

PRIME ACADEMY
30TH SESSION MODEL EXAM – ADVANCED ACCOUNTING
QUESTION PAPER

Total No. of Questions: 6
Time Allowed: 3 Hrs

ADAG

Total No. of Printed Pages: 4
Maximum Marks: 100

All are compulsory

Wherever appropriate, suitable assumptions to be made by the candidate

Working notes should form part of the answer

1. Answer the following:

- (a) The following bills are due for payment on different dates, and it is desired to make a single payment for the total amount :

Dated	7 th April due 17 May for	Rs.3000
Dated	14 th May due July 22nd	Rs.6,000
Dated	5 th June due August 2 nd for	Rs.5,000
Dated	15 th June due 30 th August for	Rs.7,000

- (b) Bala, Babu and Barat were partners in a firm sharing profits and losses in the ratio of 2:2:1 respectively with the capital balance of Rs.50,000 for Bala, Rs.70,000 for Babu and for Barat Rs.35,000. Babu declared to retire from the firm and balance in reserve on the date was Rs.25,000. If goodwill of the firm was valued as Rs.30,000 and profit on revaluation was Rs.7,500, then what amount will be payable to Babu.
- (c) Suja and Sumitha were partners sharing profits in the ratio 5:3, they admitted Suvitha giving her 3/10 share of profits. If Suvitha acquires 1/5th share from Suja and 1/10th from Sumitha, calculate the new profit sharing ratio.
- (d) Calculate the amount of Insurance claim to be lodged, based on the following information:
Value of stock destroyed by fire Rs.90,000
Insurance policy amount (subject to average clause) Rs.65,000
Value of stock salvaged from fire Rs.40,000
- (e) A trader purchased goods for Rs.1,70,000. The opening stock of inventory prior to the said purchase was Rs.30,000. His sales was Rs.2,10,000. Find out the closing stock of inventory if the Gross profit margin is 25% on cost.
- (f) If both the sides of a cash book are not tallied i.e. debit side exceeds credit side then what are the possible items for recording the difference?
- (g) State the decision made in the Garner vs Murray case, when there is insolvency of a partner.
- (h) A company took a construction contract for Rs.100 lakhs in January, 2009. It was found that 80% of the contract was completed at a cost of Rs.92 lakhs on the closing date i.e. on 31.3.2010. The company estimates further expenditure of Rs.23 lakhs for completing the contract. The expected loss would be Rs.15 lakhs. Can the company recognise the loss in the financial statements prepared for the yearended 31.3.2010?
- (i) Can internally generated brands, publishing titles and other similar items be recognized as intangible assets?
- (j) What is the maximum rate of underwriting commission on shares and debentures?

(10x2=20 Marks)

2.

The income and expenditure account of Country club for the year ended 31-3-2010 is as follows:-

Dr

Cr

Income and expenditure Account for the year ended 31-3-2010

	Rs		Rs
To Salaries	24750	By Subscriptions	37500
To General expenses	500	By Entrance fees	250
To Audit fees	1250	By Contribution for annual dinner	11000
To Secretary's Honorarium	1000	By profit on Annual Sports meet	750
To Stationery & Printing	450		
To Annual dinner expenses	11500		
To Interest and Bank charges	150		
To Depreciation	9300		
	49500		49500

The Accounts have been prepared after the following adjustments:

Subscriptions outstanding on 31st March 2009 Rs.600

Subscriptions received in advance on 31st March 2009 Rs.450

Subscriptions received in advance on 31st March 2010 Rs.270

Subscriptions outstanding on 31st March 2010 Rs 750

Salaries outstanding on 31st March,2009 and 31st March 2010 were respectively Rs.2,000 and Rs.2,250.General expenses include insurance prepaid to the extent of Rs.60.Audit fees for 2009-2010 are as yet unpaid:during 2009-2010,audit fees for 2008-2009 were paid amounting to Rs.1,000.

The club owned freehold lease of ground valued at Rs.10, 000. The club had sports equipment on 1st April.2009 valued at Rs.12,600.At the end of the year,after deprecition,this equipment amounted to Rs.13,700.In 2008-2009 the club had raised a loan of Rs.2,000.This is outstanding throughout the year 2009-10.On 31st march ,2010 cash in hand amounted to Rs.1,600.

Prepare receipts and payments Account for the year ended 31st March, 2010 and the Balance Sheet at the end of the year. (16 Marks)

3. The following is the balance sheet of sick Co. Ltd as on 31st March2010:

Liabilities	Rs	Assets	Rs
1,000 14% Redeemable Preference shares of Rs 100 each	1,00,000	Fixed Assets	15,00,000
Equity Shares of Rs 10 each	7,00,000	Current Assets	35,00,000
12% Debentures	3,00,000	Profit and Loss Account	3,00,000
Current Liabilities	39,00,000		
Provision for Taxation	3,00,000		
	53,00,000		53,00,000

The following scheme of reorganization is sanctioned:

(1) Fixed Assets are to be written down by 33 1/3%

(2) Current Assets are to be revalued at Rs 27,00,000.

(3) Preference shareholders decide to forego their right to arrears of dividend which are in arrears for three years.

(4) The Taxation liability of the company is settled at Rs 4,00,000.

- (5) One of the creditors of the company. To whom the company owes Rs 25,00,000, decides to forego 50% of his claim. He is allotted 1,00,000 equity shares of Rs 5 each in part satisfaction of the balance of his claim.
- (6) The rate of interest on debentures is increased to 14%. The debenture holders surrender their existing debentures of Rs 100 each and exchange the same for fresh debentures of Rs 75 each.
- (7) All existing equity shares are reduced to Rs 5 each.
- (8) All preference shares are reduced to Rs 75 each.

Pass journal entries and show the balance sheet of the company after giving effect to the above
(16 Marks)

4. Carlin & Co. has head office at New York (U.S.A.) and branch at Mumbai (India). Mumbai branch furnishes you with its trial balance as on 31st March, 2010 and the additional information given thereafter:

	Dr.	Cr
	Rupees in thousands	
Stock on 1st April, 2010	300	—
Purchases and sales	800	1,200
Sundry Debtors and creditors	400	300
Bills of exchange	120	240
Wages and salaries	560	—
Rent, rates and taxes	360	—
Sundry charges	160	—
Computers	240	—
Bank balance	420	—
New York office a/c	—	1,620
	<u>3,360</u>	<u>3,360</u>

Additional information:

- (a) Computers were acquired from a remittance of US \$ 6,000 received from New York head office and paid to the suppliers. Depreciate computers at 60% for the year.
- (b) Unsold stock of Mumbai branch was worth Rs. 4,20,000 on 31st March, 2010.
- (c) The rates of exchange may be taken as follows:
 - (i) on 1.4.2009 @ Rs. 40 per US \$
 - (ii) on 31.3.2010 @ Rs. 42 per US \$
 - (iii) average exchange rate for the year @ Rs. 41 per US \$
 - (iv) Conversion in \$ shall be made upto two decimal accuracy.

You are asked to prepare in US dollars the revenue statement for the year ended 31st March, 2010 and the balance sheet as on that date of Mumbai branch as would appear in the books of New York head office of Carlin & Co. You are informed that Mumbai branch account showed a debit balance of US \$ 39609.18 on 31.3.2010 in New York books and there were no items pending reconciliation
(16 Marks)

5.

- (a) Mr. Amar, Akbar and Anthony were partners sharing profits and losses in the ratio of 9:4:3. It was provided for in the partnership deed that in the event of death or retirement of a partner, his legal representatives would receive:
 - (a) the balance to the credit of his capital account as on that date.
 - (b) his share of profits from the date of the last accounting year to the date of his death on the basis of the profits of the previous year
 - (c) his share of goodwill as calculated on the basis of two and half years purchase of average profits of the previous four years.

Anthony died on 16th december 2009. His capital as on 1st April 2009 was Rs.70,000 and drawings to the date of death was Rs.12,000. The profits of the firm were 2005-06 Rs.85,500; 2006-07 Rs.1,02,500; 2007-08 Rs.1,08,000 and 2008-09, Rs.1,32,000, the accounts have been closed every year on 31st March. The partners had severally insured their lives as follows: Amar Rs.1,00,000; Akbar Rs.80,000 and Anthony Rs.60,000, the premiums were charged to Profit and loss account. The surrender value of these policies at the time of Anthony's death were 25% of face values.

Prepare Anthony's capital account, showing the amount payable to Anthony's executors.

(8 Marks)

- (b) Sakthi Finance and Investments Ltd., held Rs.26,000, 8% debentures of ACC Ltd. On July 1, 2009 which appeared in the books at Rs.25,090. Interest is payable on July 31st and January 31. On October 1, 2009, a further Rs.13,000 debentures in ACC Ltd., were purchased at Rs.98 cum interest and on January 1, 2010, a further Rs.7,800 debentures were purchased at Rs.97 ex-interest.

On March 31, 2010, Rs 20,800 debentures were sold at Rs.101 cum interest and on June 1, 2010 Rs 15,600 debentures were sold at Rs.102 ex-interest.

Prepare investment account for the period ending on June, 2010.

(8 Marks)

6. Answer any four

- (a) Mr. Sundhar tells you that his capital on 31st December 2009 is RS.1,40,250 and his capital on 1st January was Rs.1,44,000. He further informs you that during the year he gave a loan of Rs.26,250 to his sister on private account and withdrew Rs.2,250 p.m. for personal use. He also used a flat for his personal purpose, the rent of which is Rs.750 per month and electricity charges on an average Rs.75 per month were paid from the business account. He sold his 8% government Bonds Rs.15,000 at 2% premium and bought that money into the business. Besides this there is no other information. You are required to calculate his profit.
- (b) When can an enterprise commence to capitalize the borrowing costs? What are the conditions to be satisfied for commencement of capitalization?
- (c) Non-Performing Assets-Write a short note.
- (d) Should appropriation to mandatory reserves be excluded from net profit attributable to equity shareholders? Kashyap Ltd. is engaged in manufacturing industrial packaging equipment. As per the terms of an agreement entered into with its debentureholders, the company is required to appropriate adequate portion of its profits to a specific reserve over the period of maturity of the debentures such that, at the redemption date, the Reserve constitutes at least half the value of such debentures. As such, appropriations are not available for distribution to the equity shareholders. Kashyap Ltd. has excluded this from the numerator in the computation of basis EPS. Is this treatment correct?
- (e) In order to value the inventory of finished goods, HR Ltd. has adopted the standard cost or raw material, labour and overheads. Income tax officer wants to know the method, as per AS-2, for the valuation of raw material.
- (f) A Ltd take over B Ltd. on April 01, 2007 and discharges consideration for the business as follows:
 - 1) Issued 42,000 fully paid equity shares of Rs. 10 each at par to the equity shareholders of B Ltd.
 - 2) 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%.
 - 3) It is agreed that the debentures of B Ltd. (Rs. 50,000) will be converted into equal number and amount of 13% debentures of A Ltd.

Calculate the amount of purchase consideration.

(4x4=16 Marks)

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SUGGESTED ANSWER

1(a)

Due Date	Amount	Number of Days	Product
May 17	Rs.3000	0	0
July 22	Rs.6,000	66	396000
Aug 2	Rs.5,000	77	385000
Aug 30	Rs.7,000	105	735000
	Rs.21,000		1516000

Average due date=May 17+(15,16,000/21000)=28th July.

1(b) Rs.95, 000

1(c) 17:11:12

1(d) Account current is a running statement of transactions between parties, maintained in the form of a ledger account, for a given period of time and includes interest allowed or charged on various items. It is prepared when transactions regularly take place between two parties. An account current has two parties – one who renders the account and the other to whom the account is rendered.

1(e) Amount of claim= (Total stock before fire / Stock destroyed by fire) × Amount of Policy
 $(1, 30,000/90,000) \times 65,000 = \text{Rs.}45, 000$

1(f) If debit side exceeds credit side then the difference may be any of the following items:

- (i) Closing cash balance or bank balance; or
- (ii) Opening bank overdraft;
- (iii) Cash purchase; or
- (iv) Payment to creditors; or
- (v) Bills Payable discharged; or
- (vi) Drawings; or
- (vii) Purchase of fixed assets; or
- (viii) Sundry expenses; or
- (ix) Cash embezzlement by cashier.

1(g) The decision in Garner vs. Murray case requires:

- (i) That the solvent partners should bring in cash equal to their respective shares Of the loss on realization;
- (ii) That the solvent partners should bear the loss arising due to the insolvency of a partner in the ratio of their Last Agreed Capitals.

The Last Agreed Capital should be interpreted as follows:

Case Meaning of Last

1. In case of Fixed Capitals Last Agreed Capital means the Fixed Capital (as given in the Balance Sheet) without any adjustment.
2. In case of Fluctuating Capitals Last Agreed Capital means the Capital after making adjustments for past accumulated reserves, profits or losses, drawings, interest on capitals,

interest on drawings, remuneration to a partner etc. to the date of dissolution but before making adjustment for profit or loss on realisation.

1(h) As per paragraphs 31 and 35 of AS 7 on Construction Contracts, an expected loss on the construction contract should be recognized as an expense immediately irrespective of

- (i) whether or not the work has commenced on the contract; or
- (ii) the stage of completion of the contract; or
- (iii) the amount of profits expected to arise in other contracts.

Hence, the company must recognize the loss immediately

1(i) Internally generated brands, mastheads, publishing titles, customer lists and items similar in substance should not be recognized as intangible assets.

Expenditure on internally generated brands, mastheads, publishing titles, customer lists and items similar in substance cannot be distinguished from the cost of developing the business as a whole. Therefore, such items are not recognized as intangible assets.

1(j) Underwriting commission on shares is 5% whereas on debentures it is 2.5%.

2.

Country Club
Receipts and Payments Account for the year ended March 31st2010.

Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
To Balance b/d (Balancing figure)		1,990	By Salaries	24,750	
To Subscriptions:			Add: paid for 2008-09	2,000	
As per income & expenditure account	37,500		Less: unpaid for 2009-10	2250	24,500
Add: Outstanding as on 31-3-09	600		By General expenses	500	
Add: Advance on 31-3-10	270		Add: Paid for 2010-11	60	560
	38,370		By Audit fees(2008-2009)		1,000
Less: Advance on 31-3-09	(450)		By Secretary's honoraum		1,000
	37,920		By Stationery & Printing		450
Less: Outstanding as on 31-3-10	750	37,170	By Annual dinner expenses		11,500
To Entrance fees		250	By interest and bank charges		150
To Contribution for annual dinner		11,000	By sports equipment		
To profit on sports meet:			(14700-12600+9300)		10,400
Receipts			BY Balance c/d		1,600
Less: Expenses		750			
Total		51160	Total		51,160

Balance Sheet as on 31-3-2010

Liabilities	Rs.	Rs.	Assets	Rs.	Rs.
Subscription received in advance		270	Freehold grounds		10000
Audit fees Outstanding		1250	Sports Equipment		
Salaries Outstanding		2250	Balance as per previous balance sheet	12600	
Bank Loan		2000	Additions during the year	10400	
Capital fund:				23000	
Balance as per previous	19740		Less: Depreciation	9300	13700

balance sheet					
Add: surplus	600	20340	Subscriptions outstanding	750	750
			Insurance Prepaid	60	60
			Cash in hand	1600	1600
Total	26110	26110	Total	26110	26110

Balance Sheet as on 31-3-2009

	Rs.		Rs.
Subscription received in advance	450	Freehold grounds	10,000
Audit fees Outstanding	2,000	Sports Equipment	12,600
Salaries Outstanding	1,000	Subscriptions outstanding	600
Bank Loan	2,000	Cash in hand	1,990
Capital Fund	19,740		
TOTAL	25,190	TOTAL	25,190

3.

		Journal	Dr	Cr
2010 March	31	14% Redeemable Preference share capital account Dr Equity share Capital Account Dr To Reconstruction Account The reduction of Rs 25 per share on 1,000 cumulative Preference shares and Rs 5 per share on 70,000 equity shares vide special resolution No....dated....confirmed by the court vide order dated.....	25,000 3,50,000	 3,75,000
2010 March	31	12% Debentures Account Dr To 14% Debentures Account To Reconstruction Account The conversion of 3,000 12% Debentures of Rs 100 each into 3,000 14% Debentures of Rs 75 each	3,00,000	2,25,000 75,000
2010 March	31	Creditors Dr To Equity share Capital Account To Reconstruction Account Sacrifice by a creditor for Rs 25,00,000 of 50% of his claim and allotment to him of 1,00,000 equity shares of Rs 5 each in part settlement of his dues vide reconstruction scheme dated.....	17,50,000	5,00,000 12,50,000
2010 March	31	Reconstruction Account Dr To Profit and Loss Account To Fixed Assets To Current Assets To Provision for Taxation	17,00,000	3,00,000 5,00,000 8,00,000 1,00,000

4.

Carlin & Co. Ltd.
Mumbai Branch Trial Balance in (US \$)
as on 31st March, 2010

	Conversion rate per US \$ (Rs.)	Dr. US \$	Cr. US \$
Stock on 1.4.2009	40	7,500.00	—
Purchases and sales	41	19,512.20	29,268.29
Sundry debtors and creditors	42	9,523.81	7,142.86
Bills of exchange	42	2,857.14	5,714.29
Wages and salaries	41	13,658.54	—
Rent, rates and taxes	41	8,780.49	—
Sundry charges	41	3,902.44	—
Computers	—	6,000.00	—
Bank balance	42	10,000.00	—
New York office A/c	—	—	39,609.18
		<u>81,734.62</u>	<u>81,734.62</u>

Trading and Profit & Loss Account for the year ended 31st March, 2010

	US \$		US \$
To Opening Stock	7,500.00	By Sales	29,268.29
To Purchases	19,512.20	By Closing stock	10,000.00
To Wages and salaries	13,658.54	By Gross Loss c/d	1,402.45
	<u>40,670.74</u>		<u>40,670.74</u>
To Gross Loss b/d	1,402.45	By Net Loss	17,685.38
To Rent, rates and taxes	8,780.49		
To Sundry charges	3,902.44		
To Depreciation on Computers (US \$ 6,000 × 0.6)	3,600.00		
	<u>17,685.38</u>		<u>17,685.38</u>

Balance Sheet of Mumbai Branch
as on 31st March, 2010

Liabilities	US \$	US \$	Assets	US \$	US \$
New York Office A/c	39,609.18		Computers	6,000.00	
Less : Net Loss	<u>17,685.38</u>	21,923.80	Less : Depreciation	<u>3,600.00</u>	2,400.00
Sundry creditors		7,142.86	Closing stock		10,000.00
Bills payable		5,714.29	Sundry debtors		9,523.81
			Bank balance		10,000.00
			Bills receivable		<u>2,857.14</u>
					<u>34,780.95</u>
		<u>34,780.95</u>			<u>34,780.95</u>

Note : The above answer has been given on the basis that the Mumbai branch is an integral foreign operation of carlin & Co.

5(a)

Anthony's capital account

		Rs.			Rs
Dec 15	To drawings		April 1	By Balance b/d	70,000
	To Executors a/c	145,375	Dec 15	By Goodwill	50,156
		12,000		By Profit and Loss a/c	17,531
				By Insurance policies	19,688
		157,375			157,375

Working note 1

Anthony's's share of goodwill= $(85,500+102,500+108,000+132,000)/4 \times 5/2 \times 3/16 = 50,156$

Working note 2

Share of profits= $132,000/12 \times 17/2 \times 3/16 = 17$

Working note 3

Share of LIC policy= $(60,000+25,000+20,000) \times 3/16 = 19,688$

5(b)

Date	particulars	Nominal	interest	cost	Date	particulars	Nominal	interest	cost
1 st july	To balance b/d	26000	867	25090	Jul 31	By Bank		1040	
1 st Oct	To Bank	13000	173	12567	31Jan	By bank-half yearly nterest		1872	
1 Jan	To Bank	7800	260	7566	31mar	By bank sale	20800	208	20800
30 June	To P&L(interest)		2583		1 June	By bank	15600	416	16016
	To P&La/c profit on sale			1643	30 june	By accured interest		347	
						By balancec/d	10400		10050
		46800	3883	46866			46800	3883	46866

Working note:

- Interest accrued= $26000 \times 8\% \times 5/12 = 867$
- Interest for half year= $2600 \times 8\% \times 6/12 = 1040$
- Cost of Debentures purchased on October 1st
 Cum interest price= $13,000 \times 98/100 = 12,740$
 Less interest $13000 \times 8\% \times 2/12 = 173$
 Cost price 12,567
- Cost of debentures purchased on Jan 1st
 Cost = $7800 \times 97/100 = 7566$
 Interest = $788 \times 8\% \times 5/12 = 260$
- Interest on Debetures= $(26000+13000+7800) \times 8\% \times 6/12 = 1872$
- Sale of Debentures
 Cum interest price= $20800 \times 101/100 = 21008$
 Less interest = 208
 Cost price 20800

7. Sale of Debentures on June 1st
 Ex- interest price= 15600
 Add: interest $15600 \times 8\% \times 4/12 = \underline{416}$
 Selling price 16016
8. Accrued interest = $10,400 \times 8\% \times 5/12 = 347$
9. Cost of remaining debentures = $45223/46800 \times 10400 = 10,050$
 Cost of debentures purchased during the year = $25090 + 12567 + 7566 = 45223$

6(a)

Statement of profit		
Particulars	Rs.	Rs.
Capital at the end		140,250
Add: Drawings made during the year		
Loan to sister	26,250	
House hold expenses (2250*12)	27,000	
Rent for the house (750*12)	9,000	
Electricity charges (75*12)	900	63,150
		203,400
Less: Capital introduced during the year (15000*102/100)		15,300
Adjusted capital at the end		188,100
Less: Capital at the beginning		144,000
Profit made during the year		44,100

- 6(b) Capitalisation of borrowing costs as part of the cost of a qualifying asset should commence only when all the following conditions are satisfied:
1. The expenditure is being incurred for the Acquisition, construction or production of a qualifying asset;
 2. Borrowing costs are being incurred; and
 3. Activities those are necessary to prepare the asset for its intended use or sale, (Including any technical or administrative work prior to the commencement of Physical construction but excluding such activities during which no production Or development takes place) are in progress.

6(c)

An asset is classified as non-performing asset (NPA) if dues in the form of principal and interest are not paid by the borrower for a period of 90 days. If any advance or credit facility granted by a bank to a borrower becomes non-performing, then the bank will have to treat all the advances/credit facilities granted to that borrower as non-performing without having any regard to the fact that there may still exist certain advances/credit facilities having performing status. Income from the non-performing assets can only be accounted for as and when it is actually received. In concept, any credit facility (assets) becomes non-performing when it ceases to generate income. The RBI has issued guidelines to commercial banks regarding the classification of advances between performing and non-performing assets. A term loan is treated as a non-performing assets (NPA) if interest and / or installments of principal remains over due for a period of more than 90 days. A cash credit/overdraft account is treated as NPA if it remains out of order for a period of more than 90 days. An account is treated as 'out of order' if any of the following conditions is satisfied:

- (a) The outstanding balance remains continuously in excess of the sanctional limit/drawing power.
- (b) Though the outstanding balance is less than the sanctioned limit/drawing power—
 - (i) There are credits continuously for more than 90 days as on the date of balance sheet or
 - (ii) Credits during the aforesaid periods are not enough to cover the interest debited during the same period.

Bills purchased and discounted are treated as NPA if they remain overdue and unpaid for a period of more than 90 days. Necessary provision should be made for non-performing assets after classifying them as sub-standard, doubtful or loss asset as the case may be.

6(d)

Para 11 of AS 20 states that “for the purpose of calculating basic earnings per Share, the net profit or loss for the period attributable to Equity shareholders should be the net profit or loss for the period after deducting preference dividends and any attributable tax thereto for the period”.

With an emphasis on the phrase “attributable to equity shareholders”, it may be Construed that amounts appropriated to Mandatory Reserves as described in this Case, though not available for distribution as dividend, are still attributable to equity shareholders. Therefore, the appropriation made to mandatory reserve created for the redemption of debentures would be included in the net profit attributable to equity shareholders for the computation of Basic EPS. The treatment made by the company is not correct.

6(e)

The use of standard cost of elements of cost of production has been suggested by AS-2 as a matter of convenience only. In fact, AS-2 aims to suggest the use of absorption costing based on normal capacity. AS-2 says that standard cost system may be used for convenience if the results approximate the actual cost. If the company can adopt absorption costing for value of inventory, then the standard cost systems need not be adopted.

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

PRIME ACADEMY
30TH SESSION MODEL EXAM – AUDITING & ASSURANCE
QUESTION PAPER

Total No. of Questions: 8

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Total No. of Printed Pages: 2

Maximum Marks: 100

All are compulsory

- 1 State with reasons (in short) whether the following statements are true or false:
- A Government company cannot contribute amounts to a political party or to any person for political purpose.
 - Fraud is more difficult to detect than error.
 - Rs.5 lakhs paid by a pharma company to the legal advisor defending the patent of a product treated as Capital Expenditure. Is the treatment correct?
 - Compliance procedures are tests designed to obtain audit evidence as to completeness, Accuracy and validity of the data produced by accounting system.
 - SA 402 deals with responsibility of the auditor of the service organization.
 - If company's cash is used personally by the cashier and is made up on demand by the managements, it can be said that the financial statements are misstated.
 - If the auditor appointed at the AGM refuses to accept the same, the Company can appoint another person by holding General Meeting.
 - Surplus on the re-issue of forfeited shares standing to the credit of share forfeited account can be distributed as dividend
 - Interest accrued but not due on "Secured loans" is required to be shown under appropriate sub-heads under the head "Secured loans".
 - Secret reserve strengthens financial position, hence they are allowed (10x2=20 Marks)

- 2 As an auditor how would you react to the following situations/comments?

- a) Z Ltd. had the following items under the head "Reserves and Surplus" in the Balance Sheet as on 31st March, 2004:

	Amount Rs. in lacs
Securities Premium Account	80
Capital Reserve	60
General Reserve	90

The company had an accumulated loss of Rs. 40 lacs on the same date, which it has disclosed under the head "Profit and Loss Account" on the assets side of the Balance Sheet. (6 Marks)

- b) Sri Limited is a manufacturing company engaged in manufacture of cement. It had three plants already commissioned in its site at Chennai. The company expanded its plant capacity by contracting with a supplier for the purchase and installation of one additional plant. The project was commenced on 1.7.2007 and the new plant commenced commercial operations on 1.1.2008. The new plant was capitalized and shown as Fixed asset as on 31.3.2008 at cost which included, besides other things, the following:
- Contract price of plant and equipment and installation costs
 - Interest due for the period till 31.3.2008 for the term loan taken from scheduled bank for financing the project which is repayable over five years commencing from 1.7.2008.

- iii. Salaries, welfare expenses of the plant engineers of the company for the period from 1.7.2007 to 31.12.2007 who supervised the contract work. (6 Marks)
- c) Auditor of AAS Ltd. was unable to confirm the existence and valuation of imported goods lying with the transporter and accepted a certificate from the management without obtaining other audit evidence. (8 Marks)
- 3a) List six documents or papers, which would normally be retained on the current audit file. (5 Marks)
- 3b) what is meant by 'Analytical Review Procedures' and to what extent they can be relied upon. State different types of analytical reviews carried out in connection with the verification of Inventories. (5 Marks)
- 4a) Part I, Schedule VI to the Companies Act, 1956, prescribes the form of balance sheet and the requirements relating thereto. What is the specific requirement as per Part I, Schedule VI to the companies Act, 1956 relating to Investment. (5 Marks)
- 4b) Describe two audit techniques which may be employed to overcome the loss of audit trail where data is processed by computer. (5 Marks)
- 5a) In case of government companies, Comptroller and Auditor General of India has a right to issue directions to auditor and do supplementary audit. Explain. (5 Marks)
- 5b) At the AGM of XYZ Ltd., Mr. Y was appointed as the statutory auditor. He, however, resigned after 3 months due to personal reason. State, how the new auditor will be appointed by XYZ Ltd. (5 Marks)
- 6) How will you verify/vouch the following?
 (a) Loss of stock by theft.
 (b) Stock lying with subcontractor for fabrication. (10 Marks)
- 7a) Describe the salient features of financial administration of local bodies. (6 Marks)
- 7b) Distinguish between Internal Control Questionnaire and Internal Control Evaluation. (4 Marks)
- 8a) Mr. X, a Director of M/s KP Private Ltd., is also a Director of another company viz., M/s GP Private Ltd., which has not filed the annual accounts and annual return for last three years 2002-03 to 2004-05. Mr. X is of the opinion that he is not disqualified u/s 274(1) (g) of the Companies Act, 1956, and auditor should not mention disqualification remark in his audit report give your comment. (5 Marks)
- 8b) You have been appointed the sole auditor of a company where you were one of the joint auditors for the immediately preceding year and the said joint auditors is not reappointed give your comment. (5 Marks)

PRIME ACADEMY
30TH SESSION MODEL EXAM – AUDITING & ASSURANCE
SUGGESTED ANSWER

- 1 a) True: Section 293A of the Companies Act, 1956 prohibits Government Company from contributing amounts to a political party or to any person for a political purpose.
- b) True: Fraud is more difficult to detect than error. This is because fraud generally involves sophisticated and carefully organized schemes to conceal it such as forgery, deliberate failure to record transactions, intentional misrepresentations to the auditor.
- c) Payment of legal fees is normally revenue expenditure irrespective of the amount involved unless same is incurred to bring any new asset into existence. By the given expenditure neither any endurable benefit can be obtained in future in addition to what is presently available nor would the capacity of the asset be increased. Hence, treating such expenditure as capital expenditure is incorrect
- d) False : Compliance procedures are tests designed to obtain reasonable assurance that those internal controls on which audit reliance is to be placed are in effect. Here auditor is concerned with assertions that the control exists and is operating effectively.
- e) False: SA 402 “Audit Considerations Relating to Entities Using Service Organizations” deals with responsibility of auditor whose client uses a service organization. In other words, it deals with responsibility of auditor of the client of the service organization.
- f) True: The amount detected and recorded may only be “tip of the ice-berg”. It may suggest serious weaknesses in internal controls. Knowledge of what the employee ought to have a direct bearing on the nature and details of checks to be applied in relation to matters dealt with by the employee.
- g) False: This is not a casual vacancy. Since the newly appointed auditor has refused to accept the appointment, no appointment can be said to have been made at the AGM. U/s 224(3) of the companies Act, 1956, the power vests with the Central Govt. to make the appointment
- h) True: The surplus on reissue of forfeited shares is credited to capital reserve account being a capital profit. Capital profit realized in cash, authorized by the articles and remains surplus after revaluation of all assets and liabilities can be distributed as dividend. (*Lubok Vs the British Bank of South America*)
- i) False: As per Part-I, Schedule VI to the Companies Act, 1956 interest accrued but not due on secured loans is required to be shown under “current liabilities”.
- j) False: A secret reserve is that whose existence is not disclosed on the face of the Balance Sheet. Its existence strengthens the financial position. However, in the light of Provisions Contained in Part-III of Schedule VI to the Companies Act, 1956, it is not possible for a company to create secret reserve.

- 2a) Debit Balance of Profit and Loss Account: Part I of Schedule VI to the Companies Act, 1956 requires that the debit balance of Profit and Loss Account shall be shown as deduction from the uncommitted reserves, if any. Hence, the accumulated loss of Rs.40 lakhs should be deducted from the General Reserve of Rs.90 lakhs, and the net amount of Rs.50 lakhs should be shown as General Reserve on the Liabilities side of the Balance Sheet. Securities Premium Account and Capital Reserves are not uncommitted reserves and, thus, these shall also be shown on the liabilities side of the balance sheet under the heading of “Reserves and Surplus”. In the present case, the disclosure requirements of Schedule VI to the Act have not been followed and, accordingly, the auditor should modify his report.
- b) Accounting for Fixed Assets and Borrowing Cost: According to AS 10, the cost of fixed asset includes all expenses for bringing into existence and working condition the asset for its intended purpose. Accordingly all expenses attributable to the construction of fourth cement plant can be added to the cost except those which had been not permitted by the AS.

The cost of purchase, installation of asset is directly related to bringing the asset into the working condition for intended use and hence is correctly capitalized.

According to AS 16 on borrowing cost, the interest expenditure on borrowing can be capitalized till the date of the cessation of construction. The capitalization ceases when substantially all activities of construction are completed. Simply, the interest can be capitalized till the completion of the project and it should not be capitalized after commencement. In the instant case of capitalization of interest, the company is partly right in capitalizing it till 31.12.2007 and is wrong for capitalizing it beyond 31.12.2007 till 31.3.2008.

The allocation of common overhead is allowed if it they are specifically relatable to Project. The salary expenditure of plant engineers may be capitalized for the construction period. Accordingly, the auditor shall qualify his report for the deviation if not adjusted, taking into account the materiality of the impact on accounts.

- c) As per AAS-11 on “Representation by Management” in the course of audit, an auditor comes across various matters in respect of which he is not able to obtain sufficient appropriate audit evidence. In such a situation he may rely on the submission by the management but he should seek corroborative audit evidence from sources inside or outside the entity and evaluate the representation made by management.

Management representation is not a substitute for other audit evidence. The auditor should seek and apply normal audit procedure. Mere possession of a certificate does not absolve the auditor from his liability. He should not seek or accept certificates when subject matter is such that it is capable of verification from internal and/or external evidences.

In the instant case, the stock of imported material lying with the transporter can be easily verified with purchase order, invoice, bill of entry, custom document, payment of F.C. etc. Therefore the auditor in this instant case has not used available evidences. He should not have rested with the certificate obtained from the management and could have evaluated other.

3a) Following six documents or papers, which would normally be retained on the current?

Audit file:

- Correspondence relating to acceptance of annual re-appointment.
- Extracts of important matters in the minutes of the board meetings and general meeting as are relevant to audit (e.g. minutes relating to declaration of dividend).
- Audit plan and audit programme.
- Analysis of transactions and balances (e.g. age-wise analysis of debtors).
- Record of audit procedures and their results (e.g. test checking of purchase invoices to vouch payments for purchases).
- Evidence regarding the supervision and review of the work of assistants.

3b) According to AAS-14 on “Analytical Procedures”, analytical procedures it means the analysis of significant ratios and trends including the resulting investigation of fluctuations and relationships that are inconsistent with other relevant information or which deviate from predicted amounts.

The application of analytical procedures is based on the expectation that relationships among data exist and continue in the absence of known conditions to the contrary. The presence of these relationships provides audit evidence as to the completeness, accuracy and validity of the data produced by the accounting system. However, reliance on the results of analytical procedures will depend on the auditor’s assessment of the risk that the analytical procedures may identify relationships as expected when, in fact, a material misstatement exists.

The extent of reliance that the auditor places on the results of analytical procedure depends on the following factors:

- (a) Materiality of the items involved, for example, when inventory balances are material, the auditor does not rely only on analytical procedures in forming conclusions. However, the auditor may rely solely on analytical procedures for certain income and expense items when they are not individually material;
- (b) other audit procedures directed toward the same audit objectives for example, other procedures performed by the auditor in reviewing the collectibility of accounts receivable, such as the review of subsequent cash receipts, might confirm or dispel questions raised from the application of analytical procedures to an aging schedule of customer’s accounts;
- (c) Accuracy with which the expected results of analytical procedures can be predicted. For example, the auditor will ordinarily expect greater consistency in comparing gross profit margins from one period to another than in comparing discretionary expenses, such as research or advertising; and
- (d) assessments of inherent and control risks, for example, if internal control over sales order processing is weak and, therefore, control risk is high, more reliance on tests of details of transactions and balances than on analytical procedures in drawing conclusions on receivables may be required.

Inventories:

- (i) Reconciliation of quantities of opening stocks, purchases, production, sales and closing stocks;
- (ii) Comparison of closing stock quantities and amounts with those of the previous year;

- (iii) Comparison of the relationship of current year stock quantities and amounts with the current year sales and purchases, with the corresponding figures for the previous year;
- (iv) Comparison of the composition of the closing stock (for example) raw materials as a percentage of total stocks, work-in-process as a percentage of total stocks) with the corresponding figures for the previous year;
- (v) Comparison of current year gross profit ratio for the previous year;
- (vi) Comparison of actual stock, purchase and sales figures with the corresponding budgeted figures, if available;
- (vii) Comparison of yield with the corresponding figure for the previous year;

4a) Investments: This item should be classified as under

1. Investments in Government or Trust securities.
2. Investment in shares, debentures or bonds.
3. Immovable properties.
4. Investments in the capital of partnership firms.
5. Balance of unutilized monies raised by issue.

Under item (2) above, investments in shares, debentures or bonds of subsidiary companies should be separately stated. In respect of all investments in shares, there should be shown separately, shares, fully paid up and partly paid up and the different classes of shares should be distinguished. The nature of investments should be disclosed and where the investments are earmarked, the fund which such investments represent should be stated. In each case, the mode of valuation, e.g., cost or market value should be stated. The aggregate amount of a company's quoted investments together with the market value thereof and the aggregate amount of a company's unquoted investments should be shown separately.

The interest accrued on investments should be shown under the heading "current assets" and not under this head. Section 372(10) provides that every investing company shall annex to each balance sheet prepared by it a statement showing the bodies corporate (indicating separately the bodies corporate in the same group) in the shares of which investments have been made by it (including all investments, whether existing or not, made subsequent to the date as at which the previous balance sheet was made out) and the nature and extent of the investments so made in each body corporate. However, in case of an investment company, it is sufficient if the statement shows only the investments existing as on the date of the balance sheet. A statement of investments (whether shown under "investments" or under "current assets" as stock-in-trade) separately classifying trade investments and other investments should be annexed to the balance-sheet. A "trade investment" means an investment by a company in the shares or debentures of another company, not being its subsidiary, for the purpose of promoting the trade or business of the first company.

The said statement should show the names of the bodies corporate, indicating separately the names of the bodies corporate under the same management in whose shares or debentures, investments have been made. The nature and extent of the investments so made in each body corporate should be given. Such statement should include all investments whether existing or not, made subsequent to the date as at which the previous balance sheet was made out. In case of an investment company, that is to say, a company whose principal business is the acquisition

of shares, stock, debentures or other securities, it will be sufficient if the statement shows only the investments existing on the date as at which the balance sheet has been made out.

In regard to the investments in the capital of partnership firms, the names of firms, with the names of all their partners, total capital and shares of each partner should be given in the statement annexed to the balance sheet. Where the company's debentures are held by a nominee or trustee for the company, the nominal amount of the debentures and the amount at which they are stated in the books of the company shall be stated. This disclosure will enable a shareholder to ascertain how much profit the company will make if the debentures purchased by the company were to be cancelled. All un-utilized monies out of the issue must be separately disclosed in the Balance Sheet of the Company indicating the form in which such unutilized funds have been invested.

- 4b) In certain cases, it is equally important for the management and for the auditor alike to maintain a permanent record of the stages in processing data, particularly where large amounts are involved and possibilities of misappropriation are considerable. In such circumstances the auditor may prevail upon the directors to ensure that visible records are produced regardless of the effect this might have on total processing time. In other circumstances, however, the loss of audit trail will need to be overcome by CAATs, such as:
- (i) The use of test packs: As has been indicated, management by exception normally, results in a loss of trail and the auditor may employ the use of test packs in order to establish the correct functioning of the controls which are alleged to reside in the normal computer programs. A series of fictitious transactions make up the test pack; some may be based on transactions known to have taken place in the past, while others may be deliberately contrived in order to test the controls, e.g. a test pack on wages would include overtime claims of varying amounts from normal to abnormal to absurd. The data in the test pack is then processed following usual routines existing elsewhere; the results are then carefully scrutinized by the auditor.
 - (ii) Special computer programs for auditors: Specially devised interrogation programs are now available by means of which the auditor may obtain a print of any information contained in the client's master files, suitably presented according to the criteria applicable. Thus, such a program would be of use to the auditor when he is assessing the adequacy of a general provision for bad debts, since it will enable him to obtain a complete printout of the debtor balances specially stratified according to the size of the amounts outstanding. Alternatively, or additionally, the balances can be stratified according to the "age" of the debts. Similar advantages obviously arise in the examination of a stock inventory where it is necessary to pay particular attention to apparently slow-moving items. Many of the programs now available also include routines for performing methodical editing and statistical functions such as the construction of a statistical sampling test involving the use of computer generated random numbers. Auditors may also use exception reporting for audit purposes by asking for programs to include exception reports in the form of a print-out useful for audit tests.
- 5a) Power of C & AG: The audits of government companies are carried out by auditors who are appointed by C&AG. The audit is done by qualified Chartered Accountants and the audit is done on similar lines with the audits of limited companies. In addition to report under section 227, the auditors have to give report on the specific matters as contained in the directives of the C&AG.

As per section 619(3) the C&AG shall have power

- a. To direct the manner in which the company's accounts shall be audited by the statutory auditor and give instruction in regard to any matter relating to the performance of his functions as such. The direction under section 619(3)(a) broadly covers the system of book keeping and accounts, internal control etc.
- b. To conduct a supplementary audit or test audit by such person as he may authorize in this behalf and require the information or additional information any person or persons so authorized, on such matters by such person or persons and in such form as C & AG may by general or special order, direct

Thus, in case of Govt. Companies, audit is conducted by professional auditors, appointed on the advice of C & AG and the latter is authorized u/s 619(4) of the Companies Act, 1956 to conduct supplementary audit or test audit. The C&AG shall direct the manner in which the company's accounts shall be audited by the statutory auditors and give such auditors necessary instructions in regard to any matter relating to the performance of their functions as such. The statutory auditor shall submit a copy of their audit report to C & AG who shall have right to comment upon or supplement the audit report submitted by the statutory auditors in such a manner as he may think fit.

- 5b) Section 224(6) of the Companies Act, 1956 deal with provisions relating to appointment of auditor caused due to casual vacancy. A casual vacancy normally arises when an auditor ceases to act as such after he has been validly appointed, e.g., death, disqualification, resignation, etc. In the instance case, Mr Y has been validly appointed and thereafter he had resigned. Thus a casual vacancy had been created on account of resignation. The law provides that in case a casual vacancy has been created by the resignation of the auditor (as in this case), the Board cannot fill in that vacancy. The company in a general meeting can only fill the same. Thus, in this case XYZ Ltd will have to call an extra-ordinary general meeting (EGM) and appoint another auditor. The new auditor so appointed shall hold office only till the conclusion of the next annual general meeting.

The provisions of the Companies Act, 1956 applicable for the appointment of an Auditor in place of a retiring auditor would equally applicable in the instant case
Are given below:

- (i) Section 225(1): Special notice shall be required for a resolution at an annual general meeting appointing as auditor a person other than a retiring auditor
- (ii) Section 190(2): Special notice is to be sent to all members of the company at least 7 days before the date of the AGM.
- (iii) Section 225(2): On receipt of notice of such a resolution, the company shall forth with send a copy thereof to the retiring auditor.
- (iv) Section 225(3): Representation if any, received from the retiring auditor should be sent to the members of the company.
- (v) Section 224A: Special resolution as required under this section should be duly passed.
- (vi) Section 224(1B): Before any appointment or reappointment of auditors is made at an annual general meeting, a written certificate is to be obtained from the auditor proposed to be appointed that his appointment will be in accordance with the limits specified in Section 224(1B).
- (vii) The incoming auditor should also satisfy himself that the notice provided for Under Sections 224 and 225 has been effectively served on the outgoing Auditor.

- 6 (a) Loss of Stock by Theft
- (i) The most important evidence for verification will be the First Information Report (FIR) filed with the Police for this theft.
 - (ii) The contents of the FIR will be cross checked with the financial books and stock records.
 - (iii) If no FIR is lodged, then deeper analysis will be required including satisfaction of the reasons for not filing FIR.
 - (iv) The quantity and value of the stolen stock is not included in the closing stock will be ensured.
 - (v) Verify whether such stock was insured and whether theft claim was lodged with the insurance company.
- (b) Stock lying with sub-contractors for fabrication
- (i) The stock lying with the sub contractor for processing should be confirmed by the confirmation letter obtained from the sub contractors.
 - (ii) The necessity of holding stock by them should be vouched. If the stock is lying with them for long, the reason for the same should be ascertained. The condition of the stock should be confirmed by the management.
 - (iii) The stock should be valued at cost or net realizable value whichever less the processing charges incurred should be added to the cost. The provision for the liability towards unpaid processing charges should be created.
 - (iv) The stock should be disclosed under the head current assets under the sub head inventory.
 - (v) Adjustment in accounts should be made for any discrepancies between stocks
- Confirmed and stock sent out as per memorandum records.

- 7a) (i) Budgetary procedure
- (a) *Objective* – The objectives of local bodies budgetary procedure are :
- * Financial Accountability,
 - * Control of expenditure, and
 - * To ensure that funds are raised and money is spent by the executive Departments in accordance with the rules and regulations and within the limits of sanction and authorization by the Legislature or council.
- (b) *Aspects* – The aspects covered in budgeting are:
- * Determining the levels of taxation e.g. various types of taxes, fees and rates; and
 - * Laying down the ceilings on expenditure, under revenue and capital heads.
- (ii) Expenditure controls
- (a) At the State and Central Government level, there is a clear demarcation Between the Legislature and executive. In a local body, legislative powers are vested in the Council whereas executive powers are delegated to the Officers e.g. Commissioners.
- (b) All matters of regular revenues and expenditures are generally delegated to The executive wing. For special situations like reduction in property taxes, Refunds of security deposits etc., sanction from the legislative wing, i.e., the Municipal Council will have to be obtained.

(iii) Accounting system

(a) Municipal accounting system has been conventionally prepared under the cash System. In the recent past however, it is being changed to the accrual system of accounting in some States like Tamil Nadu.

(b) The accounting system is characterised by –

- * Subsidiary and Statistical Registers for taxes, assets, cheques, etc;
- * Separate vouchers for each type of transaction;
- * Compulsory monthly bank reconciliation;
- * Submission of summary reports on periodical basis to different authorities a Regional and State level.

7b) Internal Control Questionnaire (ICQ) and Internal Control Evaluation (ICE): The Internal control questionnaires show the area where weakness occur or likely to occur. They do not give any idea of the importance of those weaknesses. The Internal Control Evaluation brings to light importance of those weakness disclosed by ICQ. Main points of distinctions are:

- (i) ICQ incorporates a large number of detailed questions but does not attempt to distinguish their relation in materiality. ICE isolates the main control objectives within the area of review.
- (ii) Weaknesses are highlighted by answer “Yes” on ICE compared with ‘No’ on ICQ.
- (iii) Answer ‘no’ in ICQ indicates a weakness real or potential, but its significance is not revealed. Whereas ICE requires audit personnel to state whether, an apparent weakness may prove to be material in relation to the accounts as a whole.
- (iv) The ‘Control Checklist’ in ICE is more than a summary of key control factors, and is no substitute for ICQ.

8 a) Disqualification of a Director u/s 274(1)(g) of the Companies Act, 1956: Section 227(3)(f) of the Companies Act, 1956 imposes a specific duty on the auditor to report whether any director is disqualified from being appointed as director u/s 274(1)(g) of the Companies Act, 1956. As per provisions of Section 274(1)(g), if a director is already holding a directorship of a “public company” which has not filed the annual accounts and annual returns for any continuous three financial years shall not be eligible to be appointed as a director of any other public company.

In this case since Mr. X is a director of Private Ltd. Company, hence the provisions of section 274(1)(g) are not applicable to him and as such he is not disqualified from directorship of both the companies. Therefore, the auditor shall not report about the disqualification u/s 227(3)(f) of the Companies Act, 1956

8 b) Appointment of Sole Auditor: When one of the joint auditors of the previous year is appointed as the sole auditor for the next year, it is similar to non re-appointment of one of the retiring joint auditors. Accordingly, provisions of the Companies Act, 1956 to be complied with are as under:

1. Ascertain that special notice u/s 225(1) of the Companies Act, 1957 was received by the company from a member at least 14 days before the AGM date.
2. Check whether the said notice has been sent to all the members at least 7 days before the date of the AGM as per section 190(2) of the Companies Act, 1956.
3. Verify the notice contains an express intention of a member for proposing the resolution for appointing a sole auditor in place of both the joint auditors who retire at the meeting but are eligible for re-appointment.

4. The notice is also sent to the retiring auditor as per section 225(2) of the Companies Act, 1956.
5. Verify whether any representation, received from the retiring auditor was sent to the members of the company.
6. Verify from the minutes book whether the representation received from the retiring joint auditor was considered at the AGM.

PRIME ACADEMY
30TH SESSION MODEL EXAM – LAW ETHICS & COMMUNICATION
QUESTION PAPER

Total No. of Questions: 16

Time Allowed: 3 Hrs

Total No. of Printed Pages: 2

Maximum Marks: 100

WMNO

All are compulsory

PART I

- 1(a) “Accepted is lighted match, white offer is a train of gun powder.” Comment 5 Marks
- (b) X, a minor was studying in B.Com in a college. On 1st July, 2009 he took loan of Rs. 10000 from B for payment of his college fees and to purchase books and agreed to repay by 31st December 2009. X possesses assets worth of Rs. 2lakhs. On due date X fails to pay back the loan to B. B now wants to recover the loan from X out of his (X's) assets. Referring to the provisions of the Indian Contract Act, 1872 decide whether B would succeed 5 Marks
- 2(i) State the following statements are correct or incorrect
- (a) Past consideration is no consideration.
- (b) When a contract is made on telephone it becomes complete at the place where the acceptance is heard.
- (c) Unilateral mistake renders an agreement void.
- (d) A proposer can be a promisor
- (e) ‘A’ owes to ‘B’ 5000 rupees. ‘C’ pays to ‘B’ 1000 rupees and ‘B’ accepts them in satisfaction and claim on ‘A’, the payment is a discharge of the whole claim.
(5x1= 5 Marks)
- 2(ii) ‘No consideration, No contract’ – state the Exceptions 5 Marks
- 3 A draws a bill on B, who accepts it without consideration. He endorses the bill to C for valuable consideration. On due date when C presents the bill to B for payment, B contends absence of consideration. Decide the case. 5 Marks
- 4 How is a holder in due course, different from a holder? 5 Marks
- 5 When Corporate Veil can be lifted? 5 Marks
- 6 How the articles of association for a Company be altered? 5 Marks
- 7 Explain “Shelf Prospectus”. 5 Marks
- 8 How to apply for a company name under E filing? 5 Marks
- 9 The plaintiff society was incorporated in 1902 under the name, “The society of Motor Manufacturers and Traders Ltd. In 1924, the defendant society was incorporated under the name “Motor Manufacturers and traders Mutual Insurance Ltd “. The plaintiff company bought an action to restrain the use of this name. Decide. 5 Marks

- 10 A Ltd issued a notice for holding of its AGM on 7th November 2009. Notice was posted to members on 16th October 2009. Some members alleged that the company had not complied with the Companies Act as regards period of notice and as such meeting was not validly called. Decide whether the meeting is validly called? 5 Marks

PART II

- 11(a) Explain the meaning of business ethics 5 Marks
- (b) Explain the features of Corporate Social Responsibility 5 Marks
- 12 What do you mean by harassment? Explain the effect of harassment 5 Marks
- 13 Explain the need of ethical behavior in marketing 5 Marks

PART III

- 14(a) Explain “Semantic problems” which is one of the causes for mis-communication 5 Marks
- (b) Kinesics (Body language) plays important role in communication. Do you agree? 5 Marks
- 15 What are the advantages of upward communication? 5 Marks
- 16 What are the types of power of attorney? Draft a power of Attorney to appear before Income-Tax Authorities 5 Marks

PRIME ACADEMY
30TH SESSION MODEL EXAM – LAW ETHICS & COMMUNICATION
SUGGESTED ANSWER

- 1(a) The quotation that Acceptance is lighted match while Offer is a train of gunpowder, is given by Sir William Anson. In this quotation, Prof. William has compared the acceptance with light of match and offer with a train of gunpowder. He makes such comparison due to the following reasons:
1. As soon as the lighted match is brought in contact with the train of gunpowder, an explosion takes place, in the same way, when Acceptance is brought in contact with offer, a contract takes place and offer loses its entity.
 2. A train may be removed before match is applied to gun powder, In the same way, an offer may be revoked before it is accepted by the offeree.
- Thus, we see that there is nothing wrong when Prof. William says, “Acceptance is lighted match, while offer is a train of gun powder”.
- (b) Yes. Y can proceed against the assets of X. The loan was given for the necessities of minor's life. (Section 68)
- 2(i)
- (f) Past consideration is no consideration.
Not correct under both, the Indian as well as English Law of contract.
- (g) When a contract is made on telephone it becomes complete at the place where the acceptance is heard.
Correct. When a contract is made on telephone it becomes complete at the place where the acceptance is heard.
- (h) Unilateral mistake renders an agreement void.
Not correct. Unilateral mistake renders an agreement void.
- (i) A proposer can be a promisor
Correct. A proposer can be a promisor.
- (j) 'A' owes to 'B' 5000 rupees. 'C' pays to 'B' 1000 rupees and 'B' accepts them in satisfaction and claim on 'A', the payment is a discharge of the whole claim.
Correct. The payment is discharge of whole claim.
- 2(ii) In our Indian Contract Act, 1872, consideration is made one of the essential elements to form a contract. It is a general rule, “No Consideration, No Contract”,
Therefore, an agreement without consideration is void,

However law recognizes certain exceptions :-

1. Love and Affection :

An agreement, without consideration, will be enforceable, if the agreement:- is in writing and registered under the law for the time being in force for the registration of documents, and is made on account of natural love and affection,

For example: A father promises in written and registered to pay his son Rs. 1,000/= p.m. in love and affection. Later on, the father cannot refuse to pay the amount on the ground that he is not getting any consideration,

2. Compensation for voluntary services : A promise to compensate, wholly or in part, a person who has voluntarily done something for the promisor, is enforceable by law without consideration.

For example: A found B's purse and returns it to him, B promised to pay a reward of Rs.100 to A. B cannot refuse to pay on the ground that there was no consideration.

3. Written promise to pay time-barred debt: A Promise made in written to pay a time –barred debt is enforceable even without consideration.

For example: A owes B Rs. 2,000/= but the debt is time – barred as per the Limitation Act. If A promises in written to pay the sum to B, then there will be a valid contract.

4. Gift actually made.

For example: On the birthday of Mr. A, Mr. B gives him a golden chain as a birthday gift, In this case, B cannot demand back the chain on the ground that there was no consideration.

5. Agency: No consideration is needed to create agency.

For example : Mr. A agrees to become the agent of Mr. B for nothing , If A enters into a contract on the behalf of B, then B cannot refuse to accept contract on the ground that he is not giving any consideration to A.

6. Contract under seal

7. Contract of Bailment

8. Contract of Guarantee

3 B is liable to pay to C, who is holder in due course.

4

Basis	Holder	Holder in due course
1. Consideration	May become Possessor or Payee of an instrument even without consideration.	Acquires possession for consideration.
2. Time of possession	Can become Possessor of instrument even after maturity.	Shall become possessor of the instrument before the amount thereon became payable.
3. Defect in title of transferor	If he had knowledge of Transferor's defective title, he cannot hold the prior parties liable.	Absence of knowledge about Transferor's defective title is what makes a Holder, Holder in due course. He becomes the payee in good faith, i.e. without having sufficient cause to believe that any defect existed in the Transferor's title.

- 5 From the juristic point of view a company is a legal person distinct from its members (Salmon v. Salomon & Co. Ltd). This principle may be referred to as the veil of incorporation. The effect of this principle is that there is a fictional veil and not a wall between the company and its members. "Lifting the veil" means looking behind the company as a legal person, i.e. disregarding the corporate entity and paying regard instead to the realities behind the legal façade. Where the courts ignore the company and concern themselves directly with the members or managers, the corporate veil may be said to have been lifted only in corporate circumstances the courts are willing to lift the corporate veil and that too, when questions of control are involved rather than merely question of ownership.

The following are the cases where modern company law disregards the principle of corporate personality or the principle that the company is a legal entity distinct and separate from its shareholders or members.

- (i) In the law relating trading with the enemy where the test of control is adopted.
- (ii) In certain matters concerning the law of taxes, death duties and stamps particularly where question of the controlling interest is in issue.
- (iii) where companies form other companies as their subsidiaries to act as their agent. The application of the doctrine may operate in favour of such companies depending upon the acts of a particular case.
- (iv) Where the benefit of limited liability of shareholders is destroyed and each shareholder's liability has become unlimited. This happens under section 45 when the number of members of a public company or private company falls below 7 or 2 respectively, and business is carried on for more than six months. In such a situation, every person who is a member and is cognizant of the fact shall be severally liable for the payment of the whole debts of the company incurred during that time.
- (v) Under the law relating to exchange control.
- (vi) Where the device of incorporation is adopted for some illegal or improper purpose, e.g., to defeat or circumvent law, to defraud creditors or to avoid legal obligations.

- 6 Procedure for alteration of Articles of association:
 - Convene a General meeting and Pass a Special Resolution.
 - File a copy of special resolution in form 23 with ROC within 30 days of the date of resolution.
 - File printed copy of altered articles of Company with the ROC within one month of the date of Central government approval wherever applicable.

- 7 Shelf prospectus means a prospectus issued by any financial institution or bank for one or more issues of the securities or class of securities specified in that prospectus. A company filing a shelf prospectus with the ROC shall not be required to file prospectus afresh at every stage of offer of securities by it within the period of validity.
 A Company filing a shelf prospectus shall be required to file an information memorandum within such time as may be prescribed by the central government prior to making of a second or subsequent offer of securities under the shelf prospectus on all material facts like new charges created , previous offer of securities and succeeding offer of securities etc.
 An information memorandum shall be issued to the public along with the shelf prospectus filed at the stages of first offer of securities and it shall be valid for one year from the date of opening the first issue under the prospectus.

- 8 File E form 1A by logging in the portal along with a payment of fees of Rs. 500/- affixing the digital signature of the applicant proposing to incorporate the company. If the proposed name is not available apply for a fresh name on the same application.

- 9 The contents of problem are identical with the case “Motor Manufacturers and Traders Ltd Vs. Motor Manufacturers and Traders Mutual Insurance Co Ltd (1925) 1 Ch 675. In that case, the Court held that the plaintiff society was a trade protection society was a trade protection society and the defendant company was an insurance company. There was great difference in their business. Therefore Court quashed the plaintiff’s petition.

- 10 Validity of Meeting:
 - (a) 21 clear days Notice of an AGM must be given.
 - (b) If Notice is sent by post, it shall be deemed to have been received on expiry of 48 hours from the time of posting.
 - (c) For working out clear 21 days, day of Notice and day of Meeting shall be excluded.

21 clear days notice has not been served and the meeting is, therefore not validly convened.

Where Notice is sent by post, it must have been sent at least sent at least 25 days before the date of the meeting.

Notice should have been posted on 14-10.2009: while actually it is posted on 16-10-2009.

Therefore Notice falls short by 2 days.

- 11(a) Business ethics refers to the application of ethical principal to business. Business ethics is a study of moral right or wrong. It concentrates on moral standards as they apply to business policies, institutions and behaviour.

For example:-

Functional Area Of Business	Ethical Practice
Plant Location	No adverse impact on local community and environment
Production	Control of Pollution
Purchase and Storage	No hoarding of raw materials and finished goods
Transportation	Complying with safety regulations
Marketing	Fair treatment to customers
Advertising	Truthful and realistic claims
Administration	Concern for Social values
Finance	Protection and appreciation of capital
Personnel	Just and equitable treatment to employees

Features of business ethics:

- (1) Business ethics is applied ethics It involves the application of what is good and right to business affairs.
- (2) Ethics is the study of Morality. However, ethics is not the same as morality.

(b) “Definition”

“CSR” is the continuing commitment by business to behave ethically and contribute to economic development, while improving the quality of life of the workforce and their families as well as of local community and society at large.

1. Nature of CSR :-Business is a part of Society : The concept of Social responsibility is based on the premise that a business firm is more than an economic institution. It is a part of Society and its activities exercise significant influence on the public. Therefore,business should work beyond the narrow goal of profit – making
2. No Charity : CSR does not mean mere charity. A business can be socially responsible without charity.
3. In the long run, Social responsibility is consistent with profit motive. A business cannot survive and grow without serving the society. By fulfilling its social obligations, business creates an environment, which is conducive to its success.

4. Social responsibility is a personal obligations :- A business firm can discharge its social responsibility only through the persons, who manage and control it.
5. Social responsibility is a reciprocal relationship : - just as business owes responsibility to society, society also is responsible to business.
6. Social responsibility is a continuing obligation :- A business firm remains responsible to the society throughout its life.

12 Harassment means intimidating and tormenting an individual or group of persons through constant interference. All acts and conducts that create a hostile or offensive working environment amount to harassment.

Effect of Harassment :

- (1) Such an environment unreasonably interferes with an individual's freedom and work performance.
- (2) It is not easy to determine whether a work environment is hostile. Much depends on the attitudes of the employees involved and the response of management to the concerns of employees.
- (3) Hostile Work environment causes stress and interferes with a person's ability to work. It may even lead to nervous breakdowns.
- (4) Harassment is a crude violation of the moral standards of utilitarianism rights and justice.
- (5) It can result in substantial costs to the firm. In addition to litigation and settlement costs, there are costs of labour absenteeism and turnover.
- (6) Productivity declines due to reduced morale and stress.
- (7) Harassment is an unjust misuse of the unequal power that an employer can exercise over the employee.

13)1. Consumer well – being : Consumers are the lifeblood of a business. Hence management should be concerned with the well being of consumers, Ethical behaviour in marketing strategies, policies and campaigns ensure recognition of consumers' interests.

2. To maintain public confidence in marketing ; Unethical marketing practices on the part of a few business firms are eroding public confidence in marketing.

3. Image Boost to the Organisation : People form an opinion about a business enterprises on the basis of their experience. Sound and ethical practices should be adopted by marketing personnel to project maintain and improve the corporate image.
4. To avoid Government regulation : Unethical marketing increase the probability of government control on business. Most of the Governmental limitations on marketing arise out of management's failure to maintain ethical standards in marketing business firms can avoid such regulation and retain their freedom of operations by caring for the interests of consumers on voluntary basis.
5. Matching power & Responsibility : Marketing Executives wield a great deal of social power as they influence markets and speak out on economic issues. However, there is a responsibility related to that power. If marketing managers do not use their power in a socially acceptable mannaer, that power will be lost in the long run.

14. Advantage of upward communication :

- (1) Subordinates send their complaints, problems and suggestions to top management using upward communication. The top management formulates its policies keeping in mind these suggestions complaints and problems of employees.
- (2) This Communication system encourages new ideas and best chosen ideas are implemented in the business.
- (3) Top Management comes to know the reactions of persons in different departments and new plans are devised to keep the business on sound footings.
- (4) The Most important advantage in this communication is that there ariss greater harmony and mutual feelings of co-operation among subordinates and managers. This paves the way for more production in the organization.

What are the types of power of attorney? Draft a power of Attorney to appear before Income-Tax Authorities?

15. BODY LANAGUAGE (KINESICS)

This is known as kinesics and is an important medium of communication. According to experts the message is conveyed as under:

7% by verbal communication,
38% by voice tone
55% by body movement

Thus, absence of body language is any message renders it incomplete. Some examples of body language are:

BODY POSITION	MESSAGE
PROTRUDING EYES	FOR DISBELIEF
RUBBING THE NOSE	WHEN TENSE
CROSSING THE HANDS	FOR FEELING SECURE
MOVING THE SHOULDERS UP AND DOWN	FOR SHOWING THAT YOU ARE DIFFERENT
PUTTING THE HAND ON FOREHEAD	FOR DISTRESS
CLOSING EYELIDS	FOR PROXIMITY

Another good example of body language is the signal used by a traffic policeman to stop the traffic.

Body language completes communication wherever a verbal message is given along with the use of body language then the message becomes clear. Body language helps in delivering the message unchanged.

16. A power of attorney falls within the law of agency. A power of attorney is a written instrument empowering a specified person or persons to act for and in the name of person executing it. The instrument of power of attorney is classified into the following two categories.

1. Specific Power of Attorney:

A specific power of attorney is given for a particular specific act for instance for appearance before Tax Authorities or before Registrar of Companies for presenting documents for incorporation of a company or before a Sub – Registrar for registration of documents etc.

2. General Power of Attorney

(a) Covering all the acts relating to the execution of the deed. Presenting the same for registration, admitting execution thereof.

(b) Such a General Power of Attorney can be registered also.

Format of Power of Attorney to appear before Income – Tax Authorities

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

Place:

Date:

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

Place:

Date:

(Address of Power of attorney holder)