XAY

Total No. of Questions : 6 **Maximum Marks : 100**
No. of Pages : 5 **Time Allowed: 3 Hours**

Answers all Questions
All Workings should form part of the answers.

1. X ,Y and Z have carried on business as drapers for twenty years and on 30th June, 2008,their balance sheet was as under:

Liabilities			Rs.	Assets	Rs.
Bank overdraft			20,000	Premises	50,000
Creditors for supplies			30,000	Plant and Machinery	32,000
Creditors for expenses			18,000	Stock in trade	40,000
Capital accounts:				Sundry debtors	48,000
(Fixed)		Rs.		Cash and bank balances	8,000
	X	30,000			
	Y	20,000			
	Z	20,000	70,000		
Current accounts:					
	X	16,000			
	Z	24,000	40,000		
			1,78,000		**1,78,000**

The profits and losses were shared in the ratio of fixed capitals as on 30th June,2008. The partners agreed that due to his old age, X would retire from the firm when its goodwill will be valued and proportionate share will be credited to X. It was also decided that premises appearing in the books at cost would be valued at its market value of Rs.80,000 and allotted to X in satisfaction of his dues. Any excess or deficit would be settled in cash. It was also agreed that stock in trade and debtors would be taken at 90% of the book value and an unrecorded liability of bonus of Rs.10,000 to staff should be brought into books. Goodwill of the firm was to be taken at Rs.70,000.

After X's retirement, the business was carried on by Y and Z sharing profits and losses equally and till 30th September, 2008, the firm had made a net profit of Rs.30,000 after crediting each partner's capital account with Rs.500 p.m. as salary. No drawings were made by the partners in the quarter.

Y and Z now find that they cannot continue the business and decide to sell it to a private limited company as and from 1st October, 2008. The company is to take over the entire business for a consideration of Rs.90,000 which the vendors agree to take 40% in 14% secured debentures and the balance in cash. To enable the company to pay the vendors and also leave it with a working capital of Rs.20,000 in addition to the working capital taken over by Y and Z, the company makes issue of equity shares of Rs.10 each at par.

Show the Balance Sheet of the company after the takeover of the business of Y and Z.

(20 marks)

2. On 31st December 2008.Mr.Ram's books and records were destroyed by fire. The following information was available:

(i)The balance sheet of Mr.Ram as on 31-12-2008 was as follows:

Capital and liabilities	Rs.	Assets	Rs
Capital	42,000	Fixtures	10,000
Creditors:		Stock	15,000
Goods	9,400	Debtors	12,000
Electricity	200	Rates paid in advance	450
Accountancy charges	500	Cash in hand	1,500
		Cash at bank	13,150
	52,100		**52,100**

(ii) the Insurance company agreed to pay Rs. 9,500 for fixtures and Rs. 10,500 for stock without production of accounts; the stock however was worth Rs.11,500.

(iii) From the bank statement and the Cheque books which were in his house, the following information on payments was available:

	Rs.
Personal expenses	8000
Sundry expenses	650
Accountancy charges	800
Electricity	750
Rates	1350
Rent	5170
Goods for resale	215800
Fixtures	2000

(iv)Total banking for the year amounted to Rs.2,45,020.

(v) All cash takings were banked except for the following payments during the year:

An Assistants salary	Rs.1,800 per annum
Goods for resale averaging	Rs.1,050 per month
Drawings varied between	Rs.2,000 to Rs.3,000 per month.

(vi) Rs.250 per month for 9 months was received in cash for subletting a portion of the shop and this was not banked.

(vii) During the year sale proceeds for waste paper amounting to Rs. 3,050 were paid into the bank.

(viii) (a) On 31-12-2008, debtors were Rs.20,500.
(b) Creditors were for goodsRs.9,000.For electricity Rs.80 ,for accounting charges Rs.75 and for rent Rs.470.
(c) Rates in advance Rs.650.
(d) cash in hand Rs.1,700
(e) during the year a bad debt of Rs. 600 was incurred.
(f) the rate of gross profit as a percentage of sale should be taken as 20%.

You are required to prepare Trading and profit and Loss account for the year ended 31-12-2008 and a balance Sheet as on that date. **(16 marks)**

3 . The following are the changes in the account balance taken from the Balance Sheets of BHIMA Ltd. at the beginning and end of the year:

	Changes in Rs in debit or (credit)
Equity share capital 30,000 shares of Rs. 10 each issued and fully paid	0
Capital reserve	(49,200)
8% Debentures	(50,000)
Debenture discount	1,000
Freehold property at cost/revaluation	43,000
Plant and machinery at cost	60,000
Depreciation on plant and machinery	(14,400)
Debtors	50,000
Stock and work-in-progress	38,500
Creditors	(11,800)
Net profit for the year	(76,500)
Dividend paid in respect of earlier year	30,000
Provision for doubtful debts	(3,300)
Trade investments at cost	47,000
Bank	(64,300)

You are informed that :

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

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

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

(d) The net profit for the year was after crediting the profit on sale of plant and charging debenture interest.

You are required to prepare a statement which will explain why bank borrowing has increased by Rs. 64,300 during the year end. Ignore taxation

(16 marks)

4

(a) There was a serious fire in the premises of Shiva And Co.,on 1st November 2008.The indemnity period lasted for 4 months during which the sales of the company were reduced to Rs. 4,00,000 only. The company closes its account on 30th June every year. The profit and loss account for the year ended 30th June 2008 is given below:

Profit and Loss Account for the year ended 30-6-2008

	Rs		Rs
To Opening Stock	10,00,000	By Sales	95,00,000
To Purchases	60,00,000	By Closing Stock	5,00,000
To Variable expenses	15,75,000		
To Standing charges	7,25,000		
To Net profit	7,00,000		
	1,00,00,000		1,00,00,000

The Company took a loss of profit policy for a sum of Rs. 12,00,000.The sales of the company for the 12 months ending the date of fire were Rs.1,00,00,000 and for the four months from 1st November 2007 to 28th February 2008 were Rs.30,00,000.

It was noted that the sales for the first four months of the year under indemnity were 20% higher than the previous year. Compute the claim for loss of profit **(8 marks).**

(b) Jegannath & CO sells goods on hire purchase basis at a profit of 50% on cost. Following particulars are supplied to you relating to the business during 2008:

	Rs.
Hire Purchase Stock (at Hire Purchase Price)	67,500
Installments due on Jan 1,2008	37,500
Goods sold on hire purchase during the year (at H.P.Price)	6,52,500
Cash recived from hire purchase customers during the year	4,50,000
Goods repossessed (installments due Rs.15,000) valued at	3,750
Hire Purchase Stock (at Hire purchase price) as on 31st Dec., 2008	2,25,000
Installments due on 31st December,2008	67,500

Prepare Hire Purchase Trading Account showing the profit earned for 2008. **(8 marks)**

5. *Answer any eight out of the following*:

(i) Ravi and Raghavan are partners in a firm .During 2006 they subscribed joint life policy paying an annual premium of Rs.4,000 for Rs.40,000.On 15th April 2008 Raghavan died .On this date the joint life policy and joint life policy reserve account stands at Rs.6,000 each..Pass necessary journal entries to record the above transactions for 2008,assuming the policy amount is duly received.

(ii) Pass journal entries to record the issue of 50,000 Debentures of Rs.1000 each issued at a discount of 5% and redeemable at a premium of 5% after 5 years.

(iii) Mr.Long sells goods to Mr.Short as follows:
Jan., 2, Rs.1,000; Feb 16,Rs.700; March 22 Rs.840.
Mr. Short sells to Mr. Long as follows:
Jan 21 Rs.500; March 8 Rs.944; April 15 Rs.340.
They agree to settle the amount on the average due date method. Terms are Mr. Long's bills at 2 months and Mr. Short's bills at one month. Find out the due date and the amount to be paid.

(iv) Pass journal entry to adjust goods worth Rs.800 purchased by the branch but payments made by the head office account, in the books of both head office and branch. The head office debited the amount in to its own purchases account.

(v) List the advantages of using an ERP

(vi) What is meant by red ink interest in an Account Current.

(vii) What do you understand by "Firm Underwriting"

(viii) During 2008 the subscription received in cash is Rs.4,20,000. It includes Rs.16,000 for 2007 and Rs.6000 for 2009.Also,Rs.30,000 has still to be received for 2008.Calculate the amount o be credited to Income and expenditure account in respect of subscription.

(ix) A Ltd., takes over B Ltd., on April 2009 and discharges the consideration for the business as follows:

(a) Issued 42,000 fully paid equity shares of RS.10 each at par to equity share holders 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 debenture holders of B Ltd., (RS. 50,000) will be converted into equal number of 13% debentures of A Ltd.

(x) Mention a few areas in which different accounting policies are encountered.

(8*2=16 marks)

6 *Answer any four out of the following:*

(a) A liquidator is entitled to receive remuneration @ 2% of the assets realized and 3% of the amount distributed among the unsecured creditors .The assets realized Rs.25,00,000 against which payment was nade as follows:

Liquidation expenses	Rs. 25,000
Preferntial creditors	Rs. 75,000
Secured creditors	Rs.10,00,000

Calculate the remuneration payable to the liquidator.

(a) Mention the costs that are excluded from the cost of inventories.

(b) Write a short note on carrying amount of investments.

(c) Write a note on treatment of assets like goodwill and reserves in amalgamation in the nature of Purchase.

(d) What are the advantages of self-balancing ledgers.

(e) A company had imported raw materials worth US Dollars 6,00,000 on 5th January,2007, when the exchange rate was Rs.43 per US Dollar. The company had recorded the transaction in the books at the above mentioned rate. The payment for the import transaction was made on 5th April, 2007 when the exchange rate was Rs.47 per US Dollar. However, on 31st March, 2007, the rate of exchange was Rs.48 per US Dollar. The company passed an entry on 31st March, 2007 adjusting the cost of raw materials consumed for the difference between Rs.47 and Rs.43 per US Dollar.In the background of the relevant accounting standard, is the company's accounting treatment correct? Discuss. **(4*4=16 Marks)**

AEC ACADEMY
28TH SESSION MODEL EXAM
ADVANCED ACCOUNTING
SUGGESSTED ANSWERS

1. Balance Sheet as at 1st October, 2008

Liabilities	Rs.	Assets	Rs.
Share Capital:		Fixed Assets:	
Authorized		Goodwill (W.N.6)	16,600
Issued and subscribed:		Plant and machinery	32,000
7,400 shares of Rs.10 each,			
fully called and paid-up	74,000		
		Current Assets:	
Secured Loans:		Cash at bank	20,000
14% secured debentures	36,000	Remaining net working capital	
		taken over	41,400
	1,10,000		1,10,000

Working Notes:

1. Revaluation Account

.	Rs.		Rs.
To Provision for bad debts account	4,800	By Premises	30,000
To Stock in trade	4,000		
To Bonus due to staff (unrecorded liability)	10,000		
To Profit transferred to:			
X's capital, (3/7)	4,800		
Y's capital, (2/7)	3,200		
Z's capital, (2/7)	3,200		
	30,000		30,000

2. X's share of goodwill =3/7* Rs.70,000= Rs.30,000
gaining ratio of remaining partners is 1:1.
Therefore, Y and Z will be debited with Rs.15,000 each.

3. X's Capital Accounts

	Rs.		Rs.
To Premises	80,000	By Balance b/d	30,000
To Cash/Bank A/c	800	By X's Current Account (transfer)	16,000
		By Revaluation Accounts (profit)	4,800
		By Y's capital Account (goodwill)	15,000
		By Z's capital Account (goodwill)	15,000
	80,800		80,800

Dr. Continuing Partners' Capital Accounts Cr.

	Y Rs	Z Rs.		Y Rs	Z Rs
To X's CapitalAccount(goodwill)	15,000	15,000	By Balance b/d	20,000	20,000
To Balance c/d	8,200	32,200	By Z's Current a/c		24,000
			By Revaluation profit)	3,200	3,200
	23,200	47,200		23,200	47,200

4. Balance Sheet of Y and Z as on 30th June, 2008

Liabilities	Rs.	Assets		Rs.
Y's Capital Account	8,200	Plant and Machinery		32,000
X's Capital Account	32,200	Stock-in-trade		36,000
Bank Overdraft	20,000	Sundry Debtors		48,000
Creditorsfor Suppliers	30,000			
for expenses	18,000			
for Bonus to staff	10,000	Less: Provision for Bad Debts	4,800	43,200
		Cash and Bank balances(80000-800)		
	1,18,400			1,18,400

Net Working Capital = Rs.(36,000 + 43,200 + 7,200 – 20,000 – 58,000) = Rs.8,400

5. Balance sheet of Y and Z as on 30th September, 2008

Liabilities	Rs.	Rs.	. Assets	Rs.	Rs.
Y's Capital Account:			Plant and Machinery		32,000
Balance on 1.7.2008 Rs	8,200		Net Working Capital:		
Add: Salary	1,500		As on 1.7.2008	8,400	
Share in profits	15,000	24,700	Add: Partners' salary	3,000	
X's Capital Account:			Profit	30,000	41,400
Balance on 1.7.2008	32,200				
Add: Salary	1,500				
Share in profits	15,000	48,700			
		73,400			73,400

	Rs.	Rs.
6. Consideration paid for business		90,000
Less: Plant and machinery taken over	32,000	
Net working capital	41,400	73,400
Amount paid for goodwill		16,600

	Rs.
7. Debentures to be issued = 40% of Rs.90,000	36,000
Cash to be paid = Rs.90,000 – Rs.36,000	54,000
Total cash required = Rs.54,000 + Rs.20,000	74,000

Hence, the company will issue 7,400 shares of Rs.10 each.

2. Trading and profit and loss account of Mr.Ram

	Rs.		Rs.
To opening stock	15,000	By Sales	289,375
To purchases	2,28,000	By Insurer	10,500
To Gross profit	57,875	By P&L a/c	1,000
	3,00,875		3,00,875
To rent	5,640	BY gross profit	57,875
To Rates	1,150	By Misc.receipts	3,050
To electricity	630	By rent received	2,250
To Salary	1,800		
To Accountant charges	375		
To Sundry expenses	650		
To bad debts	600		
To Fire loss-stock	1,000		
-fixtures	2,500		
To net profit	48,830		
	63,175		63,175

Balance Sheet as on 31-12-2008

Liabilities	Rs.	Assets	Rs.
Sundry creditors for goods	9000	Sundry debtors	20,000
Expenses unpaid		Cash in hand	1700
Electricity	80	Cash at bank	23650
Accountant charges	75	Insurance claim	20000
Rent	470	Rates paid in advance	650
Capital			
Opening balance 42,000			
Add :Profit 48,830			
Less: Drawings 33,955	56955		
	66500		66500

Cash Book (summary)

	Cash Rs.	Bank Rs		Cash Rs	Bank Rs
To Balance b/d	1,500	13,150	By Sundry receipts	12,600	215,800
To cash		241,970	By Fixtures		200
To Misc.Receipts		3,050	BY rent		5,170
To rent	2,250		By rates		1,350
To sundry debtors (bal.charge)	280,275		By accountancy charges		800
			By electricity		750
			By sundry expenses		650
			By drawings	25,955	8,000
			By Bank	241,970	
			By Salary	1,800	
			By Balance c/d	1,700	23,650
	284,025	258,170		284,025	258,170

Sundry Debtors Account

	Rs		Rs.
To Balance b/d	12,000	By Cash	280,275
To Sales	289,375	By Bad debts	600
		By Balance c/d	20,500
	301,375		301,375

Sundry Creditors Account

	Rs		Rs.
To cash and Bank	228400	By Balance b/d	9400
To Balance c/d	9000	By Purchases(bal. Figure)	228000
	237400		237400

Expenses Account

Particulars	Electricity Rs	Accountancy Charges Rs	Rent Rs	Rates Rs
Amount paid	750	800	5170	1350
Add: Outstanding on 31-12-2007	80	75	470	
Paid in advance on 1-1-2007				450
	830	875	5640	1800
Less: Outstanding on 1-1-2007	200	500	-	-
Paid in advance on 31-12-2008	-	-	-	650
	630	375	5640	1150

Cost of Sales is Rs.2,31,500;Gross profit is 25% of cost ,ie.,Rs.57,875.The amount of sales is therefore Rs.,2,89,375.

3. Bittu Ltd Cash Flow Statement for the year ended

	Rs.	Rs.
Cash flows from operating activities		
Net profit	76,500	
Adjustments for		
Depreciation (W.N.4)	27,900	
Profit on sale of plant (W.N.2)	(2,500)	
Accrued Interest on debentures for half year	2,000	
Operating profit before working capital changes	1,03,900	
Adjustments for:		
Increase in debtors less provision for doubtful debts	(46,700)	
Increase in stock and work-in-progress	(38,500)	
Increase in creditors	11,800	
Net cash from operating activities		30,500
Cash flows from investing activities		
Purchase of plant and machinery (W.N.1)	(78,000)	
Proceeds from sale of plant	7,000	
Proceeds from sale of freehold property (W.N.3)	6,200	
Increase in trade investments	(47,000)	
Net cash used in investing activities		(1,11,800)
Cash flows from financing activities		
Proceeds from issuance of debentures at discount	49,000	
Debenture interest paid	(2,000)	
Dividend paid in respect of earlier year	(30,000)	
Net cash from financing activities		17,000
Excess of outflows over inflows		(64,300)
Cash and cash equivalents at the beginning of the year		Nil
Cash and cash equivalents at the end of the year		(64,300)

Thus, the shortfall of Rs. 64,300 was made up through borrowings from bank.

Working Notes:

	Rs
1. Acquisition of plant and machinery: Rs.	
Amount of increase, at cost	60,000
Add: Cost of plant disposed of	18,000
Cost of plant and machinery purchased	78,000

2. Profit on sale of plant = Rs. 7,000 - (Rs. 18,000 - Rs. 13,500)
= Rs. 7,000 - Rs. 4,500 = Rs. 2,500

3. Proceeds from sale of freehold property:
Capital reserve 49,200
Less: Increase in freehold property (given) 43,000
Proceeds from sale 6,200

4. Depreciation on Plant and Machinery provided for the year:
Increase in Provision for Depreciation (given) 14,400
Add: Accumulated depreciation on plant sold 13,500
Depreciation for the year 27,900

4a)Step 1 Calculation of amount of short sales:	Rs.
Sales from 1-11-2007 to 28-2-2008	30,00,000
Add: 20% increase expected in current year	6,00,000.
	36,00,000.
Less: Sales from 1-11-08 to 28-2-2009	4,00,000.
	32,00,000

Step 2:
Calculation of rate of gross profit:

G/P ratio= $\frac{\text{Net profit+ standing charges}}{\text{Sales}}$ *100.

=$\frac{7,00,000+7,25,000}{95,00,000}$ *100

=15%.

Step 3:
Calculation of loss of profit s on short sales:

15% on short sales.
=15/100*32,00,000
+4,80,000.

Step 4
Claim for Loss:

=Loss of profit*Amount of policy/Gross profit on preceding 12 months sales.
=4,80,000*12,00,000/15,00,000
=Rs.3,84,000.

Gross profit on sales for 12 months preceding the date of fire 15% on Rs.1,00,00,000=Rs.15,00,000.

4b)
Profit=50% on cost=1/3 on sales

Hire purchase trading account

Particulars	Rs	Particulars	Rs
To opening balance		By cash	450000
Hire purchase stock	67500	By goods repossessed	3750
Hire purchase debtors	37500	By goods sold on HP 652500*1/3	217500
To goods sold on HP	652500	By stock reserve (67,500*1/3)	22500
To stock reserve (225000*1/3)	75000	By closing balance	
To General P&L account	153750	Hire purchase stock	225000
		Hire purchase debtors	67500
	986250		986250

5(i)

		Rs.	Rs.
Insurer a/c	Dr.	40,00,000	
To Joint Life Policy			60,000
To Joint life policy reserve a/c			39,40,000

(Being the amount agreed by the insurance company on the death of the partner.)

Joint life policy reserve a/c	Dr.	40,00,000	
To Ravi's capital a/c			20,00,000
To Raghavan's capital a/c			20,00,000.

(Being the profit from the joint life policy shared among the partners)

Bank a/c	Dr.	40,00,000	
To Insurer a/c			40,00,000

(Being the policy amount received)

5(ii)

		Rs.	Rs.
Bank a/c	Dr.	4,75,00,000	
Loss on issue of debenture's a/c	Dr.	25,00,000	
Discount on issue of debentures a/c	Dr.	25,00,000	
To Debenture's a/c			5,00,00,000
To Premium on redemption of debenture's a/c.			25,00,000

(Being the issue of 50,000 debentures of Rs.1000 each at a discount of 5% and redeemable at a premium of 5%)

5(iii)

Mr Short in Account current with Mr.Long
(taking Feb.24 as the base date)

Date	Particular	Due date	Rs.	Day	Product	Date	Particular	Due date	Rs.	Day	Product
2/1	To Sales	5/3	1000	9	9000	21/1	By Purchases	24/2	500	0	0
16/2	To Sales	19/4	700	54	37800	8/3	By Purchases	11/4	944	46	43424
22/3	To Sales	25/5	840	90	75600	15/4	By Purchases	18/5	340	83	28220
									756		50756
			2540		122400				2540		122400

Average due date=Feb 24+50,756/756

=Feb 24+67 days
=May 2.

On May 2,Mr.Short should pay Rs.756 to Mr.Long.

5(iv)

In the books of the head office

	Rs.	Rs.
Branch a/c	Dr.800	
To Purchases A/c		800

(Being the rectification of wrong debit to purchases for goods purchased for branch)

In the books of the branch

Purchase a/c	Dr.800	
To Head office a/c		800

(Being purchases paid for by head office)

5(v)

The advantages of using an ERP package are:

1. Standardized processes and procedures : An ERP is a generalised package which covers most of the common functionalities of any specific module.

2. Standardized reporting : Majority of the desired reports are available in an ERP package. These reports are standardised across industry and are generally acceptable to the users.

3. Duplication of data entry is avoided as it is an integrated package.

4. Greater information is available through the package.

5(vi)

Red ink interest: In an Account Current, interest is calculated on the amount of a bill from the date of transaction to the closing date of the period concerned. In case the due date of the bill falls after the closing date of the account, then no interest is allowed for that period. Such interest is customarily written in red ink in the appropriate side of the Account Current. This interest is called Red-Ink Interest and is treated as negative interest.

5(vii)

Firm under-writing: 'Firm underwriting' signifies a definite commitment by underwriters to take up specified number of shares irrespective of the number of shares subscribed for by the public. In such a case, unless it has been otherwise agreed, the underwriter's liability is determined without taking into account the number of shares taken up 'firm' by him. In other words, the underwriter is obliged to take up:

1. The number of shares he has applied for 'firm'; and

2. The number of shares he is obliged to take up on the basis of the underwriting agreement.

5(viii)

		Rs.	Rs.
Amount received			4,20,000
Add: outstanding on 31st Dec.,2008			30,000
			4,50,000
Less: Received on account of	2007	16,000	
	2009	6,000	22,000
Subscription to be credited to Income and Expenditure account			4,20,800

5(ix)

	Rs.	Rs.
Equity Shares(42,000*10)		4,20,000
Preference share capital	1,70,000	
Add premium	17,000	1,87,000
Purchase consideration		6,07,000

5(x)

Following are some of the areas in which different accounting policies may be adopted by different enterprises:

(i) Methods of depreciation, depletion and amortization.

(ii) Treatment of expenditure during construction.

(iii) Valuation of inventories.

(iv) Treatment of goodwill

(v) Valuation of investments.

(vi) Valuation of fixed assets

6 (a)

Computation of Liquidator's Remuneration

		Rs.
(i)	2% of the assets realized: 2% of 25,00,000	50,000
(ii)	3% of Preferential Creditors of Rs.75,000	2,250
(iii)	3% of amount distributed among unsecured creditors 13,47,750*3/100	39,255
Total		91,505

Working note:

Amount available for Unsecured Creditors:

	Rs	Rs.
Total assets realized		25,00,000
Less: Liquidation expenses	25,000	
Preferential creditors	75,000	
Secured Creditors(presuming they are to be paid out of assets realized)	10,00,000	
2% on Assets realized ie on Rs.25,00,000	50,000	
3% on Preferential creditors	2,250	11,52,250
Amount available to Unsecured creditors including liquidator's remuneration on payment to Unsecured creditors		13,47,750

6 (b)
In determining the cost of inventories, it is appropriate to exclude certain costs and recognize them as expenses in the period in which they are incurred. Examples of such cost are:

(i) Abnormal amounts of wasted materials, labour, or other production costs.
(ii) Storage costs, unless production process requires such storage.
(iii) Administrative overheads that do not contribute to bringing the inventories to their present location and condition.
(iv) Selling and distribution costs.

6(c)
The carrying amount for current investment is the lower of cost and fair value. Valuation of current investments on overall basis is not considered appropriate. The more prudent and appropriate method is to carry investments individually at the lower of cost and fair value. Any reduction to fair value and any reversals of such reductions are included in the profit and loss statement.

Long-term investments are usually carried at cost. Where there is a decline, other than temporary, in the carrying amount of long-term investments, the resultant reduction in the carrying amount is charged to profit and loss statement. The reduction in carrying amount is reversed when there is a rise in the value of the investment, or if the reasons for the reduction no longer exist.

6(d)
Any excess of the amount of the consideration over the value of the net assets of the transferor company acquired by the transferee company should be recognised in the transferee company's financial statements as goodwill arising on amalgamation. If the amount of the consideration is lower than the value of the net assets acquired, the difference should be treated as Capital Reserve. The goodwill arising on amalgamation should be amortized to income on a systematic basis over its useful life. The amortization period should not exceed five years unless a somewhat longer period can be justified.

Where the requirements of the relevant statute for recording the statutory reserves in the books of the transferee company are complied with, statutory reserves of the transferor company should be recorded in the financial statements of the transferee company. The corresponding debit should be given to a suitable account head (e.g., 'Amalgamation Adjustment Account') which should be disclosed as a Part of 'miscellaneous expenditure' or other similar category in the balance sheet. When the identity of the statutory reserves is no longer required to be maintained, both the reserves and the aforesaid account should be reversed.

6(e)
Following are the advantages of self-balancing ledger system:

(i) It fixes the responsibility on the ledger keeper who had to balance the ledger. The error is localised.
(ii) Interim accounts can be prepared without personal ledger to be balanced.
(iii) The total amount due from debtors and total amount payable to suppliers and creditors is readily available.
(iv) The maintenance of general ledger would be easy as the voluminous debtors and creditors details are maintained in control accounts.

6(f)
As per AS 11 (revised 2003), 'The Effects of Changes in Foreign Exchange Rates', monetary items denominated in a foreign currency should be reported using the closing rate at each balance sheet date. The effect of exchange difference should be taken into profit and loss account. Sundry creditors is a monetary item, hence should be valued at the closing rate i.e, Rs.48 at 31st March, 2007 irrespective of the payment for the same subsequently at lower rate in the next financial year. The difference of Rs.5 (48-43) per US dollar should be shown as an exchange loss in the profit and loss account for the year ended 31st March, 2007 and is not to be adjusted against the cost of raw- materials. In the subsequent year, the company would record an exchange gain of Re.1 per US dollar, i.e., the difference between Rs.48 and Rs.47 per Us dollar. Hence, the accounting treatment adopted by the company is incorrect.

YAZ

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

Answer question nos. 1 and 2 and any four from the rest.

1. As an auditor, comment on the following:

a. In cases were audit sample selection has been done on a random basis, no statistical process for selection of samples need to be followed'. (Marks 5)

b. A Ltd., wanted to treat the heavy advertisement expenditure incurred by them to launch a new product as Revenue Expenditure. The product did not pick up and the sales were negligible. It is anticipated that no material benefit will accrue in future from such heavy advertisement expenditure. (Marks 5)

c. A company has made addition to its factory buildings by its own workmen, at a cost of Rs.4,50,000 for wages and materials. The lowest estimate form an outside contractor to carry out the same work was Rs.6,00,000. The directors contend that as they were fully entitled to employ an outside contractor, it is reasonable to debit the factory building account with Rs.6, 00,000. (Marks 5)

d. During the year under audit, A Ltd, credited to the P & L A/c, the entire profit of Rs.5 lakhs on the sale of land not required for its use. You are informed that directors would like to propose dividend out of above profit. (Marks 5)

2.

a. E and S were appointed as Joint Auditors of X and Y Ltd. What will be their professional responsibility in a case where the company has cleverly concealed certain transactions that escaped the notice of both the auditors? (Marks 4)

b. As an auditor, how would you react to the following situation. A Ltd, requiring to make and maintain cost accounts and records contends that the auditor need not report on the non-maintenance of cost records because the provisions of cost-audit were not made applicable to it. How would you react to the above situation? (Marks 4)

c. Mr. Rajendra, a fellow member of the Institute of Chartered Accountants of India, work as a manager of Shrivastava & C0., a Chartered Accountant firm, signed the audit report of OM Ltd., on behalf of the Shrivastava & Co. (Marks 4)

d. A company had a branch office, which recorded a turnover of Rs.1,99,000 in earlier year. The auditor's report of the earlier year had no reference regarding the branch audit had not been carried out by the statutory auditor. Comment. (Marks 4)

3.

(a) As an internal auditor, design an efficient system of internal controls for cash receipts. (Marks 8)

(b) What are the special steps involved in conducting the audit of an educational institution? (Marks 8)

4. Write short notes on-

(a) Organisation and operational controls
(b) Systems development and documentation controls
(c) Hardware controls
(d) Access controls (4 x 4 Marks)

5.

(a) State any four principal aspects to be covered in audit. (Marks 4)

(b) Explain the advantages of audit working papers. (Marks 4)

(c) What are the methods of selecting the sample items under AAS-15? (Marks 4)

(d) What is the need for identification and disclosure of related party and related party transactions. (Marks 4)

6. What are the qualifications, disqualifications, appointment, powers and duties of Cost Auditor? (Marks 16)

7. (a) What are the objectives of AAS-16? Mention indicators of potential going concern problem. Name some mitigating factors. (Marks 8)

(b) Write a short note on- audit of Government expenditure. (Marks 8)

8. Explain the following:

(a) Option on share capital

(b) Sweat equity shares

(c) Qualified audit report

(d) Auditor’s right on lien

(4 x 4 Marks)

AEC ACADAMY
28^{th} SESSION MODEL EXAM
ADVANCED AUDITING
SUGGESTED ANSWERS

1(a)

Importance of sample selection

AAS-15, Audit Sampling, has defined audit sampling as 'the process of applying audit procedures to less than hundred per cent of a population in order to estimate some characteristic about population'. Sample selection crucial to the process of audit sampling. AAS-15 points out that a sample can only be expected to be representative of the population if:

(i) it is drawn from the whole population;
(ii) all sampling units have an equal chance of being selected.

Use of random sampling – If a sample is selected at random, it would be representative one. The sample selection should be done by using random number tables. This ensures freedom from bias.

Following statistical process – In case the random sample has been selected by using random number tables or using computers, there is no need to follow statistical process for sample selection as the sample would be a representative one. In fact, selection of an audit sample on random basis is the pre-requisite for application of statistical techniques.

1(b)

An expenditure is treated as revenue expenditure if benefits are not like to extend for more than one year. In the present case the sales of the product are negligible. Therefore, treat it is as revenue expenditure even if the amount is heavy as no future benefits expected.

1(c)

As per the requirements of AS-10, Accounting for fixed assets, cost of a self – constructed fixed asset should comprise of those costs which relate directly to the asset; and those which can be attributed to the construction activity in general and can be allocated to that specific asset. Any internal profits are ignored.

In the present case, the contention of the directors is not acceptable as it goes against the requirements of AS-10 (stated above). The company should capiutalise only Rs.4,50,000 as cost of the factory.

1(d)

As per the decision of the courts in Lubbock v. The British Bank of South America Ltd. And Foster v. The New Trinidad Lake Asphalte Co. Ltd. Capital profits can be distributed as dividends if the articles of the company permit it, surplus is actually realized and it remains after a proper valuation of the whole of assets and liabilities.

In the present case, profit of Rs.5 lakhs in the sale of land is capital profit and can be used by directors to declare dividends if the above conditions are satisfied.

2(a)

(i) AAS-4 has laid down auditors' responsibility for detection of frauds and errors.

It states that when planning and performing audit procedures and evaluating and reporting the results thereof, the auditor should consider the risk of material misstatements in the financial statements resulting from fraud or error.

The auditor has to provide reasonable assurance that no material misstatements resulting from fraud or error exist in the financial statements.

(ii) AAS-12 deals with the responsibilities of joint auditors.

Each joint auditor is entitled to assume that the other joint auditor has carried out their part of audit work in accordance GAAP.

Joint auditors have individual responsibility for certain aspects of work and joint and several responsibility for certain areas.

(iii) Given situation

In the present case, if we read AAS-4 and AAS-12 together and assume that both the joint auditors E and S has exercised reasonable care and skill to discharge their responsibilities, they would not be held liable for discovering the concealment.

In case X and Y Ltd. Can establish professional negligence on the part of E and S, we can held them liable for not exercising reasonable care and skill.

2. (b)

(i) Legal provisions

Section 209 (1) (d) empowers the Central Government to make it compulsory in case of specified classes of companies to maintain cost records.

The Central Government may order audit of cost records maintained under section 209 (1) (d) according to provisions of section 233B.

Section 227 (3) includes cost records in the term proper books of account on which the auditor has to expression opinion on.

(ii) In the given situation section 209(1) (d) is applicable to the company though section 233B is not applicable. The auditor should not accept the management's contention since he would not be discharging his duty under section 227(3) if he accepts it.

2. (c)

Signing of audit report

(a) Section 229 has laid down that only the person appointed as auditor of the company can sign the auditor's report or sign authenticate any other document of the company as required by law to be signed or authenticated by the auditor.

(b) This section further lays down that in case a partnership firm is appointed as an auditor, then only a partner of the firm practicing in India can do so.

(c) AAS-28 has emphasized that an audit report should be signed by the auditor in is personal name and in case of a firm being appointed, in the name of audit firm also. Membership number assigned by the ICAI should also be mentioned

In the present case, Mr.Rajendra though a fellow of ICAL, is not a partner of Shrivastava & Co. He is a manager there. On the basis of the provisions of section 229 and the requirements of AAS- 28, we can conclude, he cannot sign the audit report of OM Ltd. It should have been signed by one of the partners of the firm.

2(d)

(i) Legal requirements

As per the Companies (Branch Audit Exemption) Rules, 1961, a branch Office of a company shall be exempt from audit if it satisfies the following conditions-

The company is carrying on any manufacturing, processing or trading activity.

The average quantum of activity does not exceed Rs.2 lakhs or 2% of the average total turnover of the company, whichever is higher.

The company auditor shall expressly state in his audit report that the branch office is exempt by virtue of quantum of activity criterion.

(ii) IN the given case-

If it is assumed that quantum of activity for branch for earlier years was less than Rs.2 lakhs. For the present financial year also the turnover is less than Rs.2 lakhs. Hence, based on above rules, it is exempted from audit.

It is also assumed that new auditor has been appointed for current financial year. The auditor should mention the fact of the branch office being exempted from audit in his report. However, new auditor is not responsible for no reference in auditor's report to the fact to branch exemption.

3(a)

Cash receipts (including from debtors) – Internal control system for all types of cash receipts is similar in design. The following discussion suggests the elements if internal control system for cash receipts from debtors which can be extended to cash receipts from dividends, interest on investments, proceeds from sale of assets or scrap materials and other similar sources.

(i) INTERNAL CHECK

Internal check with regards to recording of cash received from debtors is summarized as follows.

INTERNAL CHECK WITH REGARDS TO CASH RECEIVED FROM DEBTORS

Function	Department / official / clerk	Related activities	Documents or records
1. Receiving mail receipts	Mailroom	Opening of mail receipts.	--
2. Prelisting of cash receipts	Mailroom	Prepares prelisting of cash receipts; restrictively endorses cheques and sends remittance advices and cheques to the clerk.	Prelist of cash receipts remittance advice.
3. Deposit of money into the bank.	Cashier	Records collection from customers in the cash receipts journal and deposits cash and cheques in banks, sends remittance advice to the clerk maintaining customers' accounts or accounts receivable ledger.	Cash receipt journal, pay-in-slips
4. Posting credit	Accounting /	Posts credits to customers'	Customers'

to customers' account	Finance	accounts.	accounts.
5. Comparison	Clerk independent of cash receipts duties.	Compare prelisting with entries in cash receipts journal, bank statement and accounts receivable ledger.	Bank statement, accounts receivable ledger

(ii) PHYSICAL CONTROLS

The most important form of physical control for cash receipts is limited access. Only the individual preparing the cash receipts listing and cashier should have access to the receipts. Cashier should be denied access to receivable records.

Companies with large volume of mail receipts sometimes use a lock-box system to strengthen internal control and hasten the depositing of cash receipts. The lock-box is actually a post office box controlled by the company's bank. The bank picks up the mail daily, credits the company for cash and sends the remittance advices to the company. Internal is strengthened by the fact that the bank has no access to the company's accounting records.

(iii) AUTHORISATION PROCEDURES

Authorisation of cash transactions embodies procedures for opening and loosing bank accounts, identifying employees who are authorised to handle cash and those responsible for approving discounts given to customers on making payments on accounts.

(iv) MONITORING SYSTEM

This is performed by the internal auditor. He may help the management in cash forecasting, suggest ways to streamline cash procedures, to accelerate / decelerate cash outflows and to utilize cash funds better

(v) OTHER RECEIPTS

For designing internal control system for other types of receipts, the basic characteristics remain the same segregation of duties with respects to receiving of receipts, prelisting, deposit of money into bank and a system of other procedures to prevent loss of cash, inaccurate calculations and recording in wrong accounts. Physical controls and Authorisation procedures should also form an important part of the system.

3(b)

The auditors of college are, generally, appointed by the management or the trust society under whose ageis the concerned institution functions and in case of university, appointment of the auditors is according to the provisions of statute governing it. The audit exercise could broadly be divided into following parts:

(i) **Preliminary work** – The auditor should try to obtain knowledge about the institution. He should

(a) Note the provisions of applicable statute.
(b) Examine the rules or trust deed as applicable.
(c) Examine the minutes of the meeting of the managing committee/governing body/ board of trustees, and any other committee to know any important decision affecting the accounts e.g., construction of seminar room, appointment of additional teaching staff, etc.
(d) Study and evaluate the accountings system and internal con trolls in order too determine the extent of audit procedures to be performed to verify receipts payments, assets and liabilities.

(ii) **Receipts**

(a) Fees from students

Examine the bills raised for fees and compare them with fee collection register to ensure their recording in it. Ascertain whether the amount receivable from students under different heads have been shown correctly in the bills. Further, examine if these bills are based on rates specified for each category of students and whether the names of all students on the roll of the institution have been duly entered in the face collection register.

Examine whether fee concession and waiver of fees have been given to students as per rules.

Verify the entries in the fee collection register with reference to counterfoils of receipts issued payments and bank pass book and statement, if money is deposited directly or by the institution itself.

Examine the statement of reconciliation of fees to ascertain the correct amount of recoverable fees. [Total of recoverable fees during and at the beginning of the year less Total fees recovered during the year]

If the institution has hostel facilities for students, the auditor should verify the bills raised for accommodation charges, electricity charges, fines, etc. He should also verify the entries on the hostel charges collection register with reference to counterfoils of receipts issued and bank pass book.

(b) Donations and endowments

They should be verified with reference to counterfoils of receipts issued to the donors. The auditor should also ensure proper recording of such amount in separate accounts depending upon their nature and purpose i.e., towards corpus fund or for specific purpose (e.g., grant of awards, etc.) or for general purposes.

(c) Other receipt

Examine whether **Interest due on investments** has been received. Verify interest receipts with reference to investment register and bank pass book.

Verify receipt of **rent** with reference to copies of lease deed or rent deed; counterfoils of receipts issued and bank pass book. Examine records relating to temporary let out of the premises e.g., for examinations, etc. and verify whether charges have been recovered at the stipulated rate.

Verify the **grants received** with reference to the sanction letter and ensure their proper classification into capital and revenue.

(iii) Expenditure – The following audit procedures may be adopted to verify expenditure under various heads:

(a) Salaries should be verified as follows:

Examine whether salaries and allowances paid are in accordance with the terms and conditions of appointment of each category of staff.

Examine the gross remuneration payable and the deductions on account of income-tax, providend fund, advance taken etc. Verify with reference to original evidence (e.g., receipted challans) timely deposit of these deductions with the proper authorities.

Vouch payments of salaries and allowances with reference to acknowledgements from the employees and trace in the bank statements.

Examine whether salaries and allowances of teaching and non-teaching staff are properly segregated.

(b) **Disbursal of scholarships** to students be verified with reference to acknowledgements from the students who received them. The auditors should endure that the criteria laid down by the institution or the donor has been adhered to.

(c) Examine the books/prize given to students with reference to relevant vouchers.

(d) Verify payment of charges for hostel such as repairs, electricity and water charges, etc. With reference to bills, receipts, etc. The auditors should examine records relating to purchases, consumption and stock of foodgrains.

(e) Examine **utilization of grants** with reference to supporting vouchers, entries in the cash books, entries in bank statements, minutes of the managing committee and utilization certificates, if any. Enquire about unauthorized expenditure out of grants and ascertain whether such amount is being claimed back.

(iv) Assets

Verify in usual manner fixed assets. Ensure that depreciation charged is adequate and his been properly disclosed.

(v) Liabilities

(a) Corpus or capital should be verified with reference to the last year's audited statements. The auditor should examine relevant documents, correspondence which has led to increase in corpus during the year due to contribution by trustees, members, etc., donations in cash and in kind (e.g., fixed assets, shares), etc.

(b) Examine the payment out of earmarked funds with reference to the authority and assess whether requirements of the trust deed and other rules and regulations with regard to earmarked funds have been complied with.

(c) Verify security deposits received from the students during the year with reference to the collection register and counterfoils of receipts issued for payments. Any refund of such security deposits should be verified with reference to the acknowledgements from them.

4(a) Orgainsation and operational controls. These controls relate to plan of the orgainsation and operation of EDP activity.

In order to ensure efficiency and effectiveness of operations it is important that plan of orgainsation should include:

Segregation of EDP department from source and user departments;

Segregation of functions within the EDP department.

Segregation of EDP department from source and user departments – The EDP department should be independent of all sources and user departments which provide input data for, or use output generated by it. EDP departments is involved in recording (processing of transactions) and thus, should not initial to or authorise them.

Segregation of functions within the EDP department – Care must be taken to ensure adequate separation of duties within the EDP department. The general responsibilities of each function for a large EDP department are summarized as follows

EDP FUNCTIONS AND RELATED RESPONSIBILITIES

Function	General responsibility
EDP Manager	Has overall charge of the data processing activities.
1. System Analyst	Design new systems and modify existing systems in accordance with the information needs of the users.

2. Programmers	Write, edit and test machine-readable computer programmes based on the system design and / or users.
3. Computer Operators	Process transaction through the system in accordance with the operator instructions for the application.
4. Librarian	Maintains custody over master files and programmes and permits access only on the basis of proper authority.
5.Data Control Group	Distributes output and performs internal audit function for EDP department.

4(b)System development and documentation controls – Systems development and documentation controls are designed to monitor, design, develop, test and document the systems and programmes constituting each application. These include-

¾ Participation by user groups and accounting and internal auditing staff in systems design.

¾ Joint system testing by user department and EDP personnel and its approval.

¾ Documentation creation and maintenance.

Various activates to be included to make effective such controls are mentioned in Table 6.2

SYSTEM DEVELOPMENT AND DOCUMENTATION CONTROLS

Control	Activities included
1. Participation in systems design	1. User groups should communicate their specific in formation need to systems analyst; accountants may have interest in systems output and internal auditor may wish to implement computer assisted audit techniques.
2. Joint system testing and obtaining approval	2. Testing of application should be undertaken and modifications, if any made. Ensure Output from the application meets a user department's information need. Approval should be obtained from appropriate level Of management, EDP and user Departments before placing the system.

3. Documentation creation and maintenance	3. There must be adequate documentation of a system design. Documentation ordinarily assumes the form of flow charts; programme documentation which includes programme flow charts, programme changes and evidence of their approval and programme description explaining the purpose for each part of a programme and programme run instructions which consists of specifying the nature and format of input, detailed operating instructions, possible errors and nature and format of output. There should be adequate documentation evidencing authorisation, testing and approval of programme changes.

4(c) **Hardware controls** – Hardware controls are built into the computer equipment by the manufacturer to detect equipment failure. Some particularly common hardware controls are:

Echo check: It implies data from a terminal when sent to central computer (output) is transmitted back to it (input) for comparison. Error signals are emitted, if necessary. It is used primarily, in telecommunications transmission.

Parity check: It is a check designed to detect errors in data transfer. Data are processed by the computer in arrays of bits i.e., binary digits of 0 or 1. Every alphabet, numeral or symbol is represented or symbolic characters, a parity bit is added, when necessary, to make the sum of all the '1' bits always odd or even. Parity check ensures that bits are not lost during transfer of data within the computers. Error signals are emitted if an odd numbered digit results when an even number is expected or vice versa.

Dual read: It implies that input data are read twice and two readings are compared.

Read after write: Under this, the computer reads back the data after they have been recorded, either in storage or on the output device back to the source unit for comparison with the original data.

In majority of cases, built-in hardware controls are adequate and reliable. Nevertheless, the entity must design a system to follow up and resolve errors, if detected. The auditor's focus, in case of hardware controls, is towards such detection and follow up system rather than the control themselves.

4(d) Access controls

In order to prevent unauthorized use of data files, programmes and their support documentation and EDP hardware, access must be limited to authorised individuals.

Access to data files, programmes and their documentation can be achieved by fixed responsibility on a person designated as librarian who would require authorised documentation to obtain any data file, programme or documentation from him.

Control over passwords in another way to limit access to files and programmes.

Access to computer hardware should be limited to authorised personnel and can be restricted through locked doors and security personnel.

5. (a)

(i) Internal control system:

Examination of the system of accounting and internal control to ascertain whether it is appropriate for the business and helps in properly recording all transactions.

Tests and enquiries to ascertain whether the system is in actual operation so that the auditor can form an opinion as to whether reliance can be placed on records as a basis for the preparation of the statements of account.

(ii) Review of systems and procedures

Review of the systems and procedures to find out whether they are adequate and comprehensive and, incidentally, whether material inadequacies weakness exists to allow frauds and errors going unnoticed.

(iii) Routine checking / Arithmetical accuracy

Examination of arithmetical accuracy of the books of account by verification of postings, balance, etc.

(iv) Vouching

Inspecting a document that supports a recorded transaction in order to verify the authority and authenticity of such a transaction.

(v) Accounting principles

(a) Ascertain that a proper distinction has been made between items of capital and revenue nature.

(b) Ensure that the amounts of various items of income and expenditure have been adjusted in the accounts corresponding to the accounting period.

(vi) Books and statements

Comparison of the balance sheet and profit and loss account or other statements with the underlying records in order to see that they are in accordance therewith.

(vii) Verification of assets

A process of substantiation of assets recorded in the books of account, by means of physical inspection and examination of legal and official documents and then forming an expert opinion as to existence, ownership, possession, classification and valuation of assets of an entity.

(viii) Verification of liabilities

Process of substantiation of liabilities recorded in books of account by examination of legal and official documents and then forming an expert opinion as to existence, obligation, completeness, valuation and disclosure of liabilities of an entity.

(ix) True and fair view

Examine the results shown by the profit and loss accounts and to see whether the results shown are true and fair.

(x) Statutory compliance

IN case of audits of corporate bodies, confirm, that the statutory requirements have been complied with.

(xi) Report

Report to the appropriate authority whether the statement of accounts examined actually reveal and fair view of the state of affairs and of the profit (or loss) earned (or incurred).

5(b)

Functions / Advantages of audit working papers – Audit working papers assist auditors in several major ways. AAS-3 'Documentation' stipulates that working papers has three functions / advantages: (1) Aid in planning and performance of audit, (2) Aid in supervision and review of the audit work and (3) Provide evidence of the audit work performed to support the auditor's opinion.

These are explained below:

(i) Organising and conducting the audit –

Working papers constitute proof of validity of client's records. They contain necessary and diverse reference information such as audit programmes, results of preceding years' audit, descriptive information about internal system, etc. Which can be used by the auditor in Organising and coordinating all phases of performance of audit and forming an opinion.

Working papers an also aid in planning and conducting a subsequent audit by providing information relevant for such an audit. For example, the previous years' working papers contain information on how much time was required to perform audit of a particular area / item, provide insight into the client's internal control structure and explanatory comments about accounting system.

(ii) Supervising and reviewing the work of assistants -

Staff assistant complete working papers and they are reviewed by senior staff members and in case of any problem / discrepancy found or any doubt raised, the concerned assistant is asked to revise the working paper.

After the senior is satisfied, the auditor would review the working papers as to their adequacy, completeness, arrangement and cross-referencing.

He may decide to perform such additional or modified procedures during the course of audit as are considered being necessary by the review of working papers.

Substantiating the auditor's report – Working papers contain the details of sufficient appropriate evidence and adequate documentation serves as basis for issuing an opinion. In the event of law suit filed against the auditor alleging negligence and fraud, working papers can serve as a proof of Defence for him.

To sum up, we can say that working papers said the auditor in many ways but as they are principal record of the extent of audit procedures applied and evidence gathered during the audit working papers should be carefully prepared.

5(c)

Three methods of sample selection have been mentioned under AAS-15. These are:

Random selection
Systematic random sapling
Haphazard Selection

Random selection

Random sampling is a method of sampling in which sample is selected at random i.e., in a manner that ensures each element in the population has an equal chance of being selected, for example, by use of random number tables.

Systematic random sampling

Under this method every item out of a selected to make a sample and 'n' being the sampling interval. The first number is picked randomly.

Haphazard selection

This method is an acceptable alternative to random selection,provided theauditor 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, he has to take guard against making a selection that is biased, for example, towards items which are easily located, as they may not be representative.

5(d)

Need for identification and disclosure of related parties and related party transactions – As per AAS-23, 'Related parties, although it is the responsibility of management to establish accounting and internal control systems, to ensure appropriate identification and disclosure of related parties and transactions with them, the auditor should also do the same due to following reasons-

(i) to ensure adhere to disclosure requirement of accounting standards (such as AS -18)

to assess the effect on financial statements(for example, some transaction may be mere book entries);

to assess the reliability of audit evidence (e.g. management representations);and

to identify motivation for related party transactions (for example, lack of sufficient working capital, excess capacity of one of related parties);

6

Qualifications of cost auditor – Section 233B prescribes the qualifications of a cost auditor. The cost audit can be conducted by –

A cost accountant within the meaning of the cost and Works Accountants Act,1959

A firm of cost accountants if all the partners of affirm are practicing cost accountant ants, and the firm itself has been constituted with the previous approval of the Central Government. the audit repot, in this case, shall be signed by any one of the partners of the firm for and on behalf of the firm.

A chartered accountant having prescribed qualifications, if the Central Government is of the opinion that sufficient number of cost accountants are not available for conducting the audit of cost accounts of the companies. However, it issue a notification with regards to this and has to specify period for which notification is applicable.

Disqualifications of cost auditor – The disqualifications of a cost auditor are listed below:

A person cannot be appointed as a cost auditor of a company if he attracts any of the disqualifications mentioned under section 226(3) and 226 (4).

A person appointed under section 224 as an independent financial auditor, shall not be appointed or reappointed for conducting the audit of the cost accounts of a company.

A person who is an employee or a partner of the company auditor or an employee of any of the partners of a firm of chartered accountants which is appointed as the company's auditor under section 224.

Internal auditor of the company cannot also be the cost auditor. As per notification issued by the Department of Company Affairs, cost auditor should not be the internal auditor of a company for the period for which he is conducting the cost audit. The cost auditor is required to comment on the scope and performance of internal audit as per the provisions of the Cost Audit (Report) Rules, 2001.If the cost auditor is also the internal auditor he would not be able to discharge his duties properly and dispassionately.

Appointment of cost auditor

The cost auditor is appointed by the board of directors of the company on receipt of the order of the Central Government. Such an appointment is made through a resolution passed either in the board's meeting or by circulation and is subject to the approval of the Central Government. Normally, prior concurrence of the Central Government is obtained before passing a resolution. The board of directors, before appointment of the auditor, shall obtain a certificate from the cost auditor to effect that the proposed appointment, if made, will be in accordance with the ceiling prescribed in the case of an auditor under section 224 (1B).

Powers of cost auditor

The cost auditor has the same powers regarding cost audit as an auditor of a company under section 227 (1) has. However, if with one hundred and thirty five days of the end of financial year the company and its officers do not make available to the cost auditor such cost accounting record, statements and other books and papers as required for the cost audit, he has to intimate this to the Central Government within ten days after expiry of the aforesaid period.

Duties of cost auditor

The cost auditor has duties similiar to those of the auditor appointed under section 224 (1). However, he does not submit his report to the shareholders. He has to make his report to the Central Government in such form and within such time as may be prescribed. At the same time, he has to forward a copy of the report to the company.

7 (a)

Objectives

Evaluate whether the going concern concept is applicable to the company's circumstances; and

Consider whether the entity will continue for a foreseeable future (means a period not to exceed one year after the balance sheet date.)

Indicators of potential going concern problem

The entity's inability to continue as a going concern may be indicated by various factors. Some potential indicators of going concern problem can be grouped as :-

(a) Negative trends
* Negative working capital
*Adverse key financial ratios
* Recurring losses
* Short term finance for long Term needs

(b)Internal matters
* Loss of key personnel
* Labour problem
* Soaring stock levels
* Out-dated products

(c) External Matters
* New legislation
* Pending litigation

(d) Other matters
* Default on a loan
* Inability to pay dividends
* Restructuring of a debt
* Restrictions placed on trade terms e.g., change from credit to cash and delivery Transaction with suppliers.

(iii) Mitigating factors – may include group support, rescheduling of loan repayments, alternative sales market and reducing level of operations, etc.

7(b)

Audit Of Expenditure

All expenditure of Government is subject to ascertain whether it was made for the specified purpose (audit of provision of funds), complied with rules and order (audit for rules and order), money for it was legally available (audit of sanction) and dye regard has been given to principles of financial propriety (audit of financial propriety)

Audit of provision of funds – In audit of provision of funds, the auditor tries to examine whether the expenditure has been made for specified purpose. The legislature exercises its financial control over the executive spending through audit of provision of funds and Appropriation Act is the principal instrument used by it for such audit.

Thus, audit of provision of funds is designed to:

Examine whether the money has been spent for the purpose specified in the Appropriation Act.

Ascertain that total expenditure against each item does not exceed the amount sanctioned under the Appropriation Act.

Audit for rules and orders – The important aspects of audit of rules and orders are as under :

The expenditure including payment for claims incurred is according to requirements of rules and orders.

All payments to Government servants have been made according to rules and orders regulating the pay, allowances, pension and other conditions of service.

The rules, regulations and orders made for made for payments are not contrary to the provisions of the Constitution or laws or requirements of audit and accounts as determined by the Comptroller and Auditor General.

Further, they should not conflict with the rules, orders, etc. made by any higher authority.

Audit of sanctions – In sanction audit, the auditor examines whether the expenditure is covered by a sanction which may be general or special and satisfies himself that the sanctioning authority is competent to do so by virtue of the powers vested by Constitution , Acts, Rules, Order or by delegation of powers made by a competent authority. Therefore, a full and upto date knowledge of the sanctioning powers of different authorities is important for audit officers.

Audit of sanction has following important aspects:-

In cases where a sanctioning authority is vested with full powers in respect of certain class of expenditure, the auditor should only examine whether sanction have been given for expenditure on the grounds of reasonableness.

In cases where a sanctioning authority is vested with powers subject to a general criteria, the auditor should examine whether due regard has been paid to it.

In cases where a sanctioning authority is vested with powers expressed in precise terms, the auditor should ascertain that the order defining its powers is obeyed exactly.

If expenditure on a scheme is likely to exceed in future the limit upto which sanction has been accorded by the original sanctioning authority, the limit upto which sanction has been accorded by the original sanctioning authority, the auditor should raise an objection.

The auditor should examine whether the administrative agency under audit has maintained an upto date and complete record of sanctions issued by different authorities in a register of sanction.

Audit of financial propriety – Audit of financial propriety is undertaken to ascertain whether commonly recognized standards of financial propriety (the quantity , quantity, morality, morality and ethics) of expenditure are being observed i.e. to say, money spent is reasonable; has been spent judiciously and prudently for the general welfare of public.

8 (a)

Option On Share Capital

(i) Definition – Option on unissued share capital is a right which a person has acquired under an agreement with the company to subscribe for share in the company, if he so chooses, Such options generally arise under the following circumstances:

Under the promoter's agreements;

Under vendors' agreements;

Under an agreement for convertible preference shares; etc.

Under Employees Stock Options Schemes (ESOPs);

Under debenture deed.

(ii) Disclosure requirement under the Companies Act,1956

Schedule VI, Part I, requires disclosure of the particulars of any such option separately indicating the form in which such unutilized funds have been invested.

In case this option is as per the general pre-emptive right, in accordance with section 81(1)of the Act to present shareholder, then no separate disclosure is required under Schedule VI.

(iii) **Accounting**

Accounting for ESOPs for unlisted companies in not required. Only disclosure in needed. However, for listed companies the guidelines issues by the SEBI with regards to accounting should have been adhered.

(iv) **Auditor's duties -** In case of option on share capital, the auditor should-

Refer to the agreement conferring options on the option holder;

In case of listed companies, examine whether ESOPs have been accounted for; and

verify that all options are disclosed.

8 (b)

Sweat equity shares

Sweat-equity shares mean equity shares issued by the company to employees or directors at a discount or for consideration other than cash. 'Sweat equity shares' may be issued for providing know-how or making available intellectual property right (say, patents) or value additions, by whatever name called.

Audit steps

(i) Ensure that the sweat shares are of a class already issued.

(ii) Examine the special resolution passed by the company in general meeting for details such as number of such shares, current market price, consideration, if any and the class or classes of directors or employees to whom such shares are to be issued.

(iii) Examine whether at the date of issue of such share not less than one year has elapsed since the date on which the company was entitled to commence business.

(iv) Ensure adherence to SEBI guidelines in case of listed companies and for other companies, ensure prescribed guidelines have been complied with.

8 (c)

(a) Qualified audit report – Qualified audit report is a report wherein the auditor has expressed a qualified opinion, that is to say, an opinion subject to certain reservations.

Important aspects in relation to qualifications in an audit report and mentioned below

i. The auditor should give a qualified opinion when the subject-matter of qualification is not highly material and pervasive and he believes that the overall financial statements give a true and fair view.

ii. A qualification should be preceded by the words ‘subject to’ or ‘except that’ to make it clear that the matter is of exceptional nature.

iii. The audit report should quantify the effect of individual qualifications and also the total effect of all qualifications on the financial statements. If precise quantification is not possible the auditor can use estimates made by the management after applying proper audit tests. The report should clearly mention the fact of reliance on such figures.

iv. The auditor shall state the reasons for his qualification.

v. In case of a limited company, if any of the statutory affirmations in section 227(2) and section 227(3) are answered in negative or with qualification by the auditor; the audit report would be termed as a ‘qualified audit report’.

vi. Qualification which deal with matters, which have an adverse effect on the functioning of the company should be in thick type or in italics.

A qualification report can result form:

Scope limitation

Disagreement with management with regard to departure from generally accepted accounting principles or adequacy of disclosure

Scope limitation – when an auditor is not able to gather sufficient appropriate evidence to support a financial assertion in financial statements i.e. there is a scope limitation, the auditor should either qualify or disclaim an opinion
Scope limitations are sometimes client-imposed. Scope limitations may be imposed by circumstances.

8. (d)

Right to lien – Section 209 of the Companies Act, 1956 provides that books of account shall be maintained at the company’s registered office unless board of directors decides to keep them at another place in India. The company must inform the Registrar of Companies, if the board so decides.

In the light of this provision, one can conclude that the auditor can exercise his right lien on books of account, if the board has authorized him to possess such records. The Institute of Chartered Accountants of England and Wales has expressed a similar view. According to the Counsel of ICAEW the auditor can exercise his right to lien if-

Books of account / documents have entrusted to the auditor by the board of directors i.e., he has not received them through irregular or illegal means.

He has done work on the documents assigned to him.

The documents retained are connected with the work on which fees have not been paid.

Thus, law has made the exercise of right to lien on books of account by the auditor difficult. But, the auditor, as per AAS-3, has an uncontestable lien on his working papers. These have been regarded as his property by the Standard.

ZLX

Total No. of Questions : 20 **Maximum Marks : 100**
No. of Pages : 5 **Time Allowed: 3 Hours**

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

PART – I

1. (a) A accepted a bill and gave it to B, who put his name as a drawer for the purpose of discounting it and paying the proceeds to it. B having to discount, returned the bill to A, who intending to cancel it fore it two pieces and threw them. B picked up the pieces, posted them together and put the bill into circulation. Examine the liability of A on the bill.

(5 marks)

1 (b) (i) State whether the following statements are correct or incorrect.
(a) a minor can enter into contract for the payment of his college tuition fees.
(b) there should be an agreement between agent and principal but not necessarily a contract.

(2x1=2 Marks)

(b) (ii) Pick up the correct answer from the following:
(a)Which of the following is the correct definition of contract:-
(1) Contract is an agreement in which one party accepts the offer of the other
(2) Contract is an agreement in which there is consideration
(3) An agreement enforceable by law is a contract
(4) An agreement in which there is a valid consideration

(b) Which of the following types of consideration is not permissible:-
(1) Past
(2) Present
(3) Future
(4) Unreal

(c) A promissory note:-
(1) Payable to bearer
(2) Payable to order on demand
(3) Payable to order after certain period
(4) None of the above

(3x1=3 Marks)

2. (a) XYZ Ltd having the registered office in Bangalore. XYZ called its Annual General Meeting on 15th August 2009 at Mumbai with reference to the provisions of the Companies Act, 1956. Examine whether the AGM was valid. (5 marks)

(b) (i) State whether the following statements are true or false.
(a) Proxy has a right to speak for demanding a poll.
(b) A public ltd manufacturing company cannot accept fixed deposits. (2x1=2 Marks)

(b) (ii) Pick up the correct answer from the following

(a) Object Clause of the company is divided into --------- types:-

(1) 2
(2) 3
(3) 4
(4) 5

(b) A Company cannot issue:-

(1) Convertible preference shares
(2) Redeemable preference shares
(3) Irredeemable preference shares
(4) Participating preference shares

(c) The financial year of AZZ Ltd ended 31^{st} March 2008. Since the due date for holding the Annual General Meeting is 30^{th} September 2008. The Company held its meeting on 29.9.2008. As per the requirements of the Companies Act, 1956.The Annual Return of the Companies should be filed with Registrar of Companies with in

(1) 30 days from 29^{th} September 2008
(2) 60 days from 29^{th} September 2008
(3) 60 days from 30^{th} September 2008
(4) 90 days from 30^{th} September 2008

(3x1=3 Marks)

3 . Pick up the correct answer from the following

(a) The Payment of Bonus Act, 1965 applies to:-

(1) Every factory
(2) Every other establishment, employing 20 or more persons on any day during accounting year
(3) Any other establishment specified by appropriate government
(4) All of the above

(b) Which of the following employees are excluded under section 32 the Payment of Bonus Act, 1965:-

(1) Seamen
(2) Employees employed by The Indian Red Cross Society
(3) Employees employed by Universities and other educational Institutions
(4) All of the above

(c) Who is entitled to bonus under the Payment of Bonus Act, 1965

(1) A part time employee who is engaged on a regular basis
(2) A probationer employee
(3) A dismissed employee reinstated with back wages
(4) All of the above

(d) The minimum working period for entitlement of bonus under section 8 of Payment of Bonus Act 1965 is:-

1) 30 days
2) 60 days
3) 90 days
4) 180 days

(e) Which of the following is not included in salary under the Payment of Bonus Act, 1965:-

(1) Any Travelling concession
(2) Any ex-gratia payment made to him
(3) Any commission payable to the employee
(4) All of the above

(5x1=5 Marks)

4. A customer of a bank drew an open cheque for Rs.10,000/- payable to J. The cheque was stolen. The thief forged the payee's endorsement and presented the cheque for payment before drawee banker. The bank cashier paid the cheque without asking for proof of his identity. Is the banker is liable? (5 Marks)

5. Explain the liabilities of a person who acquires on Establishment from an employer and the employer who sells the 'Establishment' under the EPF Act, 1952.

GELONA Group of industries sold its textiles unit to the giant group of industries. GELONA group contributed 25% of total contribution of the pension scheme which was due before sale under the Act. The transferee Company refused to bear the remaining 75% contribution in the pension scheme. Decide under EPF Act who will be liable to pay for the remaining contribution in case of transfer of Establishment and upto what extent.

(5 Marks)

6. What is meant by Assignment? Distinguish between Negotiation & Assignment.

(5 Marks)

7. Explain the provisions of the payment of Gratuity Act, 1972 relating to 'forfeiture of the amount of Gratuity' payable to an employee. (5 Marks)

8. What do you mean by 'Pre-incorporation Contracts? Explain legal position of such contracts.

(5 Marks)

9. The following information is available from the audited balance sheet as at 31-3-2008 of AIMS Ltd. which is an unlisted company:

	Rs. (in Lacs)
Equity share Capital (30 Lac equity shares of Rs.10/- each full paid up) -------	300.00
Share Premium --	30.00
General reserve --	100.00

Share Capital

Secured Loans --	400.00
Unsecured Loans --	220.00

The company seeks to implement buy back of its shares in May 2008. Compute the maximum limit upto which buy back is permitted in the financial year 2008-09.

(5 Marks)

10. Examine the validity of the following proxies and suggest remedies where possible:

I. L, a member of a private company, appoints B and C as proxies dividing his voting rights between them. B and C are not members of the company.

II. X, the director of Y Limited is authorized to represent Y limited at the General Meeting of ABC limited. He in turns appoints a proxy Z.

III. Y, a member of a company not having share capital, appoints a proxy. Articles of the company are silent as to the power to appoint proxies.

(5 Marks)

11. Distinguish between Memorandum of Association and Articles of Association.

(5 Marks)

12. Seven textile companies decided to start a new company which will provide processing facilities for its members. Advise whether seven companies can form a new company?

(5 Marks)

PART II

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

13. Ramesh accepted a position of Manager (administration) at Diamond Vocational Training Institute, Delhi. He moved with his family from Agra to Delhi. Soon, he was promoted to Vice President (Administration), overseeing the purchase department of the Institute. His oldest son, Ashok also got a good job as sales executive at IB Computer Corporation in Delhi. As Vice President, Ramesh quickly saw the need for 40 to 50 computers in his office.

    Although Diamond had a bidding policy, Ramesh purchased IB Computer Corporation's computers for about Rs.30,000 each, when another popular brand IBC was selling for around Rs.25,000 and had more promising features than the IB computer. Ashok handled the sale and received a healthy commission on the sale. If the purchase had gone through the normal bidding process, the IB model would not have been selected. Is it acceptable for a V.P. to bypass the normal routine to do business with a family member? (10 marks)

14. Explain the meaning of "Morals and Ethics". (5 marks)

15. What do you mean by Ethical Dilemmas? (5 marks)

16. Explain the ethics which should be followed by Finance and Accounting Professionals. (5 marks)

PART III

Question no. **17 is compulsory** and answers any **two** questions from the rest.

17. What are the advantages of oral communication. Mention any four differences between written communication and oral communication. (10 marks)

18. What is grapevine? What are the factors responsible for grapevine? (5 marks)

19. Draft a specific Power of Attorney authorizing Mr. Ramesh to appear before income tax authorities. (5 marks)

20. What are the factors influence in the ethical communication? (5 marks)

AEC ACADAMY
28th SESSION MODEL EXAM
LAW ETHICS AND COMMUNICATION
SUGGESTED ANSWERS
PART – I

1. a) A is liable on the bill, if the bill comes into the hands of Holder in due course.

b) (i) (a) True. A minor can enter into contract for the payment of his college tuition fees.
(b) True. There should be an agreement between agent and principal but not necessarily a contract.

(ii) (a)An agreement enforceable by law is a contract
(b)Unreal
(c)Payable to order on demand

2(a) The AGM is not valid because the AGM has to held at the token or city where the registered office of the Company is situated and AGM cannot be held on public holidays.

(b) (i) (a) True. (b) True.

(ii)(a) 3
(b) Irredeemable preference shares
(c) 60 days from 29th September 2008

3. (a) All of the above
(b)All of the above
(c) All of the above
(d) 30 days
(e) All of the above

4. Banker is not liable Sec. 85(1) and 10

5. **Liability in case of transfer of Establishment – Sec. 17B**

* An Employer, in relation to an Establishment, * Transfers that Establishment in whole or in part; *By sale, gift, lease or licence or in any other manner whatsoever.	* In respect of the period up to the date of such transfer; * The Employer an the Person to whom Establishment is so transferred; * **Shall jointly and severally be liable;** * To pay the Contribution and other sums due from the employer under any provision of this Act/ Scheme/ Pension Scheme/ Family Pension Scheme, * The liability of transferee shall be limited to value of assets obtained by him by such transfer.

Analysis of given case:

The transferor GELONA Group and the transferee Giant Group will be jointly and severally liable for the remaining 75% of the contribution. However if the transferor Company refuses to pay, the transferee Company will be held liable subject to the value of assets obtained by the Company by such transfer.

6.

Basis	Negotiation	Assignment
1. Meaning	A Transfer by Negotiation takes place when a P/N, B/E or Cheque is transferred to any person, so as to constitute that person the holder thereof.	A Transfer by Assignment takes place when the holder of an instrument transfers it to another so as to confera right on the transferee to receive the payment of the instrument.
2. Consideration	Consideration is presumed.	Transferee must prove consideration.
3. Mode	Can be effected by * Delivery for bearer instruments and * By Indorsement and Delivery for order instruments.	Is effected by – * writing either in the instrument itself; or *writing on a separate document which has to be signed by the transferor.
4. Title	A Holder in due course gets a better title than its Transferor.	Title of Transferee is always subject to title of its Transferor, even though he took the assignment for value and in good faith.
5.Notice of transfer	No information of transfer of a Negotiable Instrument needs to be given to the Debtor.	Assignment does not bind the Debtor, unless a notice of assignment has been given to him and he has expressly or impliedly assented to it.

7. Forfeiture of gratuity: Section 4(6) of the payment of Gratuity Act, 1972 deals with cases in which gratuity payable to an employee may be forfeited.

According to the provisions of the Act, the gratuity of an employee whose service have been terminated for any act willful omission or negligence causing any damage or loss to, or destruction of, property belonging to the employer, shall be forfeited to the extent o the damage or loss so caused.

The gratuity payable to an employee may be wholly or partially forfeited if the services of such employee have been terminated for his disorderly conduct or any other act of violence on his part or

Any act which constitutes an offence involving moral turpitude, provided that such offence is committed by him in the course of his employment.

8. **Meaning:**
Pre-incorporation contracts are those contracts, which are entered into by promoters for the company, which is yet to be incorporated.

Legal Position of Such Contracts:

1. The benefits of pre-incorporation contracts are to be enjoyed by the company.

2. Company not bound by such Contracts: As the company cannot be a party to a preliminary contract, so it can not be bound by such contract, even when it takes the benefit of such contract. Consider the following leading cases – i) Clintons Claim, ii) English Colonial Co. Ltd.

3. Company cannot enforce Pre-Incorporation Contract: Since the company is not bound by pre-incorporation contract, so it cannot enforce the contract made before its incorporation.

4. Personal Liability of Promoters: The pre-incorporation contracts are deemed to have been entered into personally by the promoters. So, they are personally liable to pay damages for failure to perform the promises made in the company's name, even if the contract expressly provides that only the company shall be answerable for performance.

9. **Computation of maximum limit of buy-back that is permissible**

(1) Maximum amount of buy-back = 25% of the total paid-up equity capital at the end of the financial year

(a) Total paid-up equity capital in financial year 2007-08 as at 31-3-2008 = Rs.300 Lakh

(b) 25% of (a) above = Rs.75 lakh

(2) The post buy-back debt owed should not be more than twice the capital and free reserves after such buy-back.

Debt owed by the company as at 31-3-2008:

Secured Loan	=	Rs.400.00 lakh
Unsecured Loan	=	Rs.220.00 lakh
Total Debt owed	**-**	**Rs.620.00 lakh**

(3) Let us assume, share capital buy back = Rs.X

$$\text{Then, Debt equity ratio after buy back} = \frac{\text{Total Debt}}{\text{Equity capital + free reserve}} = 2$$

$$\frac{620}{(300-X) + (100-X)} = 2$$

$\Rightarrow X = \text{Rs.}45$ Lac

So, the maximum permissible buy back is Rs.75 Lac or Rs.45 Lac, whichever is lower, i.e.Rs.45 Lac.

10.

(i) Invalid: If the articles are silent, the members of private company cannot appoint ore than one proxy at a time.

(ii) Valid: The presence of the representative of a company is treated as a 'member present in person'. A person entitled to present in person can further appoint proxy. So, in the given, appointment of Mr. Z is valid. His presence shall be counted as a 'member present by proxy'.

(iii) Invalid: If the articles are silent, then a member of a company without share capital cannot appoint proxy.

11.

S.No	Memorandum of Association	Articles of Association
1.	They are fundamental conditions upon which Company is allowed to be incorporated; introduced for benefit of Creditors, outside Public and Shareholders.	They are internal regulations of Company; to regulate relationship between Company and shareholders/members and amongst members themselves.
2.	Lays down the area beyond which the activities of the Company cannot go. MOA lays down parameters for AOA.	Provides fro regulations inside the area outlined by MOA; i.e. AOA are subordinate to MOA.
3.	Name Clause, Situation Clause, Object Clause, Liability Clause, Capital Clause and Association Clause.	Contains regulations for Company management and those that regulate relationship between members inter se.
4.	Can be altered only under certain circumstances and in the manner provided. Approval of Central Government/CLB is required, besides approval of Shareholders in a General Meeting by way of Ordinary or Special Resolution.	Can be altered by the members by passing a Special Resolution only.
5.	Companies Act.	Both Companies Act and the MOA.
6.	Acts beyond scope of MOA are ultra vires and hence void. This cannot be ratified by members.	Acts ultra vires AOA can be ratified by members' resolution, provided that they are within the scope of MOA.

12. As per Section 12 of the Companies Act, 1956, any two or more persons in case of private limited company and seven or more persons in case of public limited company can incorporate a company. Person includes artificial persons and therefore seven companies can form either a private limited company or a public limited company.

PART – II

13. VP must have followed the fair procedure in purchasing the computers and he should not have by passed the normal routine to do business with a family member. Purchasing the computer from IB Corporation where VP's son is employee is not objectionable. But purchasing the computer at higher value and without inviting the tender from various sellers is not acceptable. The business ethics are obviously not followed by VP.

14. Morals and Ethics

The word "Moral" is defined as relating to principles of right and wrong. Let us draw a distinction between Ethics and Morals. Although both words are broadly defined in contemporary English as having to do with right and wrong conduct, the root word for ethical is the Greek "ethos, "meaning "character", while the root word for Moral is Latin "mos," meaning "custom".

Character and custom, however, provide two very different standards for defining what is right and what is wrong. Character is a personal attribute, while custom is defined by a group over time. People have character. Societies have custom. To violate either can be said to be wrong, within its appropriate frame of reference.

Another way to look at the distinction is to say that morals are accepted from an authority (cultural, religious, etc.), while ethics are accepted because they follow from personally accepted principles. For example, if one accepts the authority of a religion, and that religion forbids stealing, then stealing would be immoral. An ethical view might be based on an idea of personal property that should not be taken without social consent (like a court order). Moral norms can usually be expressed as general rules and statements such as "always tell the truth". And are typically first absorbed as a child from family, friends, school, religious teaching and other associations. Morals work on a smaller scale than ethics, more reliably, but by addressing human needs for belonging and emulation, while ethics has a much wider scope. It is the process of examining the moral standards of an individual or society to determine whether these standards are reasonable or unreasonable in concrete situations and issues.

15. Meaning: In many cases, Business interests come into conflict with moral values. Businessmen are faced with moral and ethical dilemmas while making a choice from various alternatives. The ethical dilemmas are highly complex and there are no clear guidelines to resolve the conflict.

For example, the gift made by a supplier to the purchase manager of a firm may be viewed as a bribe, etc.

Ethical behaviors create goodwill and reputation that expand opportunities for profit. While competing for customers and workers, the company with a reputation for ethical behaviour has an edge over others which are considered unethical

16.

1. Integrity: Finance and Accounting Professionals should be honest and straight-forward, while discharging their professional duties.

2. Objectivity: According to this principle,-

(a) Finance and Accounting Professionals should use their professional judgement,

(b) They should not allow bias, conflicting interests or undue influence of others to override their professional judgements.

(c) They should communicate information fairly and objectively in such a way that the communication with the end user is complete and transparent.

3. Confidentiality: Finance and Accounting Professionals should refrain from disclosing confidential information related to their work.

4. Professional Competence and Due Care: Finance and Accounting Professionals should update their professional skills regularly.

5. Professional Behaviour: Finance and Accounting Professionals comply with relevant laws and regulations and avoid actions which may result into discrediting the profession.

PART – III

17. Advantages of oral communication:

1. **Saves time:** In oral communication, messages are not sent in written form. This saves the time and messages reach the employees quickly.

2. **Economy:** Oral communication is an economic source of communications because no paper, ink or pen is involved n this method.

3. **Clarity of the message:** The message is quite clear in oral communication, because in case of any confusions, the clarification is sought immediately from the sender without losing any time. The process of communication is successful when message is received in the same spirit is being delivered.

4. **More effective:** Oral communication is more effective in its nature. A message can be communicated effectively by body language i.e. different gestures such as nodding, shaking the head or neck, raising eye brows etc. it can be made even more effective at different times by the feelings of happiness, anger, respect and disdain etc.

5. **Co-operation:** Managers and their subordinates come into direct contact with each other in oral communication. This paves the way for better co-operation among employees of the organization.

6. **Knowledge of Re-action:** One can easily understand the reaction on the part of receiver of the message through his feelings. If the effect of message is not as was intended, then message can again be conveyed in a better way.

Difference between Verbal Communication and Written Communication

Head of Differences	Verbal Communication	Written Communication
1. Form:	This is in verbal form.	This is written form.
2. Expenditure:	Saves money, because no need of paper, ink etc.	Expenditure is involved on paper, ink etc.
3. Time:	Time is not wasted in writing the message	Time is wasted in writing the message.
4. Effect:	More effective, because gestures make the message quite interesting.	There is nothing of this sort like gestures/using body language.
5. Feedback:	Immediate feedback from the receiver of the message.	Delayed feedback.
6. Productivity:	Communication is prompt, so productivity is more.	Productivity is known at a later stage.
7. Co-operation:	Personal contact paves the way for co-operation	Lack of personal contacts results in less cooperation.
8. Presence of parties:	It is a must.	Not necessary.
9. Secrecy:	Message remains secret.	Message does not remain secret.
10. Proof:	No proof remains.	Proof remains for future references.

18. Grapevine is informal communication. It runs in all directions – horizontal, vertical, diagonal. As the management experts put it, it "flow around water coolers, down hallways, through lunch rooms, and wherever people get together in group".

Factors responsible for Grapevine:

The following factors are responsible for grapevine:

(a) Feelings of uncertainty, when the organization is passing through a difficult period.

(b) Feeling of inadequacy, lack of self-confidence on the part of the employees, leading to the formation of groups.

(c) Formation of a favoured group by the manager, giving other employees feeling of insecurity or isolation.

19. Format letter to appear before Income Tax authorities

I/we --------------------- residing at ---------------------- hereby authorize Mr Ramesh to represent me/my family in connection with ---------------------------- for the year ------ . His statement and explanation will be binding on us.

Place
Date: Signature

I, Ramesh, Chartered Accountant hereby declare that I am duly qualified to represent the above-mentioned person.

Place:
Date: Signature
Address: Ramesh
Chartered Accountant,
225, M G Road,
Nungambakkam,
Chennai – 600034.

20. (1) How to act, while communicating? : Initially, communicators face 3 choices- To speak, To listen, or To remain silent. Each choice implies an ethical decision.

(2) What to communicate? : While disclosing information, feelings and motives, ethical element needs to be kept in view. The contents and mode of communication have to be decided with ethical judgment.
Clearly, some messages should not be communicated, like 'confidential information about organization'. But should one share these confidential information with a colleague? That choice involves an ethical decision.

(3) When to communicate? : A particular message may be ethical at one point of time and unethical at another time. For example, If the information relating to the profitability of company is communicated before the release of the financial statements, then it will be communication of 'insider information', which is unethical. But if the same information is communicated after release of the financial statement, then it will not be unethical.

(4) How to communicate: There are 3 main modes of communication- word spoken, writing and body language. Ethics is involved in each act of communication.

(5) Where to communicate? The selection of the place of communication also involves ethical consideration. For example, a crowded public place is not a suitable place for BOD meeting to discuss the confidential policies of the company. A competitor overheard the discussion and took undue advantage of it.
But, the same crowded public place is a suitable to hold press conference to disclose information about the new product of the company.

(6) What are organizational values? : Organizational value is an very important factor of ethical communication.

¾ Values refer to those principles, in which the organization and its people strongly believe in and consider them significant. Whenever members of the organization are in doubt about the choice to be made, they rely on the deep-rooted values of the organization. These values help in taking decisions.

¾ Organisational values are reflected in the vision and mission statements of the organization. Many organizations display their vision and mission statements in several places so that employees know what the organization values.

¾ While communicating with people inside and outside, the employees are guided by the values of the organization.