any part thereof.
- (4) Where the fulfilment of a condition or warranty is excused by law by reason of impossibility of performance or otherwise.

12. According to section 9 of the Negotiable Instruments Act, 1881 'holder in due course' means any person who for consideration because the possessor of a promissory note, bill of exchange or

cheque if payable to bearer or the payee or endorsee thereof, if payable to order, before the amount in it became payable and without having sufficient cause to believe that any defect existed in the title of the person from whom he derived his title.

As 'A' in this case prima facie became a possessor of the bill for value and in good faith before the bill became payable, he can be considered as a holder in due course.

But where a signature on the negotiable instrument is forged, it becomes a nullity. The holder of a forged instrument cannot enforce payment thereon. In the event of the holder being able to obtain payment in spite of forgery, he cannot retain the money. The true owner may sue on tort the person who had received. This principle is universal in character, by reason where of even a holder in due course is not exempt from it. A holder in due course is protected when there is defect in the title. But he derives no title when there is entire absence of title as in the case of forgery. Hence 'A' cannot receive the amount on the bill.

13. The problem is based on the provisions of the Negotiable Instruments Act, 1881 as contained in Section 29. A legal representative of a deceased person who signs his own name on a negotiable instrument, is personally liable for the entire amount thereon, unless he expressly limits his liability to the extent of the assets received by him as such (Section 29).

Applying the above provisions to the given problem P is entitled to recover Rs.50000/- from M. M cannot refuse to pay the amount since he has inherited the assets of the deceased. He will be liable to the extent of the full amount of the bill, even if he has inherited the property valued less than the amount of the bill. Thus in the first case he will be liable to full amount of Rs.50000. In the second case since he has made a limit in the instrument itself before signing on it, his liability will be only to the extent of Rs.50000 and not to the extent of the full amount as given on the instrument though he might have inherited the property value greater amount than that of the instrument.

14. According to section 73 of Negotiable Instrument Act, 1881. A cheque must in order to charge any person except the drawer, be presented within a reasonable time after delivery thereof by such person. In order to charge an indorser, the cheque must be presented within a reasonable time from the delivery of the cheque by such indorser and from the time when the holder receives it from any prior indorser.

Hence C can enforce payment against B but not against A.

15. Yes, it is a valid Bill and Mr. Vinod is liable thereon. The drawee may be named or otherwise indicated in the Bill with reasonable certainty. In the present case, the description of the place of residence indicates the name of the drawee and Mr. Vinod, by his acceptance, acknowledges that he is the person to whom the bill is directed (Gray vs milner 1819, 2 Taunt 739).
16. In case of cheques, the paying banker is given statutory protection against the payment of cheques having forged indorsements. And the banker cannot be held liable if it makes payment in good faith and without any negligence (Section 85, the Negotiable Instruments Act, 1881). But the banker will not be protected where the payment of a cheque is made on which the drawer's signature was forged. The reason for the same is that the banker is protected only in case of forgery of indorser's signature and not in case of forgery of drawer's signature.
17. It is provided in section 93 of the Negotiable Instruments Act, 1881 that when a promissory note, bill of exchange or cheque is dishonoured by non-acceptance, or non-payment, the holder thereof, or some party thereto who remains liable thereon, must give notice that the instrument has been dishonoured to all other parties whom the holder seeks to make severally liable thereon, and to some one of several parties whom he seeks to make jointly liable thereon.

Further, section 94 enshrines the law with regard to the mode of giving notice of dishonour. Notice of dishonour may be given to a duly authorised agent of the person to whom it is required to be given, or where he has died to his legal representatives, or where he has been declared an insolvent, to his assignee. The notice may be oral or written, may if written, be sent by post and may be in any form, but it must inform the party to whom it is given, either in express terms or by reasonable intendment that the instrument has been dishonoured, and in what way, and that he

will be held liable thereon, and it must be given within a reasonable time after dishonour, at the place of business, or (in case of such party has no place of business) at the residence of the party for whom it is intended.

If the notice is duly directed and sent by post and miscarries, such miscarriage does not render the notice invalid.

18. Rights and obligations of the finder of a lost instrument: When a negotiable instrument has been lost, the finder or the endorsee from the finder is not entitled to receive the amount of it from maker, acceptor, or holder or from any party prior to such holder. He is bound to return the instrument to the real owner. But if the instrument lost by one and if it passes by delivery, the third party acquiring it bona fide and for valuable consideration and before maturity is entitled both to retain the instrument against the real owner and to payment from the prior parties thereon. The possessor or endorsee is also entitled to receive amount when the person through whom he claims was a holder of the lost instrument in due course.

The loser of the instrument has the right to apply to the drawer for a duplicate of the lost bill. If the drawer does not grant the application the loser may compel him to provide him with a duplicate (Section 45A, Negotiable Instrument Act, 1881).

Instrument obtained by unlawful means: If an instrument is obtained from any maker acceptor or holder by means of an offence or fraud, the possessor is not, ordinarily entitled to receive the amount under it from such maker, acceptor or holder, or from any party prior to such holder (Section 58).

Instrument obtained by unlawful consideration: When an instrument has been obtained from any maker, acceptor or holder for an unlawful consideration, no possessor is ordinarily, entitled to receive the amount due thereon from such maker, acceptor or holder or from any party prior to such holder. The consideration may be lawful either because it is immoral and contrary to public policy or because it is specially interdicted or prohibited by the statute.

If the consideration for a note, bill of exchange or cheque is unlawful, the instrument is void. Therefore, every agreement of which the object or consideration is unlawful is voidable and creates no obligation between the parties thereto. A promissory note executed in payment of a debt arising out of share speculation is void. But a holder in due course obtains a good title to an instrument which was originally made or drawn or subsequently negotiated for an unlawful consideration (Section 53).

19. Section 84 of the Negotiable Instruments Act, 1881 provides that where a cheque is not presented for payment within a reasonable time of its issue and the drawer or person on whose account it is drawn had the right at the time when presentation ought to have been made, as between himself and the banker, to have the cheque paid and suffers actual damage through the delay, he is discharged from the liability, that is to say, to the extent to which such drawer or person is a creditor of the banker to a larger amount than would have been if such cheque had been paid. In determining what is a reasonable time, regard shall be had to the nature of the instrument, the usage of trade and of banker, and the facts of the particular case.

Applying the above provisions to the given problem since the payee has not presented the cheque to the drawer's bank within a reasonable time when the drawer had funds to pay the cheque, and the drawer has suffered actual damage, the drawer is discharged from the liability.

20. Minor being a party to Negotiable Instrument: Every person competent to enter into contract has capacity to incur liability by making, drawing, accepting, endorsing, delivering and negotiating a Promissory Note, Bill of Exchange or clearance (Section 26, Para 1, Negotiable Instrument Act, 1881).

As a Minor's agreement is void, he cannot bind himself by becoming a party to a Negotiable Instrument. But he may draw, endorse, deliver and negotiate such instruments so as to bind all parties except himself (Section 26, para 2).

In view of the provisions of Section 26 explained above, the promissory note executed by A and B is valid even though a minor is a party to it. B, being a minor is not liable; but his immunity from

liability does not absolve the other joint promissory, viz., A from liability [Sulochona v. Pondiyan Bank Ltd.,].

21. The facts of the problem are identical with the facts of a case known as H.N.D. Mulla Feroze Vs. C.Y. Somaya Julu, J(2004) 55 SCL (AP) wherein the Andhra Pradesh High Court held that although the petitioner has a legal liability to refund the amount to the appellant, petitioner is not the drawer of the cheque, which was dishonoured and the cheque was also not drawn on an account maintained by him but was drawn on an account maintained by the company. Hence, it was held that the petitioner J could not be said to have committed the offence under Section 138 of the Negotiable Instrument Act, 1881. Therefore X also is not liable for the cheque but legally liable for the payments for the goods.
22. (i) Section 17-A of EPF & MP Act, 1952 provides for the transfer of accounts of an employee in case of his leaving the employment and taking up employment in another establishment and to deal with the case of an establishment to which the Act applies and also to which it does not apply. The option to get the amount transferred is that of the employee.
- (ii) Where an employee of an establishment to which the Act applies leaves his employment and obtains re-employment in another establishment to which the Act does not apply, the amount of accumulations to the credit of such employee in establishment left by him shall be transferred, within such time as may be specified by the Central Government in this behalf, 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 [Sub-Section (1)].
- (iii) Conversely, when an employee of an establishment to which the Act does not apply leaves his employment and obtains re-employment in another establishment to which the Act applies, the amount of accumulations to the credit of such employee in the 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 employed [Sub-Section (2)].
23. Protection against attachment (Section 10 E. P. F & M. P Act, 1952): The amount standing to the credit of any member in the fund or credit of any exempted employee in provident fund shall not in any way be capable of, being assigned or charged and shall not be liable to attachment under any decree or order of any Court in respect of any debt or liability incurred by the member or the exempted employee. Neither the Official Assignee appointed under the Presidency-Town Insolvency Act, 1909 nor any Receiver appointed under the Provincial Insolvency Act, 1920, shall be entitled to or have any claim on any such amount.

The amount standing to the credit of the aforesaid categories of persons at the time of their death and payable to their nominees under the Scheme or the rules vest in nominees. And the amount shall be free from any debt or other liability incurred by the deceased or the nominee before the death of the member or of the exempted employee and shall also not be liable to attachment under any decree or order of any Court.

Priority of payment of contribution over other debts (Section 11): If the employer is adjudged an insolvent or if the employer is a company and an order for winding thereof has been made, the amount due from the employer whether in respect of the employee's contribution or the employer's contribution must be included among the debts which are to be paid in priority to all other debts under Section 49 of the Presidency-Towns Insolvency Act, Section 61 of the Provincial Insolvency Act, Section 530 of the Companies Act, 1956, in the distribution of the property of the insolvent or the assets of the company. In other words, this payment will be a preferential payment provided the liability therefore has accrued before this order of adjudication or winding up is made.

24. Powers of the Central Government to authorize certain employers to maintain Provident Fund Accounts under the Employees' Provident Funds and Misc. Provisions Act, 1952 (Section 16A):
Under Section 16A of the Employees Provident Fund and Miscellaneous Provisions Act, 1952, the Central Government may, on an application made to it in this behalf by the employer and majority

of employees in relation to an establishment employing 100 or more persons, authorize the employer, by an order in writing, to maintain a provident fund account in relation to the establishment subject to such terms and conditions as may be specified in the scheme.

The Central Government shall, however, not make such authorization if the employer of such establishment had committed any default in the payment of provident fund contribution or had committed any other offence under the Act during the three years immediately preceding the date of such authorization.

When an establishment is authorized to maintain a provident fund account, the employer in relation to such establishment shall maintain such account, submit such return, deposit the contribution in such manner, provide for such facilities for inspection, pay such administrative charges and abide by such other terms and conditions, as may be specified in the scheme.

Any authorization so made by the Central Government may be cancelled by an order in writing if the employer fails to comply with any of the terms and conditions of the authorization or where he commits an offence under any of the provisions of the Act. Before canceling the authorization, the Central Government shall give the employer a reasonable opportunity of being heard.

25. Every employee of an establishment covered under the Act is entitled to bonus from his employer in an accounting year provided he has worked in that establishment for not less than thirty working days in the year on a salary less than Rs.3,500 per month [Section 2(13) read with Section 8].

If an employee is prevented from working and subsequently reinstated in service, employee's statutory liability for bonus cannot be said to have been lost. Nor can the employer refuse for such bonus. [ONGC vs. Sham Kumar Sahegal [1995] 1 LLJ].

There are, however, certain disqualifications of an employee to claim bonus in an accounting year. An employee who has been dismissed from service for (a) fraud; (b) riotous or violent behaviour while on the premises of the establishment; or (c) theft, misappropriation or sabotage of any property of the establishment is not entitled for bonus. [Section 9].

An employee in the following cases is entitled to bonus:

- (i) A temporary workman is entitled to bonus on the basis of total number of days worked by him.
- (ii) An employee of a seasonal factory is entitled to proportionate bonus and not the minimum bonus as prescribed under Section 10 of the Act.
- (iii) A part time employee as a sweeper engaged on a regular basis is entitled to bonus. [Automobile Karmchari Sangh vs. Industrial Tribunal [1970] 38 FJR 268].
- (iv) A retrenched employee is eligible to get bonus provided he has worked for minimum qualifying period. [East Asiatic Co. (P.) Ltd. vs. Industrial Tribunal [1961] 1 LLJ 720].
- (v) A probationer is an employee and as such is entitled to bonus. [Bank of Madura Ltd. vs. Employee's Union, 1970, (2) LLJ (21)].
- (vi) A dismissed employee reinstated with back wages is entitled to bonus. [Gannon India Ltd. vs. Niranjana Das [1984] 2 LLJ 223].
- (vii) A piece-rated worker is entitled to bonus. [Mathuradas Kani vs. Tribunal AIR, [1958], SC 899].

An employee in the following cases is not entitled to bonus:

1. An apprentice is not entitled to bonus. [Wheel & Rim Co. vs. Government of T.N. [1971] 2 LLJ 299 40 FJR 18].
2. An employee employed through contractors on building operation is not entitled to bonus. (Section 32).
3. An employee who is dismissed from service on the ground of misconduct as mentioned in Section 9, is disqualified for any bonus and not merely for bonus of the accounting year in

which he is dismissed (Pandian Roadways Corporation Ltd. vs. Presiding Officer [1996] 2 CLR 1175 (Mad.).

26. Funds not to be divided by way of profit (Section 33): Generally, no part of the funds of a registered society shall be divided by way of bonus or dividend or otherwise among its members. However, where the liability is limited, at least one-fourth of the net profits in any year must be carried to a reserve fund, and payments from the remainder of such profits and from any divisible profits of past years may be made among the members to such extent and under such conditions as may be prescribed by the rules or bye-laws. In the case of societies with unlimited liability, no distribution of profits shall be made, without the permission of the State Government.

Contributions to charitable purpose (Section 34) : The Section permits a registered society to contribute to a charitable purpose subject to certain conditions and limitations. First, one-fourth of the net profits in any year shall have been carried to a reserve fund, as contemplated by the first proviso to Section 33. Thereafter, out of the remaining net profits, the aforesaid registered society may contribute an amount not exceeding 10% to any charitable purpose, as defined in the Charitable Endowments Act. Also such a contribution can be made only with the sanction of the Registrar.

Within the meaning of Section 2 of the Charitable Endowments Act, 1890, "charitable purpose" includes relief to the poor, education, medical relief, and the advancement of any other object of general public utility, but does not include a purpose which relates exclusively to religious teaching or worship.

27. Inspection by the Registrar under Cooperative Societies Act, 1912: Enquiry by the Registrar (Section 35)

The Registrar may on his own motion, and shall on the request of the collector, or on the application of a majority of the Committee, or of not less than 1/3rd of the members, hold an inquiry or direct some person authorized by him by order in writing in this behalf to hold an inquiry into the constitution, working and financial condition of a registered society. All the officers (and members) of the society are bound to furnish such information as may be demanded of them by the Registrar or by the person authorized by the Registrar.

Inspection of books of indebted society: (Section 36) The Registrar shall, on the application of a creditor of a registered society, inspect or direct some person authorized by him by order in writing in this behalf to inspect the books of the society, provided that:

- (i) The applicant satisfies the Registrar that the debt, and sum then due, and that he has demanded payment thereof but has not received satisfaction within a reasonable time.
- (ii) The applicant deposits with the Registrar such sum as security for the costs of the proposed inspection, as the Registrar may require.

28. Expulsion of a member of a society:

A member who degenerates in conduct or character and thereby prejudices the society may be expelled from the society subject to the provisions in the bye-laws of the society for this purpose. The bye-laws of the society should contain such provisions and thereupon he may be expelled if :

- (i) he fails to fulfil his obligations in the matter of dues (the number of months arrears being specified).
- (ii) he becomes a member of another similar society and refuses to withdraw and thereby it may be possible that he may pass on such information to a rival society of which he is a member.
- (iii) he is to be proceeded against for debts;
- (iv) he becomes insolvent.
- (v) he engages in such activities as might be contrary to the principles of the society;
- (vi) he becomes insane;
- (vii) he is convicted by a criminal court, especially of bribery, forgery, theft or fraud; and

(viii) he has committed an act which is considered dishonourable by a managing committee.

If a member of a society with unlimited liquidity joins another society and so pledges his liquidity twice over he should be expelled.

29. The right of withdrawal from the membership of a society by a member is in conformity with the principles of cooperation. In the case of a society with unlimited liability, a member thereof should be able to withdraw before any liability is incurred. He is only liable for the debts that exist at the time he ceases to be a member (Section 23, Cooperative Societies Act, 1912).

Where the member ceases to reside within the area of the society [Section 6(1) (a)], both the member and the society may insist on withdrawal. The share value is paid to the member, but he has no claim on the reserve or other assets and may be made to pay off his share of any deficit. His legal claim in share capital lapses in 2 years. If the society is dissolved within 6 months of the withdrawal, the withdrawal is null and void.

30. The net profits of a Multi State Cooperative Society are to be appropriated in the following manner:

1. at least 25% of the net profits should be transferred to the Reserve Fund.
2. 1% of the net profits (Rule 4 of the rules of operation) should be credited to the National Co-operative Union of India Ltd. as contribution to the education fund maintained by the Union.
3. for constitution of or contribution to special funds as may be specified in the bye-laws.
4. not more than 5% of net profits for giving donations or charities for charitable purposes as defined in Section 2 of Charitable Endowments Act, 1990.
5. for payment of ex-gratia amount to employees to the extent and in the manner specified in the bye-laws.
6. for payment of dividends.

Such societies are prohibited for using its funds for any political purposes. [Section 61 (3)]. Further in terms of the provisions of Section 61 the society is subject to the following restrictions with regard to disposal of Net Profit:

1. no dividend shall be declared or paid except from out of the Net Profits and shall not exceed 12% per annum on the paid up share capital.
2. no dividend shall be declared or paid while a claim due from a Multi State Cooperative Society to a depositor or lender remains unsatisfied.
3. no donation made by the Multi State Cooperative Society out of the net profits of any year exceed Rs. 5 lakhs.

Thus applying the above provision in the given cases the answers to the questions asked are as under:

- (i) Declaration of dividend @ 11% on the paid share capital of the society is quite valid as it does not exceed 12%.
- (ii) The decision to donate Rs. 10 lakhs out of the society's Net Profits is not valid since the limit is Rs. 5 lakhs in a year:-

31. Procedure for registration of a Multi State Cooperative Society and the documents to be filed;

1. An application for the registration of a society shall be made to the Central Registrar in prescribed form with requisite particulars.
2. The application shall be signed by members of the Society, in case of which all members are:
 - (a) Individuals - at least 50 persons from each of the state concerned.
 - (b) Cooperative societies - duly authorized representatives of at least 5 such societies registered with different states.

- (c) Multi-State Cooperative Society and other Co-operative Societies - duly authorized representatives of each of such societies, subject to condition of at least two of co-operative societies registered not in the same state.
- (d) Cooperative; Societies or Multi-State Co-operative Societies and Individuals by at least:
 - (i) 50 persons being individuals from each of the two states or more and
 - (ii) One cooperative society from two states or more, or one multi-state cooperative society.

3. Application shall be accompanied by 4 copies of the proposed bye-laws of the multi-state cooperative society and the persons by whom or on whose behalf such application is made shall furnish such information in regard to the society as the Central Registrar may require.

After receiving the application duly accompanied with documents, the Central Registrar may register the multi-state cooperative society and its bye-laws if he is satisfied that the application complies with the provisions of the Act and the Rules;

basis criterion that its objects are to serve the interests of members in more than one State, bye-laws provide for social and economic betterment of its members through self-help and mutual aid in accordance with the cooperative principles, and the proposed bye-laws are not contrary to the provisions of the Act and the Rules. The Central Registrar shall then issue a Certificate of Registration under his signature and bearing his official seal containing the registration number and the date of registration of the society.

32. **Meaning of Expert and his Liability:** The term 'Expert' includes an engineer, valuer, accountant any other person whose profession gives authority to a statement made by him. These experts have been included in the provisions of Companies Act, 1956 under section 59(2). The report of an expert cannot be included in a prospectus if he is in any way connected with the formation or promotion a management of the company. (Section 57).

An expert is liable for any mis-statement in the prospectus if it is based and concerned to his report. Even if he is unconcerned or unconnected or impartial, his report in this capacity can not be included :

- (a) Unless he has given his written consent to the issue of the prospectus and has not withdrawn such consent before the delivery of the copy of the prospectus to the Registrar for registration, and
- (b) Unless a statement as to his consent and non-withdrawal of it appears in the prospectus (Section 58).

When an expert is not liable: An expert who would be liable by reason of having given his consent to the issue of prospectus containing a statement made by him will not be liable if he proves:

- (i) that having given his consent to the issue of the prospectus, he withdrew it in writing before the delivery of a copy of the prospectus for registration; or
- (ii) that after the delivery of a copy of the prospectus for registration but before allotment, he on becoming aware of the untrue statement withdraw his consent in writing and gave reasonable public notice thereof and the reasons therefor; or
- (iii) that he was competent to make the statement and he had reasonable ground to believe, and did up to the time of allotment of the shares' or debentures believe that the statement was true. [Section 62(3)].

An expert can also claim indemnity against who included his name in the prospectus in case where he has not given his consent, or he has withdrawn his consent before the issue of the prospectus.

33. (i) 21 days' clear notice of an AGM must be given [Section 171]. In case notice is sent by post, then section 53(2) provides that the notice shall be deemed to have been received on expiry of 48 hours from the time of its posting. For working out clear 21 days, the day of the

notice and the day of the meeting shall be excluded. Accordingly, 21 clear days' notice has not been served and the meeting is, therefore, not validly convened.

- (ii) Worked as per (I) above, notice falls short by 2 days (i.e. Notice should have been posted on 14.10.06). In other words, notice of the general meeting must have been sent at least 25 days before the date of the meeting i.e. 7th November, 2006 (where the notice is sent by post)
- (iii) According to section 171(2), an AGM called at a notice shorter than 21 clear days shall be valid if consent is accorded thereto by all the members entitled to vote thereat. Thus, if all the members of the company approve to the shorter notice, shortfall may be condoned.

34. Section 169 of the Companies Act, 1956 contains provisions regarding holding of extra-ordinary general meetings. It provides that if directors fail to call a properly requisitioned meeting, the requisitionists or such of the requisitionists as represent not less than 1/10th of the total voting rights of all the members may call a meeting to be held on a date fixed within 3 months of the date of the requisition.

Where a meeting is called by the requisitionists and the registered office is not made available to them, it was decided in *R. Chettair v. M. Chettair* that the meeting may be held anywhere also.

Further, resolutions properly passed at such a meeting, are binding on the company.

35. Shelf Prospectus: According to Section 60-A (as inserted by the Companies (Amendment) Act, 2000) 'Shelf Prospectus' means a prospectus issued by any financial institution or bank for one or more issues of the securities or class of securities specified in that prospectus.

Any public financial institution, a public sector bank or scheduled bank whose main object is financing, shall file a shelf prospectus. 'Financing means making loans to or subscribing in the capital of, a private industrial enterprise engaged in infrastructural financing, or such, other company as the Central Government may notify in this behalf.

A company filing a shelf prospectus with the Registrar shall not be required to file prospectus afresh at every stage of offer of securities by it within a period of validity of such shelf prospectus. It shall be required to file an information memorandum. On all material facts relating to new charges created, changes in the financial position as have occurred between the first offer of securities, previous offer of securities and the succeeding offer of securities within the time prescribed by the Central Government, prior to making of a second or subsequent offer of securities under the shelf prospectus.

An information memorandum shall be issued to the public along with shelf prospectus filed at the stage of the first offer of securities and such prospectus shall be valid for a period of one year from the date of opening of the first issue securities under that prospectus.

Where an update of information memorandum is filed every time an offer of securities is made, such memorandum together with the shelf prospectus shall constitute the prospectus.

36. Small Depositor: A 'Small Depositor' means a depositor who has deposited in a financial year a sum not exceeding Rs.20,000 in a company and includes his successors, nominees and legal representatives. It does not include those depositors who renew their deposits and those depositors whose repayment is not made due to death or has been stayed by a competent court. (Section 58AA: Companies (Amendment) Act, 2000).

As per the provisions of Section 58AA, every company accepting deposits from the small depositors shall intimate to the CLB within 15 days, the name and address of each small depositor(s) to whom it had defaulted in repayment of deposit or interest thereon. Thereafter, intimation shall be given on a monthly basis.

On receipt of the intimation as aforesaid, it shall:

- (i) exercise the powers conferred on it under Section (9) of Section 58A i.e. direct the company to repay the deposit.
- (ii) Pass an appropriate order within 30 days from the date of receipt of intimation.

Where the order is passed after the expiry of 30 days, the small depositor must be given opportunity of hearing, it shall not be necessary for a small depositor to be present at the hearing of the proceedings.

37. The problem in question relates to reduction of membership below the statutory minimum, Section 12 of the Companies Act, 1956 requires a public company to have a minimum of seven members. If at any time the membership of a public company falls below seven and it continues its business for more than six months, then according to section 45 of the Companies Act, 1956 every such member who was aware of this fact, would be individually (personally) liable for all debts contracted after six months.

Thus, in the above problem, the remaining six members shall incur personal liability for the debts contracted by the company:

- (i) If they continued to carry on the business of the company with that reduced membership (i.e., 6) beyond six month period;
 - (ii) Only those members who knew of this fact of reduced membership shall be liable, for instance, one of the members who was abroad and thus not aware of those developments, shall not be liable.
 - (iii) The liability shall extend only to the debts contracted after six months from the date of auction of that member's shares.
38. Where the present 'object clause' of a company does not contain any enabling provision for the company to carry on the new business which it proposes to start, the 'object clause' will have to be altered suitably. The object clause can be altered, as Section 17(1) of the Companies Act stipulates that to carry on some business which under existing circumstances may conveniently or advantageously be combined with the business of the company.

The Companies are under liberty to alter the object clause without confirmation by Company Law Board. As Mitra J. observed in *Re Ganeshbari Tea Co. (Pvt) Ltd.*, 1964, Comp. Cas. 556: "In deciding as to whether it should be allowed to start additional business, an application made in this behalf is not to be disallowed merely because the new business is wholly different from and bears no relation to the existing business of the company. All that is essential is that it should be capable of being conveniently and advantageously combined with the existing business and is not destructive of or inconsistent with the existing business". It is likely, therefore, that the alteration will be confirmed.

39. Procedure to be followed for conducting business through postal ballot (Section 192A).
- (a) The company may make a note below the notice of general meeting for understanding of members that the transactions(s) at serial number requires consent of shareholders through postal ballot;
 - (b) The board of directors shall appoint one scrutinizer, who is not in employment of the company, may be a retired judge or any person of repute who, in the opinion of the board can conduct the postal ballot voting process in a fair and transparent manner;
 - (c) The scrutinizer will be in position for 35 days (excluding holidays) from the date of issue of notice for annual general meeting. He has to submit his final report on or before the said period.
 - (d) The scrutinizer will be willing to be appointed and he is available at the registered office of the company for the purpose of ascertaining the requisite majority;
 - (e) The scrutinizer shall maintain a register to record the consent or otherwise received, including electronic media, mentioning the particulars of name, address, folio number, number of shares, nominal value of shares, whether the shares have voting, differential voting or non-voting rights and the scrutinizer shall also maintain record for postal ballot which are received in defaced or mutilated form. The postal ballot and all other papers relating to postal ballot will be under the safe custody of the scrutinizer till the chairman considers, approves and signs the minutes of the meeting. Thereafter, the scrutinizer shall

return the ballot papers and other related papers/register to the company so as to preserve such ballot papers and other related papers/register safely till the resolution is given effect to;

- (f) Consent or otherwise relating to issue mentioned in notice for annual general meeting received after 35 days from the date of issue will be strictly treated as if the reply from the member has not been received. [Companies (Passing of the Resolution by Postal Ballot) Rules, 2001 Notification No. G.S.R.337 (E), dated 10th May, 2001].

If default is made in following this procedure, fine of Rs. 50,000 can be levied for each default.

40. (a) Alteration of objects: The members of a company may rightly expect that their money would be employed only for the objects for which the company has been established. Accordingly, the Companies Act, 1956 permits alteration of the objects clause only so far as is considered necessary for specified purposes. Section 17 permits a company to alter its objects for the under mentioned purposes:

1. To carry on business more economically or more efficiently.
2. To attain the main purpose of the company by new or improved means.
3. To carry on some business which under the existing circumstances may convenient or advantageously be combined with the existing business.
4. To change or enlarge local area of operations.
5. To restrict or abandon any of the existing objects.
6. To sell or dispose of the whole or any part of the undertaking or any of the undertakings.
7. To amalgamate with any other company or body of persons.

The alteration must be effected by a special resolution only and no permission of Company Law Board is required. Due attention has to be given to protect the rights and interests of the members of the company and of every class of them, as well as of the rights and interests of the creditors of the company and of every class of them.

- (b) A subscriber to the memorandum cannot after the issue of the certificate of incorporation, repudiate his subscription on the ground of misrepresentation, or fraud, although he retains any claims for damages against the person who misled him. [Re Metal Constitutents Ltd. vs. Lord Lurgans. (1902)].

41. (a) The purpose of having Capital Clause in the Memorandum of the Association of a company is to state the amount of the share capital with which the company is to be registered and state the division thereof into shares of a fixed amount. The capital with which a company is registered is called Registered or Authorised or Nominal capital. A company cannot issue more shares than are authorised for the time being by the Memorandum of Association. The shares issued by a company can only be equity shares or preference shares (Section 85).

The purpose of having 'Liability Clause' is to disclose in the Memorandum of Association that the liability of the members of the company is limited to the extent of the face value of the shares held by them. In case of a guarantee company, the liability shall be limited to the extent of the face value of shares and the amount of guarantee that the individual members have given to the company. This means that the members can be called upon to pay the company at any time the uncalled or unpaid amount on the shares held by them, or upto the maximum of the amount which they have guaranteed (the liability for guaranteed amount arises only in case of winding up when the assets of the company are not sufficient to meet out the liabilities).

Imposition of additional liability upon members: A limited liability company cannot impose upon its members additional liability. This can, however, be done by altering the memorandum or Articles of Association so as to impose any additional liability on the members or to compel them to buy additional shares of the company only if all the members

agree in writing to such change either before or after the change. In case where the company is a club or any other association and the alteration requires members to pay recurring or periodical subscriptions or charges at a higher rate, a written consent of members is not required to bind them (Section 38).

(b) Mode of registration/incorporation of company

In the case of a public company with or without limited liability any 7 or more persons can form a company by subscribing their names to memorandum and otherwise complying with the requirements of the Act. In exactly the same way, 2 or more persons can form a private company [Section 12]. Persons who form the company are known as promoters. It is they who conceive the idea of forming the company. They take all necessary steps for its registration:

- (a) Lawful purpose: The essence of validly incorporated company is that it must consist of a particular number of persons and be an association for a lawful purpose. Unless the purpose appears to be unlawful *ex facie* or is transparently illegal or prohibited by any statute, it cannot be regarded as an unlawful purpose.
- (b) Applying for the name: The promoters of the company should decide upon at least three suitable names in order of preference to afford flexibility to the Registrar to decide the availability of the name.
- (c) Documents to be filed: After getting the name approved, the certain documents along with the application and prescribed fees, are to be filed with the Registrar.
- (d) Subscribing their names: Subscribing name means signing the names. Section 15 stipulates that the Memorandum should be signed by each subscriber who should add his address, description and occupation in the presence of one witness.
- (e) Commencement of business.
- (f) Statement in Lieu of Prospectus: If a public company does not issue a prospectus inviting the public to purchase its share because the directors think they can sell the shares even without the issue of the prospectus, it can do so.
- (g) Certification of incorporation: Upon the registration of the documents mentioned earlier under the head "Documents to be filed for registration of the company" and the payment of the necessary fees, the Registrar of Companies issues a certificate that the company is incorporated, and in the case of a limited company that it is limited.

Effect of Registration [Section 34]

1. On the registration of the Memorandum of a company, the Registrar shall certify under his hand that the company is incorporated and in the case of a limited company, that the company is limited.
 2. From the date of incorporation mentioned in the certificate, the company becomes a legal person separate from the incorporators, and there comes into existence a binding contract between the company and its members as evidenced by the Memorandum and Articles of Association [Hari Nagar Sugar Mills Ltd. Vs. S.S. Jhunjhunwala AIR 1961 SC 1669]. It has perpetual existence until it is dissolved by liquidation or struck out of the register, and has the common seal. A shareholder who buys shares, does not buy any interest in the property of the company but in certain cases a writ petition will be maintainable by a company or its shareholders.
42. Where a shareholder wishes to transfer only part of his shareholding or wishes to sell them to two or more persons, he is required to lodge the share certificate with the company. Where he has already lodged with the company the relevant share certificates together with an instrument of transfer for part of the shares, he may request the company to certify on the instrument of the transfer that the share certificate for the shares covered by the instrument of transfer has been lodged with the company.

An instrument of transfer shall be deemed to be certificated if it bears the words "certificate lodged" or the words to the like effect. Certification is, therefore, the act of noting by the secretary etc., stating that the share certificate has been lodged with the company.

Any person who becomes a nominee by virtue of the provisions of Section 109A, upon the production of such evidence as may be required by the Board and subject as hereinafter provided, elect, either-

- (a) to a registered himself as holder of the share or debenture, as the case may be; or
- (b) to make such transfer of the share or debenture, as the case may be as the deceased shareholder or debenture holder, as the case may be, could have made.

If the person being a nominee, so becoming entitled, elects to be registered as holder of the share or debenture, himself as the case may be, he shall deliver or send to the company a notice in writing signed by him stating that he so elects and such notice shall be accompanied with the death certificate of the deceased shareholder or debenture holder, as the case may be. (Sub-section 2).

All the limitations, restrictions and provisions of this Act relating to the right to transfer and the registration of transfers of shares or debentures shall be applicable to any such notice or transfer as aforesaid as if the death of the member had not occurred and the notice or transfer were a transfer signed by that shareholder or debenture holder, as the case may be. (Sub-section 3).

person, being a nominee, becoming entitled to a share or debenture by reason of the death of the holder shall be entitled if he were the registered holder of the share or debenture except that he shall not, before being registered a member in respect of his share or debenture, be entitled in respect of it to exercise any right conferred by membership in relation to meetings of the company:

Provided that the Board may at, any time, give notice requiring any such person to elect either to be registered himself or to transfer the share or debenture, and if the notice is not complied within ninety days, the Board may thereafter withhold payment of all dividends, bonuses or other moneys payable in respect of the share or debenture, until the requirements of the notice have been complied with (Sub-section 4).

43. The answer is 'No'. The rights of Shareholders can be varied only if the consent in writing of the holders constituting not less than three-fourths of the issued shares of the concerned class has been taken, or only if the sanction through a special resolution passed at a separate meeting of the holders of the issued shares of that class has been taken prior to the variation of the rights. However, if such variation is prohibited by the terms of the aforesaid class of shares, then the variation will not be possible. [Section 106].

The variation as contemplated by Section 106 is the variation which is to the prejudice of any class of shareholders. That is to say, in case the variation involves curtailment of rights of any class or classes of shareholders, the aforesaid consent or sanction of the said class or classes will be required. If the variation pertains to adding or enhancing right of any classes, then also the compliance with the provisions of Section 106 is necessary. It has been held that a variation, which affects only the enjoyment of a right without modifying the right itself, does not fall within the purview of Section 106 [In re Hindustan General Electrical Corporation, A.I.R. 190 Cul. 672]. Once the variation is effected in strict consonance with the provisions of Section 106, it is complete, no further steps being necessary to adopt it [In re Ramuria Cotton Mills Ltd. 53 C.W.N. 11], in the event of the variation of right being a part of a scheme or arrangement with the intervention of the Court under Section 391 (this is excluded from the syllabus), Section 106 will be inapplicable in General Electrical Corporation [Supra].

If the minority feels oppressed or prejudiced by the variation as aforesaid, then Section 107 will have to be invoked.

In the light of the above-mentioned provisions, the procedure, which is generally followed in regard to variation of rights attached to, a particular class of shares is as under:

A meeting of the shareholders, holding the shares of the class, rights attached to which are sought to be altered, is convened. (The quorum for meeting shall be at least 2 persons present in person or by proxy in the case of a private company; in the case of a public company, the number of member present should be 5). If the meeting passes the special resolution then variation can be proceeded with [Section 170(2)(b); Section 174(1)].

Shareholders holding not less than 10 per cent, in the aggregate, of issued shares of that class, being persons who have not consented to or voted for the resolution for the variation of the rights may apply to the Court to have the variation cancelled. The application has to be made within 21 days from the date of passing of the resolution. In the case where an application has been made, the variation shall be effective only after the Court has confirmed it. The decision of the Court on any such application shall be final. If the Court has made an order, the company must, within 30 days after the service on the company of any order by it, forward copy of it to the Registrar [Section 107]. It would be worth noting in this context that sub-division of shares is not tantamount to variation.

44. Issue of Shares to Non-member: As per the provisions of the Companies Act, 1956 contained in Section 81(1) to (3) the directors of the company are under obligation to make offer of the new shares (known as rights shares) to the existing members of the company in proportion to their share holding. These shares can be offered to the persons who are not the members of the company or to the outsiders or any persons (including the equity shareholders) if the following procedure has been adopted:

1. A special resolution has been passed to that effect by the shareholders in general meeting
2. If an ordinary resolution is passed and the approval of the Central Government is obtained. The Central Government will accord its approval if it is satisfied that the proposal is most beneficial to the company.
3. If any shareholder to whom the shares are offered declines to accept the shares. In such a case the Board of directors of the company may dispose of the shares in such manner as they think most beneficial to the company.
4. If the new shares are issued within 2 years from the formation of the company or 1 year of the allotment made for the first time.

The provisions of Section 81, however, do not apply:

1. to a private company.
 2. to the increase of the subscribed capital of a company caused by the exercise of an option attached to debentures issued or loans raised by the company to convert such debentures or loans into shares in the company, or to subscribe for shares in the company. But the terms of issue of such debentures or the terms of such loans should include a term providing for such option and such term:
 - (i) either has been approved by the Central Government before the issue of debentures or the raising of the loans, or is in conformity with the rules, if any, made by the Central Government in this behalf, and
 - (ii) in the case of debentures or loans (other than debentures issued to, or loans obtained from, the government or any institution specified by the Central Government) has also been approved by a special resolution passed by the company in general meeting before the issue of the debentures or the raising of the loans.
45. 'Pari Passu': Pari passu clause in a debenture means that all the debentures of the series are to be paid rateably, if, therefore, security is insufficient to satisfy the whole debts secured by the series of debentures, the amounts of debentures will abate proportionately. If the clause is not made a use of then the debentures rank in accordance with the date of issue, and if they are all issued on the same date they will be payable according to their numerical order. A company, however, cannot issue a new series of debentures so as to rank 'puri passu' with prior series

unless the power to do so is expressly reserved and contained in the debenture deed of the previous series.

Registration: In the event of the 'puri passu' clause being included in the debentures secured by a charge, it is enough if the following particulars are filed with the Registrar of Companies within 30 days after the execution of the deed containing the charges or where there is no deed after the, execution of debentures of the series:

- (i) the total amount secured by the whole series;
- (ii) the dates of the resolutions authorising the issue of the series;
- (iii) the date of deed, if any, by which security is created;
- (iv) a general description of the property charged; and
- (v) the name of the trustees for debenture holders, if any, together with the deed containing the charge or a certified copy of the deed or, if there is no deed, one of the debentures of the series (Section 128).

Where more than one issue is made of debentures in the series, particulars of the date and the amount of each issue must be filed with the Registrar. But an omission to do so will not affect the validity of the debentures issued.

46. Registration of charge : The prescribed particulars of the charge together with the instrument, if any by which the charge is created or evidenced, or a copy thereof shall be filed with the Registrar within 30 days after the date of the creation of charge. [Section 125 (1)]. In this case particulars of charge have not been filed within the prescribed period of 30 days.

However, the Registrar is empowered under proviso to section 125 (1) to extend the period of 30 days by another 30 days on payment of such additional fee not exceeding 10 times the amount of fee specified on Schedule X as the Registrar may determine. Taking advantage of this provision, ABC Ltd., should immediately file the particulars of charge with the Registrar and satisfy the Registrar that it had sufficient cause, for not filing the particulars of charge within 30 days of creation of charge.

If the charge was created on 12th Feb., 2006, then the company has to apply to the Company Law Board (Now Tribunal) under Section 341 and seek extension of time for filing the particulars for registration. The company must satisfy the Company Law Board (Now tribunal) (a) that the omission was accidental or due to inadvertence or due to some other sufficient cause or was not of the nature to prejudice the position of creditors or shareholders of the company, or that it is just and equitable to grant relief on the other grounds. On such satisfaction, the Company Law Board (Now Tribunal) may extend the term for the registration of charge or; such terms and conditions as it may think expedient. Once the time is extended and it is made out that the particulars have been filed within the extended time, the registrar is bound to register the charge.

47. The promoters remain personally liable on a contract made on behalf of a company which is not yet in existence. Such a contract is deemed to have been entered into personally by the promoters and they are liable to pay damages for failure to perform the promises made in the company's name (Scot v. Lord Ebury), even though the contract expressly provided that only the company shall be answerable for performance.

In *Kelner v. Baxter* also it was held that the persons signing the contracts viz. Promoters were personally liable for the contract.

Further, a company cannot ratify a contract entered into by the promoters on its behalf before its incorporation. Therefore, it cannot by adoption or ratification obtain the benefit of the contract purported to have been made on its behalf before it came into existence as ratification by the company when formed is legally impossible. The doctrine of ratification applies only if an agent contracts for a principal who is in existence and who is competent to contract at the time of contract by the agent.

The company can, if it desires, enter into a new contract, after its incorporation with the other party. The contract may be on the same basis and terms as given in the pre-incorporation contract made by the promoters. The adoption of the pre-incorporation contract by the company will not create a contract between the company and the other parties even though the option of the contract is made as one of the objects of the company in its Memorandum of Association. It is, therefore, safer for the promoters acting on behalf of the company about to be formed to provide in the contract that: (a) if the company makes a fresh contract in terms of the pre-incorporation contract, the liability of the promoters shall come to an end; and (b) if the company does not make a fresh contract within a limited time, either of the parties may rescind the contract.

Thus applying the above principles, the answers to the questions as asked in the paper can be answered as under:

- (i) the promoters in the first case will be liable to the suppliers of furniture. There was no fresh contract entered into with the suppliers by the company. Therefore, promoters continue to be held liable in this case for the reasons given above.
- (ii) in the second case obviously the liability of promoters comes to an end provided the fresh contract was entered into on the same terms as that of pre-incorporation contract.

48. The membership of a company may be acquired in the following ways :

1. By subscribing to memorandum (Section 41): This section provides that the subscribers of the memorandum of association shall be deemed to have agreed to become the members of the company and on its registration shall be entered as members in the register of members.
2. By allotment: A person may become a shareholder by agreeing to take shares in the company by allotment.
3. By transfer: Section 41 says that every subscribers to the memorandum of a company and every other person who agrees in writing to become a member of the company and whose name is entered in its register of members. Thus it requires two thing a) an agreement in writing to become a member and b) an entry in the register.
4. By transmission: Here a person may become a shareholder by transmission of shares through death, lunacy or insolvency.
5. By estoppel: This arises when a person holds himself out as a member or knowingly allows his name to remain on the register when he has actually parted with his shares. In the event of winding up he will be liable like other genuine members as a contributory (Hansraj A. Ashtana). However, he may escape liquidity by applying for removal of his name under Section 155.

Answer to the problem :

Every person who is competent to contract may become a member. A minor and a person of unsound mind, being incompetent to contract, cannot be members of the company. It has been held in *Mohri Bihi vs. Dharmadas Ghose* (1930) that since a minor has no contractual capacity, the agreement with the minor is void ab initio.

The Companies Act, 1956 prescribes no qualification for membership. Therefore, in India, the minor may be allotted shares. His name may remain on a company's register of members, but during minority he incurs no liability. In the given problem the company issued 20 partly paid shares and registered it in the minor's name. The transaction was void and the father who signed the application on the minor's behalf could not be treated as having contracted for the shares; as such he could not be placed on the list of contributions when the company goes in liquidation. The facts of this problem are related to *Palaniappa B. Official Liquidator* AIR 1942 Mod. 470).

49. Problem on service of document upon a company: The problem as asked in the question is based on the provisions of the Companies Act, 1956 as contained in Section 51. Accordingly a document may be served on a company or on its officer at the registered office of the company. It must be sent either by post or by leaving it at its registered office. If it is sent by post, it must be either by post under a certificate of posting or by registered post. When a notice has been

addressed to the company and served on the directors, it constitutes a good service (Benabo v. Jay (William) and Partners Ltd.) The articles of a company which contain the provisions contrary to Section 51 cannot be enforced nor can they limit the mode of service to only one of the modes provided by the Statute (Sadasiv Shankar Dandige V. Gandhi Seva Samaj Ltd.).

Accordingly in the first case the refusal by the Mars Company Ltd. of the service of the document is not valid.

In the second case Ramesh can claim damages on this account from the Company.

50. Problem on notice and validity of proceedings of the meeting: The problem as asked in the question is based on the provisions of the Companies Act, 1956 as contained in Section 172 read with Section 53. Accordingly, the notice may be served personally or sent through post to the registered address of the members and, in the absence of any registered office in India, to the address, if there be any within India furnished by him to the company for the purpose of servicing notice to him. Service through post shall be deemed to have effected by correctly addressing, preparing and posting the notice. If, however, a member wants to notice to be served on him under a certificate or by registered post with or with acknowledgement due and has deposited money with the company to defray the incidental expenditure thereof, the notice must be served accordingly, otherwise service will not be deemed to have been effected.

Accordingly, the questions as asked may be answered as under:

- (i) The contention of Diensh shall be tenable, for the reason that the notice was not properly served and meetings held by the company shall be invalid.
- (ii) In view of the provisions of the Companies Act, 1956, as contained in Section 172, the company is not bound to send notice to Dinesh at the address outside India. Therefore, answer in the second case shall differ from the first one.



THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA
PROFESSIONAL COMPETENCE COURSE(PCC)
SYLLABUS

GROUP I

- Paper – 1 : Advanced Accounting
Paper – 2 : Auditing and Assurance
Paper – 3 : Law, Ethics and Communication

GROUP II

- Paper – 4 : Cost Accounting and Financial Management
Paper – 5 : Taxation
Paper – 6 : Information Technology and Strategic Management

GROUP – I

PAPER – 1 : ADVANCED ACCOUNTING

(One paper – Three hours – 100 Marks)

Level of Knowledge: Working knowledge

Objectives:

- (a) To lay a theoretical foundation for the preparation and presentation of financial statements,
- (b) To gain working knowledge of the professional standards, principles and procedures of accounting and their application to different practical situations,
- (c) To gain the ability to solve simple problems and cases relating to company accounts including special type of corporate entities, partnership accounts and
- (c) To familiarize students with the fundamentals of computerized system of accounting.

Contents

1. Conceptual Framework for Preparation and Presentation of Financial Statements
2. Accounting Standards

An overview; standards setting process

Working knowledge of:

- AS 1: Disclosure of Accounting Policies
- AS 2: Valuation of Inventories
- AS 3: Cash Flow Statements
- AS 4: Contingencies and Events occurring after the Balance Sheet Date
- AS 5: Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies
- AS 6: Depreciation Accounting
- AS 7: Construction Contracts (Revised 2002)
- AS 9: Revenue Recognition
- AS 10: Accounting for Fixed Assets
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- AS 12: Accounting for Government Grants
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- AS 19: Leases
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- AS 26: Intangible Assets
- AS 29: Provisions, Contingent Liabilities and Contingent Assets.

3. Company Accounts

- (a) Preparation of financial statements – Profit and Loss Account, Balance Sheet and Cash Flow Statement
- (b) Profit (Loss) prior to incorporation

- (c) Alteration of share capital, Conversion of fully paid shares into stock and stock into shares, Accounting for bonus issue, Accounting for employee stock option plan, Buy back of securities, Equity shares with differential rights, Underwriting of shares and debentures, Redemption of debentures
 - (d) Accounting for business acquisition, Amalgamation and reconstruction (excluding problems of amalgamation on inter-company holding)
 - (e) Accounting involved in liquidation of companies, Statement of Affairs (including deficiency/surplus accounts) and liquidator's statement of account of the winding up.
4. Financial Statements of Banking, Insurance and Electricity Companies
 5. Average Due Date, Account Current, Self-Balancing Ledgers
 6. Financial Statements of Not-for-Profit Organisations
 7. Accounts from Incomplete Records
 8. Accounting for Special Transactions
 - (a) Hire purchase and instalment sale transactions
 - (b) Investment accounts
 - (c) Departmental and branch accounts including foreign branches
 - (d) Insurance claims for loss of stock and loss of profit.
 9. Advanced Issues in Partnership Accounts

Final accounts of partnership firms – Admission, retirement and death of a partner including treatment of goodwill; Dissolution of partnership firms including piecemeal distribution of assets; Amalgamation of partnership firms; Conversion into a company and Sale to a company.
 10. Accounting in Computerised Environment

An overview of computerized accounting system–Salient features and significance, Concept of grouping of accounts, Codification of accounts, Maintaining the hierarchy of ledger, Accounting packages and consideration for their selection, Generating Accounting Reports.

Note – If either old Accounting Standards (ASs), Announcements and Limited Revisions to ASs are withdrawn or new ASs, Announcements and Limited Revisions to ASs are issued by the Institute of Chartered Accountants of India in place of existing ASs, Announcements and Limited Revisions to ASs, the syllabus will accordingly include/exclude such new developments in place of the existing ones with effect from the date to be notified by the Institute.

PAPER– 2 : AUDITING AND ASSURANCE

(One Paper —Three hours — 100 Marks)

Level of knowledge: Working Knowledge

Objective:

To understand objective and concepts of auditing and gain working knowledge of generally accepted auditing procedures and of techniques and skills needed to apply them in audit and attestation engagements and solving simple case-studies.

Contents

1. Auditing Concepts —Nature and limitations of Auditing, Basic Principles governing an audit, Ethical principles and concept of Auditor's Independence, Relationship of auditing with other disciplines.

2. Auditing and Assurance Standards —Overview, Standard-setting process, Role of International Auditing and Assurance Standards Board and Auditing and Assurance Standards Board in India.
3. Auditing engagement —Audit planning, Audit programme, Control of quality of audit work— Delegation and supervision of audit work.
4. Documentation — Audit working papers, Audit files: Permanent and current audit files, Ownership and custody of working papers.
5. Audit evidence — Audit procedures for obtaining evidence, Sources of evidence, Reliability of audit evidence, Methods of obtaining audit evidence % Physical verification, Documentation, Direct confirmation, Re-computation, Analytical review techniques, Representation by management.
6. Internal Control — Elements of internal control, Review and documentation, Evaluation of internal control system, Internal control questionnaire, Internal control check list, Tests of control, Application of concept of materiality and audit risk, Concept of internal audit.
7. Internal Control and Computerized Environment, Approaches to Auditing in Computerised Environment.
8. Audit Sampling — Types of sampling, Test checking, Techniques of test checks.
9. Analytical review procedures.
10. Audit of payments — General considerations, Wages, Capital expenditure, Other payments and expenses, Petty cash payments, Bank payments, Bank reconciliation.
11. Audit of receipts — General considerations, Cash sales, Receipts from debtors, Other Receipts.
12. Audit of Purchases — Vouching cash and credit purchases, Forward purchases, Purchase returns, Allowance received from suppliers.
13. Audit of Sales — Vouching of cash and credit sales, Goods on consignment, Sale on approval basis, Sale under hire% purchase agreement, Returnable containers, Various types of allowances given to customers, Sale returns.
14. Audit of suppliers' ledger and the debtors' ledger — Self-balancing and the sectional balancing system, Total or control accounts, Confirmatory statements from credit customers and suppliers, Provision for bad and doubtful debts, Writing off of bad debts.
15. Audit of impersonal ledger — Capital expenditure, deferred revenue expenditure and revenue expenditure, Outstanding expenses and income, Repairs and renewals, Distinction between reserves and provisions, Implications of change in the basis of accounting.
16. Audit of assets and liabilities.
17. Company Audit — Audit of Shares, Qualifications and Disqualifications of Auditors, Appointment of auditors, Removal of auditors, Powers and duties of auditors, Branch audit , Joint audit , Special audit, Reporting requirements under the Companies Act, 1956.
18. Audit Report — Qualifications, Disclaimers, Adverse opinion, Disclosures, Reports and certificates.
19. Special points in audit of different types of undertakings, i.e., Educational institutions, Hotels, Clubs, Hospitals, Hire-purchase and leasing companies (excluding banks, electricity companies, cooperative societies, and insurance companies).
20. Features and basic principles of government audit, Local bodies and not-for-profit organizations, Comptroller and Auditor General and its constitutional role.

Note: Candidates are expected to have working knowledge of relevant Auditing and Assurance Standards issued by the ICAI with reference to above-mentioned topics.

PAPER – 3 : LAW, ETHICS AND COMMUNICATION

(One paper – Three hours — 100 Marks)

Level of Knowledge: Working knowledge

Part I : Law (60 Marks)

Objective:

To test working knowledge of business laws and company law and their practical application in commercial situations.

Contents

Business Laws (30 Marks)

1. The Indian Contract Act, 1872
2. The Negotiable Instruments Act, 1881
3. The Payment of Bonus Act, 1965
4. The Employees' Provident Fund and Miscellaneous Provisions Act, 1952
5. The Payment of Gratuity Act, 1972.

Company Law (30 Marks)

The Companies Act, 1956 – Sections 1 to 197

- (a) Preliminary
- (b) Board of Company Law Administration — National Company Law Tribunal; Appellate Tribunal
- (c) Incorporation of Company and Matters Incidental thereto
- (d) Prospectus and Allotment, and other matters relating to use of Shares or Debentures
- (e) Share Capital and Debentures
- (f) Registration of Charges
- (g) Management and Administration – General Provisions – Registered office and name, Restrictions on commencement of business, Registers of members and debentures holders, Foreign registers of members or debenture holders, Annual returns, General provisions regarding registers and returns, Meetings and proceedings
- (h) Company Law in a computerized Environment – E-filing.

Note: If new legislations are enacted in place of the existing legislations, the syllabus would include the corresponding provisions of such new legislations with effect from a date notified by the Institute.

Part II : Business Ethics (20 Marks)

Objective:

To have an understanding of ethical issues in business.

Contents

1. Introduction to Business Ethics

The nature, purpose of ethics and morals for organizational interests; Ethics and Conflicts of Interests; Ethical and Social Implications of business policies and decisions; Corporate Social Responsibility; Ethical issues in Corporate Governance.

2. Environment issues

Protecting the Natural Environment – Prevention of Pollution and Depletion of Natural Resources; Conservation of Natural Resources.

3. Ethics in Workplace

Individual in the organisation, discrimination, harassment, gender equality.

4. Ethics in Marketing and Consumer Protection

Healthy competition and protecting consumer's interest.

5. Ethics in Accounting and Finance

Importance, issues and common problems.

Part III : Business Communications (20 Marks)

Objective:

To nurture and develop the communication and behavioural skills relating to business

Contents

1. Elements of Communication

- (a) Forms of Communication: Formal and Informal, Interdepartmental, Verbal and non-verbal; Active listening and critical thinking
- (b) Presentation skills including conducting meeting, press conference
- (c) Planning and Composing Business messages
- (d) Communication channels
- (e) Communicating Corporate culture, change, innovative spirits
- (f) Communication breakdowns
- (g) Communication ethics
- (h) Groups dynamics; handling group conflicts, consensus building; influencing and persuasion skills; Negotiating and bargaining
- (i) Emotional intelligence - Emotional Quotient
- (j) Soft skills – personality traits; Interpersonal skills ; leadership.

2. Communication in Business Environment

- (a) Business Meetings – Notice, Agenda, Minutes, Chairperson's speech
- (b) Press releases
- (c) Corporate announcements by stock exchanges
- (d) Reporting of proceedings of a meeting.

3. Basic understanding of legal deeds and documents

- (a) Partnership deed
- (b) Power of Attorney
- (c) Lease deed
- (d) Affidavit
- (e) Indemnity bond
- (f) Gift deed
- (g) Memorandum and articles of association of a company
- (h) Annual Report of a company.

GROUP II

PAPER – 4 : COST ACCOUNTING AND FINANCIAL MANAGEMENT

(One paper – Three hours — 100 Marks)

Level of Knowledge: Working knowledge

Part I : Cost Accounting (50 Marks)

Objectives:

- (a) To understand the basic concepts and processes used to determine product costs,
- (b) To be able to interpret cost accounting statements,
- (c) To be able to analyse and evaluate information for cost ascertainment, planning, control and decision making, and
- (d) To be able to solve simple cases.

Contents

1. Introduction to Cost Accounting

- (a) Objectives and scope of Cost Accounting
- (b) Cost centres and Cost units
- (c) Cost classification for stock valuation, Profit measurement, Decision making and control
- (d) Coding systems
- (e) Elements of Cost
- (f) Cost behaviour pattern, Separating the components of semi-variable costs
- (g) Installation of a Costing system
- (h) Relationship of Cost Accounting, Financial Accounting, Management Accounting and Financial Management.

2. Cost Ascertainment

- (a) Material Cost
 - (i) Procurement procedures— Store procedures and documentation in respect of receipts and issue of stock, Stock verification
 - (ii) Inventory control —Techniques of fixing of minimum, maximum and reorder levels, Economic Order Quantity, ABC classification; Stocktaking and perpetual inventory
 - (iii) Inventory accounting
 - (iv) Consumption — Identification with products of cost centres, Basis for consumption entries in financial accounts, Monitoring consumption.
- (b) Employee Cost
 - (i) Attendance and payroll procedures, Overview of statutory requirements, Overtime, Idle time and Incentives
 - (ii) Labour turnover
 - (iii) Utilisation of labour, Direct and indirect labour, Charging of labour cost, Identifying labour hours with work orders or batches or capital jobs
 - (iv) Efficiency rating procedures
 - (v) Remuneration systems and incentive schemes.

(c) Direct Expenses

Sub-contracting — Control on material movements, Identification with the main product or service.

(d) Overheads

(i) Functional analysis — Factory, Administration, Selling, Distribution, Research and Development

Behavioural analysis — Fixed, Variable, Semi variable and Step cost

(ii) Factory Overheads — Primary distribution and secondary distribution, Criteria for choosing suitable basis for allotment, Capacity cost adjustments, Fixed absorption rates for absorbing overheads to products or services

(iii) Administration overheads — Method of allocation to cost centres or products

(iv) Selling and distribution overheads — Analysis and absorption of the expenses in products/customers, impact of marketing strategies, Cost effectiveness of various methods of sales promotion.

3. Cost Book-keeping

Cost Ledgers—Non-integrated accounts, Integrated accounts, Reconciliation of cost and financial accounts.

4. Costing Systems

(a) Job Costing

Job cost cards and databases, Collecting direct costs of each job, Attributing overhead costs to jobs, Applications of job costing.

(b) Batch Costing

(c) Contract Costing

Progress payments, Retention money, Escalation clause, Contract accounts, Accounting for material, Accounting for plant used in a contract, Contract profit and Balance sheet entries.

(d) Process Costing

Double entry book keeping, Process loss, Abnormal gains and losses, Equivalent units, Inter-process profit, Joint products and by products.

(e) Operating Costing System

5. Introduction to Marginal Costing

Marginal costing compared with absorption costing, Contribution, Breakeven analysis and profit volume graph.

6. Introduction to Standard Costing

Various types of standards, Setting of standards, Basic concepts of material and Labour standards and variance analysis.

Part II : Financial Management (50 Marks)

Objectives:

- (a) To develop ability to analyse and interpret various tools of financial analysis and planning,
- (b) To gain knowledge of management and financing of working capital,
- (c) To understand concepts relating to financing and investment decisions, and
- (d) To be able to solve simple cases.

Contents:

1. Scope and Objectives of Financial Management
 - (a) Meaning, Importance and Objectives
 - (b) Conflicts in profit versus value maximisation principle
 - (c) Role of Chief Financial Officer.
2. Time Value of Money

Compounding and Discounting techniques— Concepts of Annuity and Perpetuity.
3. Financial Analysis and Planning
 - (a) Ratio Analysis for performance evaluation and financial health
 - (b) Application of Ratio Analysis in decision making
 - (c) Analysis of Cash Flow Statement.
4. Financing Decisions
 - (a) Cost of Capital — Weighted average cost of capital and Marginal cost of capital
 - (b) Capital Structure decisions — Capital structure patterns, Designing optimum capital structure, Constraints, Various capital structure theories
 - (c) Business Risk and Financial Risk — Operating and financial leverage, Trading on Equity.
5. Types of Financing
 - (a) Different sources of finance
 - (b) Project financing — Intermediate and long term financing
 - (c) Negotiating term loans with banks and financial institutions and appraisal thereof
 - (d) Introduction to lease financing
 - (e) Venture capital finance.
6. Investment Decisions
 - (a) Purpose, Objective, Process
 - (b) Understanding different types of projects
 - (c) Techniques of Decision making: Non-discounted and Discounted Cash flow Approaches — Payback Period method, Accounting Rate of Return, Net Present Value, Internal Rate of Return, Modified Internal Rate of Return, Discounted Payback Period and Profitability Index
 - (d) Ranking of competing projects, Ranking of projects with unequal lives.
7. Management of Working Capital
 - (a) Working capital policies
 - (b) Funds flow analysis
 - (c) Inventory management
 - (d) Receivables management
 - (e) Payables management
 - (f) Management of cash and marketable securities
 - (g) Financing of working capital.

PAPER – 5 : TAXATION

(One paper — Three hours – 100 Marks)

Level of Knowledge: Working knowledge

Objectives:

- (a) To gain knowledge of the provisions of Income-tax law relating to the topics mentioned in the contents below and
- (b) To gain ability to solve simple problems concerning assessee's with the status of 'Individual' and 'Hindu Undivided Family' covering the areas mentioned in the contents below.

Part I : Income-tax (75 marks)

Contents

1. Important definitions in the Income-tax Act, 1961
2. Basis of charge; Rates of taxes applicable for different types of assessee's
3. Concepts of previous year and assessment year
4. Residential status and scope of total income; Income deemed to be received / deemed to accrue or arise in India
5. Incomes which do not form part of total income
6. Heads of income and the provisions governing computation of income under different heads
7. Income of other persons included in assessee's total income
8. Aggregation of income; Set-off or carry forward and set-off of losses
9. Deductions from gross total income
10. Computation of total income and tax payable; Rebates and reliefs
11. Provisions concerning advance tax and tax deducted at source
12. Provisions for filing of return of income.

Part II : Service tax and VAT (25 marks)

Objective:

To gain knowledge of the provisions of service tax as mentioned below and basic concepts of Value added tax (VAT) in India.

Contents:

1. Service tax – Concepts and general principles
2. Charge of service tax and taxable services
3. Valuation of taxable services
4. Payment of service tax and filing of returns
5. VAT – Concepts and general principles.

Note: If new legislations are enacted in place of the existing legislations the syllabus will accordingly include the corresponding provisions of such new legislations in the place of the existing legislations with effect from the date to be notified by the Institute. Students shall not be examined with reference to any particular State VAT Law.

PAPER – 6 : INFORMATION TECHNOLOGY AND STRATEGIC MANAGEMENT

(One paper – Three hours – 100 Marks)

Level of Knowledge: Working knowledge

Section A : Information Technology (50 Marks)

Objective:

To develop an understanding of Information Technology and its use by the business as facilitator and driver.

Contents

1. Introduction to Computers

(a) Computer Hardware

Classification of Computers - Personal computer, Workstation, Servers and Super computers

Computer Components - CPU, Input output devices, Storage devices

(b) BUS, I/O CO Processors, Ports (serial, parallel, USB ports), Expansion slots, Add on cards, On board chips, LAN cards, Multi media cards , Cache memory, Buffers, Controllers and drivers

(c) Computer Software

Systems Software - Operating system, Translators (Compilers, Interpreters and Assemblers), System utilities

General Purpose Software/ Utilities - Word Processor, Spread Sheet, DBMS, Scheduler / Planner, Internet browser and E-mail clients

Application Software - Financial Accounting, Payroll, Inventory

Specialised Systems – Enterprise Resource Planning (ERP) , Artificial Intelligence , Expert Systems, Decision Support Systems – An Overview

2. Data Storage, Retrievals and Data Base Management Systems

(a) Data and Information Concepts: Bits, Bytes, KB, MB, GB, TB

(b) Data organization and Access

Storage Concepts : Records, Fields, Grouped fields, Special fields like date, Integers, Real, Floating, Fixed, Double precision, Logical, Characters, Strings, Variable character fields (Memo); Key, Primary key, Foreign key, Secondary key, Referential integrity, Index fields.

Storage techniques: Sequential, Block Sequential, Random, Indexed, Sequential access, Direct access, Random access including Randomizing

Logical Structure and Physical structure of files

(c) DBMS Models and Classification:

Need for database, Administration, Models, DML and DDL (Query and reporting); Data Dictionaries, Distributed data bases, Object oriented databases, Client Server databases, Knowledge databases

(d) Backup and recovery – backup policy, backup schedules, offsite backups, recycling of backups, frequent checking of recovery of backup

(e) Usage of system software like program library management systems and tape and disk management systems – features, functionalities, advantages

(f) Data Mining and Data Warehousing - An overview

3. Computer Networks & Network Security

(a) Networking Concepts – Need and Scope, Benefits

Classification: LAN, MAN, WAN, VPN; Peer-to-Peer, Client Server

Components- NIC, Router, Switch, Hub, Repeater, Bridge, Gateway, Modem

Network Topologies– Bus, Star, Ring, Mesh, Hybrid, Architecture :Token ring, Ethernet

Transmission Technologies and Protocols – OSI, TCP/IP, ISDN etc.

Network Operating System

(b) Local Area Networks- Components of a LAN, Advantages of LAN

(c) Client Server Technology

Limitation of Single user systems and need for Client Server Technology

Servers - Database, Application, Print servers, Transaction servers, Internet servers, Mail servers, Chat servers, IDS

Introduction to 3- tier and “n” tier architecture (COM, COM+)

(d) Data centres: Features and functions, Primary delivery centre and disaster recovery site

(e) Network Security

Need; Threats and Vulnerabilities; Security levels; techniques

4. Internet and other technologies

(a) Internet and world-wide web, Intranets, Extranets, applications of Internet, Internet protocols

(b) E-Commerce - Nature, Types (B2B, B2C, C2C), Supply chain management, CRM, Electronic data interchange (EDI), Electronic fund transfers (EFT), Payment portal, E-Commerce security;

(c) Mobile Commerce, Bluetooth and Wi-Fi

5. Flowcharts, Decision Tables.

Section B : Strategic Management (50 Marks)

Objectives:

- (a) To develop an understanding of the general and competitive business environment,
- (b) To develop an understanding of strategic management concepts and techniques,
- (c) To be able to solve simple cases.

Contents

1. Business Environment

General Environment % Demographic, Socio-cultural, Macro-economic, Legal/political, Technological, and Global; Competitive Environment.

2. Business Policy and Strategic Management

Meaning and nature; Strategic management imperative; Vision, Mission and Objectives; Strategic levels in organisations.

3. Strategic Analyses

Situational Analysis – SWOT Analysis, TOWS Matrix, Portfolio Analysis % BCG Matrix.

4. Strategic Planning

Meaning, stages, alternatives, strategy formulation.

5. Formulation of Functional Strategy

Marketing strategy, Financial strategy, Production strategy, Logistics strategy, Human resource strategy.

6. Strategy Implementation and Control

Organisational structures; Establishing strategic business units; Establishing profit centers by business, product or service, market segment or customer; Leadership and behavioural challenges.

7. Reaching Strategic Edge

Business Process Reengineering, Benchmarking, Total Quality Management, Six Sigma, Contemporary Strategic Issues.

TRANSITION SCHEME FOR STUDENTS OF PROFESSIONAL EDUCATION (COURSE-II)

- (1) Professional Education (Course-II) students who have passed Professional Education (Examination-I) / Foundation Examination can switch over to Professional Competence Course. Such students are classified into two categories –

Category (a)

- Students who have passed one of the Groups of Professional Education (Examination-II);
- Students who have appeared in Professional Education (Examination-II), but not passed any of the Groups; and
- Students who have registered for Professional Education (Course- II) and eligible to appear in Professional Education (Examination-II), but not yet appeared.

Category (b)

- Students who are registered, provisionally or otherwise, for Professional Education (Course-II), but ineligible to appear in Professional Education (Examination-II).

Transition scheme for the students falling under Category (a) above is as under:

- (i) Register concurrently for Professional Competence Course (PCC), Articled / Audit training and 100 Hours Information Technology Training.

Complete 100 hours Information Technology Training:

Appear in Professional Competence Examination (PCE) in the eligible attempt of Professional Competence Examination without the requirement of completion of minimum 18 months of practical training in accordance with the eligibility norm stated in Para (2); or

- (ii) Continue with Professional Education (Examination-II) till the last Professional Education (Examination - II) to be held in May 2008.

Transition scheme for the students falling under Category (b) above is as under: -

- (i) Register concurrently for Professional Competence Course (PCC), Articled / Audit training and 100 Hours Information Technology Training;

Complete 100 hours Information Technology Training;

Appear in Professional Competence Examination (PCE) in May 2008 or thereafter, after completion of minimum 15 months of articled training or equivalent period of audit training 3 months prior to the first day of the month in which examination is held. The students are permitted to undergo training partly as an articled assistant and partly as an audit assistant.

- (ii) Continue with Professional Education (Course-II)/Examination till the last Professional Education (Examination-II) to be held in May 2008.

Note: 6 months of articleship training is equivalent to 8 months of audit training. Any fractional period of audit training is not counted. So a student who falls under Category (a) and who is undergoing audit training has to complete 24 months of training for appearing in PCE.

Relevant extracts of Implementation Schedule

Commencement of New Scheme	September 13, 2006
Registration commences for Articles under New Scheme [Applicable to students who are studying Professional Education (Course-II) after passing Professional Education (Examination-I) / Foundation Examination]	September 13, 2006
Last Professional Education (Examination-II)	May, 2008
First Professional Competence Examination for students joining Professional Competence Course after passing Professional Education (Examination-I) /Foundation Examination	May, 2007

- (2) Eligibility norm of Professional Education (Course –II) students who have switched over / will switch over to Professional Competence Course (PCC) to appear in Professional Competence Examination (PCE)
- (i) All such students have already appeared in Professional Education (Examination –II) and passed one of the Groups or could not pass any of the Groups or eligible to appear Professional Education (Examination-II) .
- (ii) Students should successfully complete 250 Hours Compulsory Computer Training programme / 100 Hours Information technology Training programme before appearing in the PCE.

SI No.	1	2
	Category of students of PE-II	Eligibility to appear in Professional Competence Examination (PCE)
1.	PE- II students who have passed foundation examination	May 2007 and thereafter
2.	PE- II students who have passed PE-I examination held in May 2005 or in any earlier term	May 2007 and thereafter
3.	PE- II students who have passed PE-I examination held in November 2005	November 2007 and thereafter
4.	PE-II students who have passed PE-I examination held in May, 2006	These students fall in category (b) and will appear PCE as per the transition scheme

See also Figure-1.

- (3) Transition Scheme for Professional Education (Course-II) Students other than those who have passed Professional Education (Examination –I) or Foundation Examination
- Continue with Professional Education (Examination-II) till the last Professional Education (Examination-II) to be held in May 2008; or
 - Switch over to Common Proficiency Test. See Figure-2.

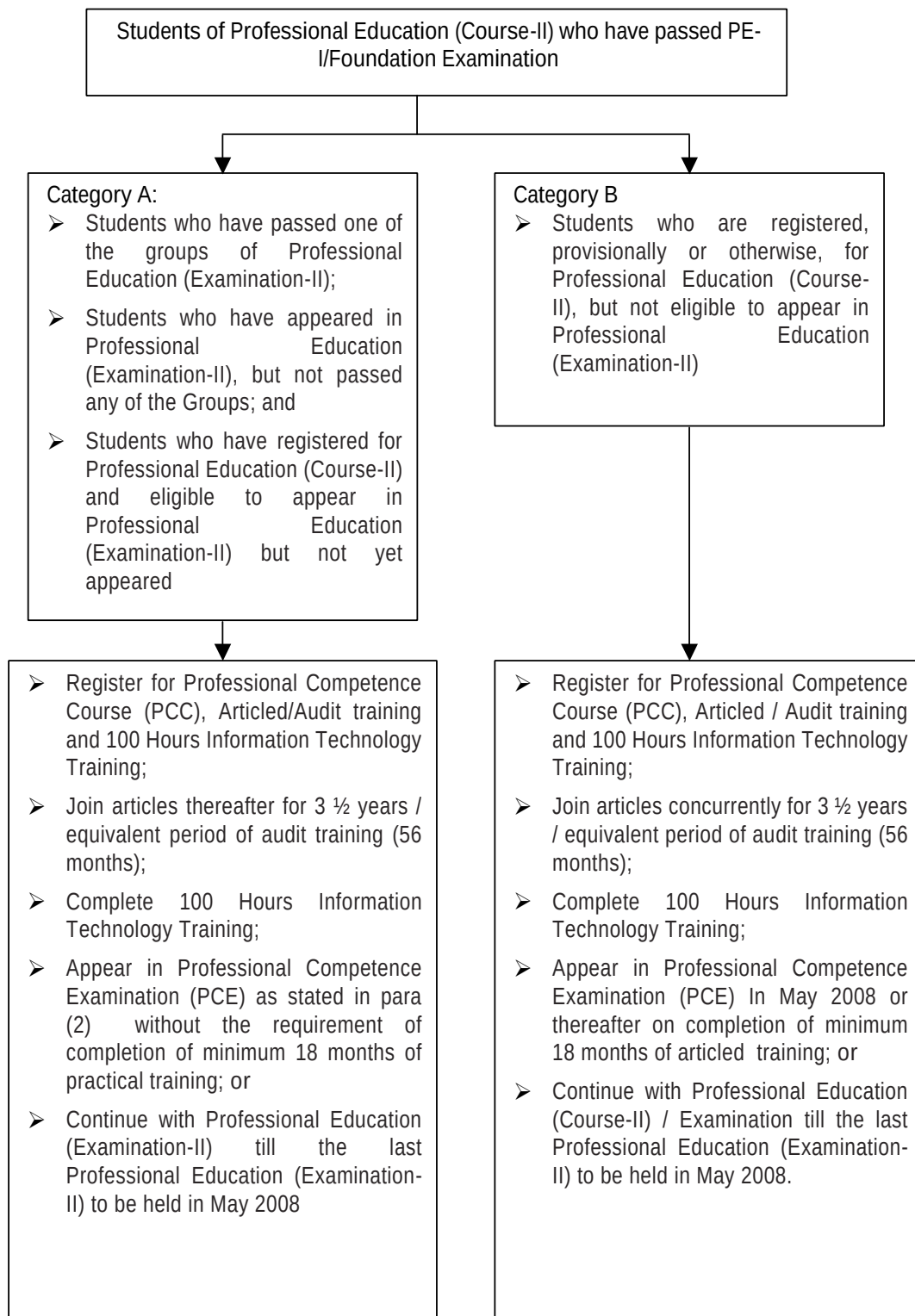


Figure-1

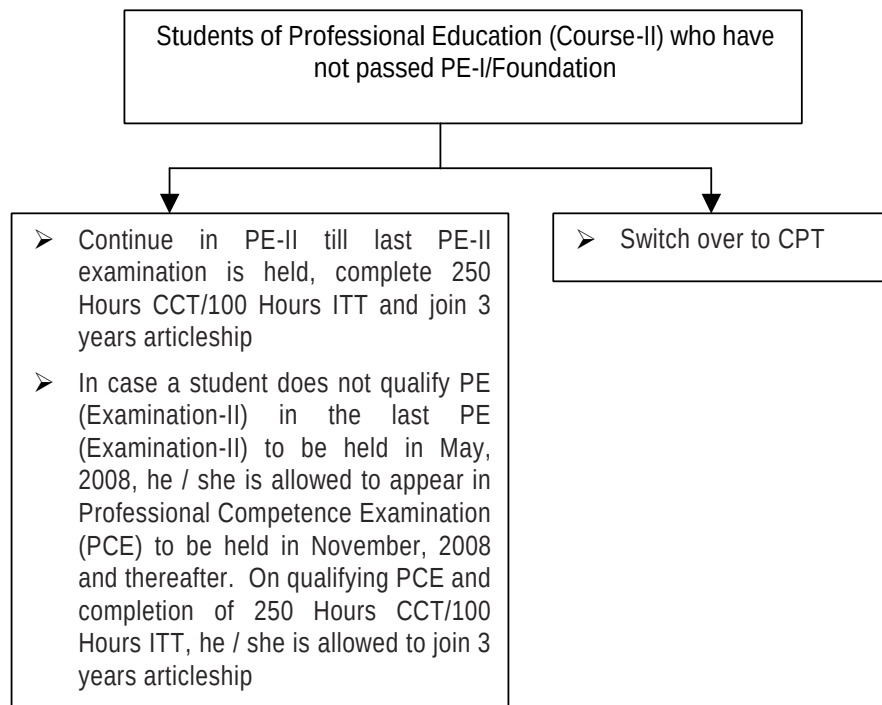


Figure-2

- (4) Subject-wise exemption: A Professional Education (Course-II) student who has been granted an exemption under Regulation 37A(7) in one or more papers shall continue to enjoy the said exemption in the corresponding paper(s) under PCC as given below :

Subject-wise Exemption for PE-II Examination

Existing	New
Professional Education (Course-II)	Professional Competence Course
Group I Paper 1: Accounting	Group I Advanced Accounting (100 Marks)
Paper 2: Auditing	Auditing and Assurance (100 Marks)
Paper 3: Business and Corporate Laws Section A: Business Law (60 marks) Section B: Corporate Laws (40 marks)	Law, Ethics and Communication Part I: Law (60 Marks) Business Laws (30 Marks) Part II: Business Ethics (20 Marks) Part III: Business Communication (20 Marks)
Group II Paper 4: Cost Accounting and Financial Management Section A: Cost Accounting (60 marks) Section B: Financial Management (40 marks)	Group II Cost Accounting and Financial Management Part I: Cost Accounting (50 Marks) Part II: Financial Management (50 Marks)
Paper 5: Income-tax and Central Sales Tax Section A: Income Tax (75 marks) Section B: Central Sales Tax (25 marks)	Taxation Part I: Income-tax (75 Marks) Part II: Service Tax and VAT (25 Marks)
Paper 6: Information Technology	Information Technology and Strategic Management Section A: Information Technology (50 Marks) Section B: Strategic Management (50 Marks)

- (5) Group-wise exemption: A student of Professional Education (Course-II) who has passed in any one but not in both the groups of the Professional (Education-II) is granted exemption from passing the same group in PCE, i.e., if a student has passed Group I of Professional Education (Course-II) he is granted exemption from appearing in Group I of PCE, or if a student has passed Group II of Professional Education (Examination-II) he is granted exemption from appearing in Group II of PCE.

RECENT PUBLICATIONS OF THE BOARD OF STUDIES

	English Rs.	Hindi Rs.	Postal Charges By Registered Parcel	
			English Rs.	Hindi Rs.
I. STUDY MATERIALS				
COMMON PROFICIENCY TEST (CPT)				
Fundamentals of Accounting	200	140		
Mercantile Laws	50	40		
General Economics	100	70		
Quantitative Aptitude	250	150		
Self Assessment CD	<u>40</u>	<u>40</u>		
	<u>640</u>	<u>440</u>	145	145
PROFESSIONAL COMPETENCE COURSE (PCC)				
Group I				
Advanced Accounting Vol. I & Vol. II	500	500		
Auditing and Assurance Vol. I	175	175		
Auditing & Assurance Standards & Guidance Note (English) Vol. II	100			
Law, Ethics and Communication	<u>275</u>	<u>275</u>		
	<u>1050</u>	<u>950</u>	215	215
Group II				
Cost Accounting & Financial Management	300	300		
Taxation	200	200		
Information Technology	150	150		
Strategic Management	<u>100</u>	<u>100</u>		
	<u>750</u>	<u>750</u>	180	180
Both Groups	<u>1800</u>	<u>1700</u>	395	395
FINAL (NEW COURSE)				
Group I				
Financial Reporting	600			
Strategic Financial Management	260			
Advanced Auditing and Professional Ethics	520			
Corporate and Allied Laws	<u>200</u>			
	<u>1580</u>		320	
Group II				
Advanced Management Accounting	240			
Information Systems Control and Audit	150			
Direct Tax Laws	340			
Indirect Tax laws	<u>290</u>			
	<u>1020</u>		225	
Both Groups	2600		540	
Information Technology Training Course Material				
Information Technology Training Programme - Modules I & II	500		90	
II. COMPILATIONS OF SUGGESTED ANSWERS				
Professional Education (Course-II)				
Paper 1: Accounting (November, 1994 – November, 2006)	60		40	
Paper 2: Auditing (May, 2000 – November, 2006)	40		40	
Paper 3: Business and Corporate Laws (May, 2000 – November, 2006)	60		40	

Paper 4 A: Cost Accounting (May, 1981 – November, 2006)	60	40
Paper 4 B: Financial Management (May, 1996 – November, 2006)	60	40
Final		
Paper 1: Advanced Accounting (May, 1996 – November, 2006)	70	40
Paper 3: Advanced Auditing (May, 2000 – November, 2006)	60	40
IV. REVISION TEST PAPERS FOR MAY 2007		
Professional Education (Course –I)	40	40
Professional Education (Course –II) (Group I & II)	80	55
Final (Group I & II)	80	55
V. PROSPECTUS		
1. Common Proficiency Test – A Simplified Entry to the Chartered Accountancy Course	100	40
2. Professional Competence Course – First Stage of Theoretical Education of the Chartered Accountancy Course inclusive of conversion form		
– With Form Nos. 102 and 103	100	40
– Without Form Nos. 102 and 103	50	40
VI. MISCELLANEOUS		
1. Model Test paper Vol. I for CPT	250	68
2. Model Test Paper Vol. I for PCC	50	36
3. Students Guide to Accounting Standard 28: Impairment of Assets	25	36
4. Supplementary Study Paper-2006 Income tax & Central Sales Tax for PE(Course-II)	30	40
5. Supplementary Study Paper -2006 Direct tax and Indirect tax for Final Course	60	40
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Paper 1 : Accounting

Accounting Standards 1 to 29 [including revised AS 15(2005)].

For the students at PE-II level, Accounting Standards and Guidance Notes related to the topics given in the study material are more relevant. They are not expected to know in detail the advanced standards like Consolidated Financial Statements (AS 21), Accounting for Investments in Associates in Consolidated Financial Statements (AS 23), Discontinuing Operations (AS 24), Financial Reporting of Interests in Joint Ventures (AS 27), Impairment of Assets (AS 28) and Provisions, Contingent Liabilities and Contingent Assets (AS 29).

For the topic of Accounts of Insurance Companies, the Insurance Regulatory and Development Authority (Preparation of Financial Statements and Auditor's Report of Insurance Companies) Regulations, 2002 will be applicable.

The study material reprinted as on July, 2006 is relevant for November, 2007 Examination.

Paper 2 : Auditing

Auditing and Assurance Standards – 1 to 30.

Students at PE II level are expected to have familiarity with all these Auditing and Assurance Standards. They are expected to know in-depth only such Auditing Standards, which have been dealt within the main text of the study material.

Paper 3 : Business & Corporate Laws

The study material reprinted as on September, 2006 is relevant for November, 2007 Examination. There has been no legislative change since then.

Paper 5 : Income-tax and Central Sales Tax

Study Material for Income-tax and Central Sales Tax - June 2005 edition should be read along with "Professional Education (Course-II) – Supplementary Study Paper - 2006 – Income-tax and Central Sales-tax" containing amendments made by the Finance Act, 2006 relevant for assessment year 2007-08.

Note – For the purposes of setting the questions in Income-tax and central sales tax, the June 2005 edition of the study material and the "Supplementary Study Paper - 2006 – Income-tax and Central Sales-tax" containing the amendments made by the Finance Act, 2006, relevant for assessment year 2007-08 should be taken into account. The study material contains the amendments made by notifications/circulars/other legislations up to 30.04.2005 and the supplementary study paper – 2006 contains the amendments made by the Finance Act, 2006 as well as amendments made by notifications/circulars/other legislations between 1.5.05 and 30.04.2006. Further, the amendments made between 1.05.2006 and 30.4.2007 would be published in the Revision Test Papers for November 2007 examination. All these amendments are relevant for November 2007 examination and hence should be taken into account for the purpose of setting questions for this exam.