

Question 1

State with reasons (in short) whether the following statement is true or false.

Surplus on the re-issue of forfeited shares standing to the credit of share forfeited account can be distributed as dividend.
(2 Marks) (Nov 2007)

Answer

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)

Question 2

Comment on the following situations/statements:

Strong Ltd. holding 60% of the equity shares in Weak Ltd. purchased goods worth Rs. 50 Lakhs from Weak Ltd. during the financial year 2006-07. The Managing Director of Strong Ltd. is of the opinion that it is normal business activity and there is no need to disclose the same in the final accounts of the Company.
(6 Marks) (Nov 2007))

Answer

As per definition given in the AS 18 "Related Party Disclosure" parties are considered to be related if at any time during the reporting period one party has the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions. Related party transaction means a transfer of resources or obligations between related parties, regardless of whether or not a price is charged. Strong Ltd. is the holding company of weak Ltd. as it holds more than 50% of the voting power of weak Ltd. and thus should be treated as related parties as per AS-18.

According to AS-18, in the case of related party transactions, following facts should be disclosed:

- (i) Related party relationship, name and nature of relationship.
- (ii) If there is transaction between the related parties then descriptions of the nature of transaction, volume of the transaction outstanding at the balance sheet date etc.

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In the instant case since there is related party transaction the contention of Managing Director of strong Ltd is not correct and the auditor should insist to make proper disclosure as required by AS-18 and if the management refuses, the auditor as per SA 550 "Related Parties", should express a qualified opinion.

Question 3

Explain the following in brief:

Director's responsibility statement.

(4 Marks) (Nov 2007)

Answer

The report of board of directors on annual accounts shall also include a 'Director's Responsibility statement' indicating therein:

- (i) That applicable accounting standards have been followed while preparing annual accounts and material departure, if any, have been explained.
- (ii) That the directors had selected such accounting policies and applied them consistently and made judgments and estimates that are reasonable and prudent so as to give a true and fair view of the state of affairs of the company at the end of the financial year and of the profit or loss of the company for the period.
- (iii) That the directors have taken proper care for maintenance of adequate accounting records in accordance with the provisions of the Companies Act for safeguarding the assets of the company and for preventing and detecting fraud and other irregularities.
- (iv) That the accounts have been prepared on a going concern basis.

Question 4

State with reasons (in short) whether the following statements are true or false.

The term 'fund' and 'reserve' can be used interchangeably.

(2 Marks) (May 2008)

Answer

False: The term 'fund' in relation to any reserve should be used only where such reserve is specifically represented by earmarked investments.

Question 5

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

TT Ltd. has suffered recurring losses due to steep fall in production and has negative net worth. Its production head, an expert, have also left the company. Reply of the management is inadequate to these developments and there is no sound action plan to mitigate these situations.

(6 Marks) (May 2008)

Answer

As per SA 570 on "going concern", when planning and performing audit procedures and in evaluating the results thereof, the auditor should consider the appropriateness of the

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going concern assumption. The auditor should evaluate the risk that the going concern assumption may no longer be appropriate. If in the auditor's judgement, the going concern is not satisfactory resolved, he should consider various appropriate options.

To judge and evaluate the continuance as a going concern, he should evaluate and gather indications from financial, operating and other resources.

In the instant case, TT Ltd. has suffered continuous losses and having negative net worth also. Besides, its production head have also left the company resulting in steep fall in production. Thus there are clear indications that there is danger to entity's ability to continue in future. Considering the fact that there is no sound plan of action from the management to mitigate these factors and to put the company back on the recovery, the going concern assumption does not hold appropriate.

Therefore, the auditor should ask the management for its adequate disclosure in the financial statement and include the same in his report. However, if the management fails to make adequate disclosure, the auditor should express a qualified or adverse opinion.

If the result of the inappropriate assumption used in the preparation of financial statements is so material and pervasive as to make the financial statements misleading, the auditor should express an adverse opinion.

Question 6

Briefly mention five important items which you would examine while verifying payment of interest out of capital during construction. (5 Marks) (May 2008)

Answer

Payment of interest out of capital during construction should be verified as follows:

- (i) Ascertain that payment is authorised by the articles or special resolution.
- (ii) Verify that prior sanction of the Central Government has been obtained.
- (iii) Verify that interest has been paid only for the period authorized by the Central Government.
- (iv) Verify that rate of interest does not exceeds such rate as notified by the Central Government.
- (v) Verify that interest paid has been added to the cost of assets created out of capital.

Question 7

State with reasons (in short) whether the following statement is true or false.

Capital profits realized in cash may be distributed as dividend, provided the articles do not prohibit, hence profit on reissue of Forfeited shares may be distributed as Dividend.

(2 marks) (Nov 2008)

Answer

False: Capital Profit or Profit on reissue of forfeited shares cannot be distributed as dividend. As per section 205(i) dividend shall be declared or paid by a company out of the profit after providing for depreciation.

Question 8

Discuss in brief the power of Company purchases its own Securities.

(5 Marks) (Nov 2008)

Answer

Power of Company to Purchase its Own Securities:

The Companies (Amendment) Act, 1999 contains elaborate provisions enabling a company to buy-back its own securities. The work security includes both equity and preference shares. As per section 77A, a company may purchase its own shares or other specified securities ("buy-back") out of-

- (i) Its free reserves; or
- (ii) The securities premium account; or
- (iii) The proceeds of any earlier issue other than from issue of shares made specifically for buy-back purposes.

No company shall purchase its own shares or other specified securities unless-

- (a) The buy-back is authorized by its Articles;
- (b) A special resolution has been passed in general meeting of the company authorizing the buy-back;
- (c) The buy-back is or less than twenty-five per cent, of the total paid-up capital (equity shares and preference shares) and free reserves of the company;
- (d) The debt equity ratio is not more than 2:1 after such buy back.
- (e) All the shares and other securities are fully paid up.
- (f) Every buy back shall be completed within 12 months from the date of passing the special resolution.
- (g) The company shall not make further issue of same kind of shares.

The company, after buy-back file with the Registration and SEBI, a return containing such particulars relating to buy-back within 30 days.

Question 9

Write short note on Payment of Interest out of Capital during construction.

(5 Marks)(Nov 2008)

Answer

Payment of Interest out of Capital during construction: As in Section 208, a company which has raised money by issue of shares to meet the cost of construction of any work or building or provision of any plant which cannot be made profitable for a long time, can pay interest on paid up capital for a period and subject to conditions specified in Sub section (2) and (7) of Section 208.

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Accordingly, the payment of interest should be verified as follows:

1. Assertion that the payment is authorized by the articles or by a special resolution.
2. Previous approval of Central Government has been obtained.
3. Confirm that the interest has been paid only for such period as has been authorized by the Central Government and does not extend beyond the half year next following during which the construction was completed or the plant was provided.
4. Verify that the rate of interest shall in no case exceed such rate as the Central government may by notification in the official gazette, direct.
5. Check that the amount of interest paid has been added to the costs of assets created out of capital.

Question 10

State with reasons (in short) whether the following statement is true or false.

Interim dividend is not a part of dividend.

(2 Marks) (Nov 2009)

Answer

False: The definition of dividend has been amended by the Companies (Amendment) Act, 2000 where the interim dividend has been treated as part of dividend. With an amendment in Section 205, the interim dividend has been brought at par with dividends declared in the normal course.

Question 11

State clearly provisions of the Companies Act, 1956 with regard to issue of shares at a discount.

(5 Marks) (Nov 2009)

Answer

Issue of Shares at a Discount: According to Section 79 of the Companies Act, 1956, a company can issue shares at a discount on the following conditions:

- (i) The issue should be authorised by an ordinary resolution of the company sanctioned by the Central Government.
- (ii) No such issue of shares at discount can be sanctioned by the Central Government in case the maximum rate of discount should exceed 10% unless the Central Government is of the opinion that a higher rate for discount is justified by the special circumstances of the case
- (iii) The issue should be made within two months of the sanction by the Central Government and not earlier than one year after the date of commencement of business.
- (iv) The issue should be a class already issued by the company.
- (v) It is the duty of the auditor to confirm that the conditions given above have been complied with by the company at the time the allotment was made.